Table of Contents

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

FORM 10-Q

☒ **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the quarterly period ended June 30, 2016

☐ **Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**

For the transition period from _____ to _____

COMMISSION FILE NUMBER: 001-34256

HEARTWARE INTERNATIONAL, INC.
(Exact name of registrant as specified in its charter)

Delaware	**26-3636023**
(State of Incorporation)	**(I.R.S. Employer Identification No.)**

500 Old Connecticut Path
Framingham, Massachusetts 01701
(508) 739-0950
(Address of principal executive offices)

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer	☒	Accelerated filer	☐
Non-accelerated filer	☐	Smaller reporting company	☐

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

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date.

Class	Shares Outstanding as of July 25, 2016
Common Stock, $0.001 Par Value Per Share	17,561,508

References

Unless the context requires otherwise, references in this Quarterly Report on Form 10-Q to "HeartWare," "the Company," "HeartWare Group," "we," "us" and "our" refer to HeartWare International, Inc. and its consolidated direct and indirect subsidiaries.

Currency

Unless indicated otherwise in this Quarterly Report on Form 10-Q, all references to "$," "U.S. $" or "dollars" refer to United States dollars, the lawful currency of the United States of America. References to "AU$" refer to Australian dollars, the lawful currency of the Commonwealth of Australia. References to "€" or "Euros" means Euros, the single currency of Participating Member States of the European Union. References to "£" or "British Pounds" refer to British pound sterling, the lawful currency of the United Kingdom.

Trademarks

HEARTWARE®, HVAD®, MVAD®, Pal™, CIRCULITE®, SYNERGY® and various company logos are the trademarks of the Company. All other trademarks and trade names mentioned in this Quarterly Report on Form 10-Q are the property of their respective owners.

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. These forward-looking statements are based on our management's beliefs, assumptions and expectations and on information currently available to our management. Generally, you can identify forward-looking statements by terms such as "may," "will," "should," "could," "would," "expects," "plans," "anticipates," "believes," "estimates," "projects," "predicts," "potential" and similar expressions intended to identify forward-looking statements, which generally are not historical in nature. All statements that address operating or financial performance, events or developments that we expect or anticipate will occur in the future are forward-looking statements, including without limitation:

- our ability to maintain continuous business operations in troubled regions of the world, including regions in the Middle East and particularly in Turkey, where the government experienced a recent coup attempt, the effects of which cannot be determined at this time;
- our ability to manage unknown impact of "Brexit" referendum, whereupon Britain voted to leave the European Economic Community (EU);
- our ability to implement systemic improvements necessary to satisfactorily address the observations cited in the June 2, 2014 warning letter we received from the United States Food and Drug Administration ("FDA");
- our expectations with respect to submissions to and approvals from regulatory bodies, such as the FDA;
- our ability to operate our business in compliance with regulatory requirements and to implement appropriate corrective and preventive actions;
- our expectations with respect to our clinical trials, including enrollment in, completion of, or outcomes of our clinical trials as well as approval of new clinical trials and continued access or supplemental protocols with respect to our existing clinical trials;
- our expectations with respect to the integrity or capabilities of our intellectual property position;
- our ability and plans to commercialize our existing products;
- our ability and plans to develop and commercialize new products and the expected features, functionalities and benefits of these products;
- our ability to successfully compete against our competitors, especially as they increase in size and leverage, including our ability to respond to bundled product offerings and competitive pricing strategies;
- our ability to successfully complete strategic transactions with third parties, including Medtronic's planned acquisition of HeartWare;
- our estimates regarding our capital requirements and financial performance, including earnings fluctuation and cash availability; and
- our ability to manage the costs and achieve the benefits of our strategic initiatives, including acquired companies and technologies.

Our management believes that these forward-looking statements are reasonable as and when made. However, you should not place undue reliance on our forward-looking statements because they speak only as of the date when made. We do not assume any obligation to publicly update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required by federal securities laws and the rules and regulations of the Securities and Exchange Commission (the "SEC"). We may not actually achieve the plans, projections or expectations disclosed in our forward-looking statements, and actual results, developments or events could differ materially from those disclosed in the forward-looking statements. Forward-looking statements are subject to a number of risks and uncertainties, including without limitation those described in Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015 filed with the SEC on February 26, 2016, and those described from time to time in our other filings with the SEC. Investors should read this entire Quarterly Report on Form 10-Q and consult their respective financial, legal or other professional adviser in relation to the subject matter therein, especially as it pertains to our risks and uncertainties outlined in Part I, Item 1A. "Risk Factors" of our Annual Report on Form 10-K, together with the information provided in our other public filings with the SEC.

On June 27, 2016, HeartWare agreed to be acquired by Medtronic, Inc. ("Medtronic"), a Minnesota corporation, subject to the satisfaction of certain conditions. Factors related to the acquisition which could cause actual results to differ from those projected or contemplated in any such forward-looking statements include, but are not limited to, the following factors: (1) the risk that the conditions to the closing of the transaction are not satisfied, including the risk that Medtronic may not receive a sufficient number of shares tendered from HeartWare stockholders to complete the tender offer; (2) potential litigation relating to the transaction; (3) uncertainties as to the timing of the consummation of the transaction and the ability of each of HeartWare and Medtronic to consummate the transaction; (4) risks that the proposed transaction disrupts the current plans and operations of HeartWare or Medtronic; (5) the ability of HeartWare to retain and hire key personnel; (6) competitive responses to the proposed transaction; (7) costs, charges or expenses resulting from or incurred in connection with the transaction; (8) potential adverse reactions or changes to business relationships resulting from the announcement or completion of the transaction; and (9) legislative, regulatory and economic developments.

Additional Information about the Transaction and Where to Find It

The tender offer by Medtronic for the outstanding shares of HeartWare commenced on July 26, 2016. Certain information related to the pending transaction included in this report is for informational purposes only and shall not constitute an offer to purchase nor a solicitation of an offer to sell any securities of HeartWare. The offer is being made pursuant to a tender offer statement on Schedule TO, which contains an offer to purchase, form of letter of transmittal and other documents relating to the tender offer (collectively, the "Tender Offer Materials"), each filed with the U.S. Securities and Exchange Commission (the "SEC") by Medtronic plc, Medtronic, Inc. and Medtronic Acquisition Corp. on July 26, 2016. On the same date, HeartWare filed with the SEC a solicitation/recommendation statement on Schedule 14D-9 with respect to the tender offer. The Tender Offer Materials, as well as the Schedule 14D-9, were also mailed to HeartWare stockholders. HeartWare's stockholders are advised to read these documents and any other documents relating to the tender offer that will be filed with the SEC carefully and in their entirety because they contain important information. HeartWare's stockholders may obtain copies of these documents for no charge at the SEC's website at www.sec.gov or by contacting HeartWare's investor relations department at HeartWare International, Inc., 500 Old Connecticut Path, Framingham, MA 01701, Attention: Investor Relations.

PART I. FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

HEARTWARE INTERNATIONAL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share data)

	June 30, 2016 (unaudited)	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$ 129,241	$ 175,047
Short-term investments	55,981	68,531
Accounts receivable, net	38,698	35,570
Inventories	37,864	39,947
Prepaid expenses and other current assets	5,407	2,868
Total current assets	267,191	321,963
Property, plant and equipment, net	14,535	15,098
Goodwill	61,253	61,233
In-process research and development	10,800	10,800
Other intangible assets, net	12,812	13,045
Long-term investment	49,428	17,620
Other assets	13,353	13,844
Total assets	$ 429,372	$ 453,603
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 15,501	$ 15,249
Other accrued liabilities	35,025	45,889
Total current liabilities	50,526	61,138
Convertible senior notes, net	192,107	187,089
Contingent liabilities – *See* Note 4	13,510	12,330
Other long-term liabilities	3,937	4,554
Commitments and contingencies – *See* Notes 12 and 13		
Stockholders' equity:		
Preferred stock – $.001 par value; 5,000 shares authorized; no shares issued and outstanding at June 30, 2016 and December 31, 2015	—	—
Common stock – $.001 par value; 50,000 shares authorized; 17,552 and 17,405 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	18	17
Additional paid-in capital	626,814	618,219
Accumulated deficit	(449,842)	(421,499)
Accumulated other comprehensive loss:		
Cumulative translation adjustments	(7,671)	(8,085)
Unrealized loss on investments	(27)	(160)
Total accumulated other comprehensive loss	(7,698)	(8,245)
Total stockholders' equity	169,292	188,492
Total liabilities and stockholders' equity	$ 429,372	$ 453,603

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

HEARTWARE INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited)
(In thousands, except per share data)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
Revenue, net	$ 68,720	$ 73,569	$ 123,794	$ 143,590
Cost of revenue	23,826	25,228	46,848	47,268
Gross profit	44,894	48,341	76,946	96,322
Operating expenses:				
Selling, general and administrative	22,780	22,247	44,254	44,176
Research and development	27,878	31,702	53,099	62,969
Change in fair value of contingent consideration	600	2,240	1,180	4,340
Total operating expenses	51,258	56,189	98,533	111,485
Loss from operations	(6,364)	(7,848)	(21,587)	(15,163)
Other income (expense):				
Foreign exchange gain (loss)	(1,418)	757	(498)	(2,941)
Interest expense	(3,793)	(3,543)	(7,533)	(6,980)
Investment income, net	890	135	1,615	281
Loss on extinguishment of long-term debt	—	(16,588)	—	(16,588)
Other, net	—	—	5	—
Loss before income taxes	(10,685)	(27,087)	(27,998)	(41,391)
Provision for income taxes	198	306	345	537
Net loss	$ (10,883)	$ (27,393)	$ (28,343)	$ (41,928)
Net loss per common share:				
Basic	$ (0.62)	$ (1.59)	$ (1.62)	$ (2.43)
Diluted	$ (0.62)	$ (1.59)	$ (1.62)	$ (2.43)
Weighted average shares outstanding:				
Basic	17,543	17,269	17,503	17,232
Diluted	17,543	17,269	17,503	17,232

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

HEARTWARE INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(unaudited)
(In thousands)

	For the Three Months Ended June 30,		For the Six Months Ended June 30,	
	2016	2015	2016	2015
Net loss	$ (10,883)	$ (27,393)	$ (28,343)	$ (41,928)
Other comprehensive income (loss)				
Foreign currency translation adjustments	391	(247)	414	(407)
Unrealized (loss) gain on investments	9	(12)	133	108
Comprehensive loss	$ (10,483)	$ (27,652)	$ (27,796)	$ (42,227)

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

HEARTWARE INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
(unaudited)
(In thousands, except per share data)

	Common Shares, $0.001 Par Value Per Share		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total
	Shares Issued	Amount				
Balance, December 31, 2015	17,405	$ 17	$618,219	$ (421,499)	$ (8,245)	$188,492
Issuance of common stock pursuant to share-based awards	147	1	—	—	—	1
Share-based compensation	—	—	8,595	—	—	8,595
Net loss	—	—	—	(28,343)	—	(28,343)
Other comprehensive loss	—	—	—	—	547	547
Balance, June 30, 2016	17,552	18	626,814	(449,842)	(7,698)	169,292

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

HEARTWARE INTERNATIONAL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited)
(In thousands)

	For the Six Months Ended June 30,	
	2016	**2015**
CASH FLOWS FROM OPERATING ACTIVITIES		
Net loss	$ (28,343)	$ (41,928)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation of property, plant and equipment	3,206	3,377
Amortization of intangible assets	929	1,020
Impairment of fixed assets	—	1,118
Share-based compensation expense	8,595	12,722
Amortization of premium on investments	420	579
Amortization of discount on convertible senior notes	4,692	4,193
Amortization of deferred financing costs	327	242
Change in fair value of contingent consideration	1,180	4,340
Loss on extinguishment of long-term debt	—	16,588
Other	89	2
Change in operating assets and liabilities:		
Accounts receivable	(3,147)	1,199
Inventories	2,332	1,516
Prepaid expenses and other current assets	(2,526)	(433)
Other non-current assets	(1,084)	—
Accounts payable	241	(2,400)
Accrued interest on convertible senior notes	—	324
Other accrued liabilities	(11,681)	(4,882)
Other long-term liabilities	(617)	(78)
Net cash used in operating activities	(25,387)	(2,501)
CASH FLOWS FROM INVESTING ACTIVITIES		
Purchases of investments	(28,132)	(16,225)
Maturities of investments	41,375	21,715
Additions to property, plant and equipment, net	(2,353)	(2,136)
Additions to patents	(696)	(806)
Investment in unconsolidated investee	(31,000)	—
Cash received from security deposits	178	294
Net cash (used in) provided by investing activities	(20,628)	2,842
CASH FLOWS FROM FINANCING ACTIVITIES		
Proceeds from issuance of convertible debt	—	79,901
Payment of convertible debt issuance costs	—	(4,261)
Repayment of convertible debt	—	(12)
Proceeds from exercise of stock options	—	31
Net cash provided by financing activities	—	75,659
Effect of exchange rate changes on cash and cash equivalents	209	2,276
INCREASE (DECREASE) IN CASH AND CASH EQUIVALENTS	(45,806)	78,276
CASH AND CASH EQUIVALENTS — BEGINNING OF PERIOD	175,047	102,946
CASH AND CASH EQUIVALENTS — END OF PERIOD	$ 129,241	$ 181,222

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

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

Note 1. Basis of Presentation

The accompanying unaudited interim condensed consolidated financial statements for HeartWare International, Inc. ("we," "our," "us," "HeartWare," the "HeartWare Group" or the "Company") have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission ("SEC") for reporting of interim financial information. Pursuant to these rules and regulations, certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States ("U.S. GAAP") have been condensed or omitted. Accordingly, these statements do not include all the disclosures normally required by U.S. GAAP for annual financial statements and should be read in conjunction with Management's Discussion and Analysis of Financial Condition and Results of Operations contained in this report and the audited financial statements and notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. The accompanying condensed consolidated balance sheet as of December 31, 2015 has been derived from our audited financial statements. The unaudited condensed consolidated statements of operations for the three and six months ended June 30, 2016 and cash flows for the six months ended June 30, 2016 are not necessarily indicative of the results to be expected for any future period or for the year ending December 31, 2016.

The preparation of our unaudited interim condensed consolidated financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting periods. Actual results could differ from those estimates.

In the opinion of management, the accompanying unaudited interim condensed consolidated financial statements contain all adjustments (consisting of only normally recurring adjustments) necessary to present fairly the financial position and results of operations as of the dates and for the periods presented.

Pending Transaction

On June 27, 2016, Medtronic, Inc. ("Medtronic"), a Minnesota corporation, Medtronic Acquisition Corp. ("Purchaser"), a Delaware corporation and a wholly-owned subsidiary of Medtronic, and HeartWare entered into an Agreement and Plan of Merger (the "Merger Agreement") pursuant to which Medtronic would acquire HeartWare. A copy of the Merger Agreement was filed as Exhibit 2.1 to HeartWare's Current Report on Form 8-K, which was filed with the SEC on June 27, 2016. Pursuant to the Merger Agreement, on July 26, 2016, Medtronic and Purchaser commenced a tender offer to purchase all of the outstanding shares of HeartWare common stock at a price of $58.00 per share (the "Offer Price"), paid to the holder in cash, without interest upon the terms and subject to the conditions set forth in the Offer to Purchase dated July 26, 2016 and in the related Letter of Transmittal (the "Offer").

The Merger Agreement provides that, among other matters, as soon as practicable after the acquisition of shares of common stock pursuant to the Offer, and the satisfaction or waiver of certain conditions in the Merger Agreement, Purchaser will merge with and into HeartWare with HeartWare surviving as a wholly owned subsidiary of Parent pursuant to Delaware General Corporation Law ("DGCL") Section 251(h) (the "Merger"). Because the Merger will be governed by Section 251(h) of the DGCL, no stockholder vote will be required to consummate the Merger. HeartWare does not expect there to be a significant period of time between the consummation of the Offer and the consummation of the Merger. At the effective time of the Merger (the "Effective Time"), each share of HeartWare common stock issued and outstanding immediately prior to the Effective Time (other than Shares (i) owned by the Company as treasury stock, (ii) owned by Parent or Purchaser, or (iii) held by a holder who is entitled to demand and properly demands appraisal for such shares of common stock in accordance with Section 262 of the DGCL shall, by virtue of the Merger and without any action on the part of the holder thereof, be automatically cancelled and converted into the right to receive an amount in cash, payable to the holder thereon, without any interest thereon, equal to the Offer Price (the "Merger Consideration"), on the terms and conditions set forth in the Merger Agreement. The Offer is described in a Tender Offer Statement on Schedule TO filed by Medtronic and Purchaser with the SEC on July 26, 2016. Also on July 26, 2016, HeartWare filed a Schedule 14D-9 containing, among other things, the HeartWare board's recommendation that all holders of HeartWare common stock accept the Offer, tender their shares of common stock pursuant to the Offer and, if required by applicable law, adopt the Merger Agreement and approve the Merger related to the Offer. Investors and security holders are urged to carefully read these documents and the other documents relating to the transactions contemplated by the Merger Agreement when they become available because these documents will contain important information relating to the Offer and related transactions. HeartWare's stockholders are advised to read these documents and any other documents relating to the tender offer that will be filed with the SEC carefully and in their entirety because they contain important information. HeartWare's stockholders may obtain copies of these documents for no charge at the SEC's website at www.sec.gov or by contacting HeartWare's investor relations department at HeartWare International, Inc., 500 Old Connecticut Path, Framingham, MA 01701, Attention: Investor Relations.

At the Effective Time, (i) each outstanding and unexercised option granted under an equity plan of the Company (whether vested or unvested) will be automatically cancelled and the option holder will be entitled to receive a cash payment from the Company in an amount equal to the product of the excess, if any, of the Merger Consideration over the exercise price of each such option and the number of unexercised shares subject to such option immediately prior to the Effective Time, less any required withholding of taxes and (ii) each outstanding restricted stock unit granted under an equity plan of the Company will be automatically cancelled, and the holder of the restricted stock unit will be entitled to receive a cash payment in an amount equal to the product of the Merger Consideration and the number of shares underlying such restricted stock unit as of immediately prior to the Effective Time (assuming achievement of all performance milestones in the case of restricted stock units that are subject to performance-based vesting), less any required withholding of taxes.

The Offer is not subject to a financing condition. The Offer is conditioned upon, among other things, (a) there being validly tendered pursuant to the Offer and not properly withdrawn prior to the Expiration Date a number of shares of HeartWare common stock that when added to the shares already owned by Medtronic, Purchaser or any wholly owned subsidiaries of their ultimate parent constitutes a majority of the then outstanding shares of HeartWare common stock (the "Minimum Condition"), and (b) approvals under applicable antitrust laws in Austria, Germany and Spain being obtained. The Offer was also conditioned on the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, having expired or been terminated. The applicable waiting period expired on July 25, 2016. The "Expiration Date" means the end of the day, immediately after 11:59 p.m. Eastern time on August 22, 2016, which is the date that is 20 business days following the commencement of the Offer, unless the Offer is extended in accordance with the terms of the Merger Agreement.

The Merger Agreement includes customary representations, warranties and covenants of HeartWare and Medtronic. HeartWare has agreed to operate its business and the business of its subsidiaries in the ordinary course of business consistent with past practices through the Effective Time. The Merger Agreement provides for the Company to pay a termination fee of approximately $27.5 million to Medtronic if HeartWare terminates the Merger Agreement under certain conditions defined in the Merger Agreement.

The summary of the Merger Agreement and the descriptions of the terms and conditions to the Offer contained in the Offer to Purchase do not purport to be complete and are qualified in their entirety by reference to the Merger Agreement and the Offer.

New Accounting Standards

Standards Pending Implementation

In March 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") 2016-09, *Improvements to Employee Share-Based Payment Accounting* ("ASU 2016-09"). ASU 2016-09 simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities and classification on the statement of cash flows. This ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016. Early adoption is permitted. The Company is currently assessing the potential impact of adopting ASU 2016-09 on its financial statements and related disclosures.

In February 2016, the FASB issued ASU 2016-02, *Leases* ("ASU 2016-02"). ASU 2016-02 supersedes the lease guidance under FASB Accounting Standards Codification ("ASC") Topic 840, *Leases*, resulting in the creation of FASB ASC Topic 842, *Leases*. ASU 2016-02 requires a lessee to recognize in the statement of financial position a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term for both finance and operating leases. This ASU is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018. Early adoption is permitted. The Company is currently assessing the potential impact of adopting ASU 2016-02 on its financial statements and related disclosures.

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, *Revenue from Contracts with Customers (Topic 606)* ("ASU 2014-09"). The updated standard is a new comprehensive revenue recognition model that requires revenue to be recognized in a manner that depicts the transfer of goods or services to a customer at an amount that reflects the consideration expected to be received in exchange for those goods or services. In July 2015, the FASB voted to approve the deferral of the effective date of ASU 2014-09 by one year. Therefore, ASU 2014-09 will become effective for us in the first quarter of our fiscal year ending December 31, 2018. Early adoption is permitted, but not earlier than the first quarter of our fiscal year ending December 31, 2017. The ASU allows for either full retrospective or modified retrospective adoption. We have not yet selected a transition method, and we are currently evaluating the effect that ASU 2014-09 will have on our consolidated financial statements and related disclosures.

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Implemented Standards

In April 2015, the FASB issued ASU 2015-03, *Interest — Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs.* In June 2015, the FASB amended ASU 2015-03 with ASU 2015-15. The updated standard requires debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of the debt liability, consistent with debt discounts. This guidance was effective for periods beginning after December 15, 2015, and interim periods within those annual periods applied retrospectively. The Company adopted this guidance in the first quarter of 2016. Debt issuance costs associated with debt were $3.6 and $4.0 million as of June 30, 2016 and December 31, 2015, respectively.

In February 2015, the FASB issued ASU No. 2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis,* which is intended to improve targeted areas of consolidation guidance for legal entities such as limited partnerships, limited liability corporations and securitization structures (collateralized debt obligations, collateralized loan obligations and mortgage-backed security transactions). This ASU focuses on the consolidation evaluation for reporting organizations (public and private companies and not-for-profit organizations) that are required to evaluate whether they should consolidate certain legal entities. In addition to reducing the number of consolidation models from four to two, the new standard simplifies the FASB Accounting Standards Codification by: i) placing more emphasis on risk of loss when determining a controlling financial interest; ii) reducing the frequency of the application of related-party guidance when determining a controlling financial interest in a variable interest entity ("VIE"); and iii) changing consolidation conclusions for public and private companies in several industries that typically make use of limited partnerships or VIEs. ASU No. 2015-02 was effective for us in periods beginning after December 15, 2015. The Company adopted this guidance in the first quarter of 2016 and it did not have an effect on our consolidated financial position, results of operations or cash flows.

In January 2015, the FASB issued ASU No. 2015-01, *Income Statement—Extraordinary and Unusual Items (Subtopic 225-20): Simplifying Income Statement Presentation by Eliminating the Concept of Extraordinary Items.* The FASB issued this ASU as part of its initiative to reduce complexity in accounting standards. This ASU eliminates from U.S. GAAP the concept of extraordinary items. Subtopic 225-20 required that an entity separately classify, present, and disclose extraordinary events and transactions. Presently, an event or transaction is presumed to be an ordinary and usual activity of the reporting entity unless evidence clearly supports its classification as an extraordinary item. If an event or transaction meets the criteria for extraordinary classification, an entity is required to segregate the extraordinary item from the results of ordinary operations and show the item separately in the income statement, net of tax, after income from continuing operations. The entity also is required to disclose applicable income taxes and either present or disclose earnings-per-share data applicable to the extraordinary item. The amendments in this ASU were effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2015. A reporting entity may apply the amendments prospectively. A reporting entity also may apply the amendments retrospectively to all prior periods presented in the financial statements. The Company adopted this guidance in the first quarter of 2016 and it did not have an effect on our consolidated financial position, results of operations or cash flows.

Reclassification of Prior Year Presentation

Certain prior year amounts have been reclassified for consistency with the current period presentation. These reclassifications had no effect on the reported results of operations. In the period ended March 31, 2016, management reassessed certain inventory policies based on recent trends, including sales, usage and forecasted usage of specific inventory items. As a result, we now expect that certain inventory could be held beyond one year. As of June 30, 2016, approximately $7.3 million of inventory was classified as non-current inventory and included within other assets on the accompanying consolidated balance sheet. To reflect the result of this change, for consistency we reclassified approximately $7.7 million of inventory as of December 31, 2015 from current assets to non-current and included within other assets on the consolidated balance sheet. Corresponding reclassifications have also been made to the Condensed Consolidated Statement of Cash Flows for the periods ended June 30, 2016 and 2015, to reflect the gross purchases and sales of these assets as a component of other non-current assets. This change in classification does not affect previously reported cash flows from operations or from financing activities in the Condensed Consolidated Statement of Cash Flows, and had no effect on the previously reported Condensed Consolidated Statement of Operations for any period.

In the period ended June 30, 2016, management reassessed classification of our Valtech investment due to size of the investment. As of June 30, 2016, approximately $49.4 million of long-term investment and other assets was classified as long-term investment on the accompanying consolidated balance sheet. To reflect the result of this change, for consistency we reclassified approximately $17.6 million of long-term investment and other assets as of December 31, 2015 to long-term investment on the consolidated balance sheet. This change in classification does not affect reported, or previously reported, cash flows from operations or from financing activities in the Condensed Consolidated Statement of Cash Flows, and had no effect on the previously reported Condensed Consolidated Statement of Operations for any period.

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Note 2. Liquidity

We have funded our operations primarily through product revenue, the issuance of shares of our common stock and the issuance of convertible notes. At June 30, 2016, we had approximately $185.0 million of cash, cash equivalents and available-for-sale investments. Our cash, cash equivalents and available-for-sale investments are expected to be used primarily to fund our ongoing operations including expanding our sales and marketing capabilities on a global basis, research and development (including clinical trials) of new and existing products, components and accessories; regulatory and other compliance functions; acquisition of, and investment in, third-party technologies; as well as for general working capital. We believe our cash, cash equivalents and available-for-sale investment balances are sufficient to support our planned operations for at least the next twelve months.

The accompanying unaudited interim condensed consolidated financial statements have been prepared in conformity with accounting principles generally accepted in the United States, which contemplate continuation of the Company as a going concern. We have incurred substantial losses from operations since our inception, and losses have continued through June 30, 2016. At June 30, 2016, we had an accumulated deficit of approximately $449.8 million.

Note 3. Balance Sheet Information

Accounts Receivable

Accounts receivable consists of amounts due from the sale of our HeartWare Ventricular Assist System (the "HVAD System") to our customers, which include hospitals, health research institutions and medical device distributors. We grant credit to customers in the normal course of business, but generally do not require collateral or any other security to support credit sales. Our receivables are geographically dispersed, with a significant portion from customers located in Europe and other foreign countries. We had one customer with an accounts receivable balance representing approximately 23% and 17% of our total accounts receivable at June 30, 2016 and December 31, 2015, respectively. A portion of this account receivable was classified as long-term as of June 30, 2016 and December 31, 2015 in accordance with our payment terms with this customer.

We maintain allowances for doubtful accounts for estimated losses that may result from an inability to collect payments owed to us for product sales. We regularly review the allowance by considering factors such as historical experience, the age of the accounts receivable balances and local economic conditions that may affect a customer's ability to pay. Account balances are charged off against the allowance after appropriate collection efforts have been exhausted and we feel it is probable that the receivable will not be recovered.

The following table summarizes the change in our allowance for doubtful accounts for the six months ended June 30, 2016 and 2015:

	2016	2015
	(in thousands)	
Beginning balance	$676	$671
Accrual/(Reversal) of expense	67	(41)
Charge-offs	—	—
Ending balance	$743	$630

As of June 30, 2016 and December 31, 2015, we recorded customer sales allowances of $73,000 and $81,000, respectively.

Inventories, net

Components of inventories are as follows:

	June 30, 2016	December 31, 2015
	(in thousands)	
Raw material	$12,394	$ 17,940
Work-in-process	9,826	8,858
Finished goods	15,644	13,149
	$37,864	$ 39,947

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Finished goods inventories includes inventory held on consignment at customer sites of approximately $7.9 million at June 30, 2016 and $6.2 million at December 31, 2015. The increase in consignment inventory as of June 30, 2016 is due to pre-shipment of batteries to execute a field action announced in September 2015 *(see Accrued Field Action Costs for more information).* We review our inventory for excess or obsolete items and write-down obsolete or otherwise unmarketable inventory to its net realizable value.

Beginning in the period ending March 31, 2016 we reassessed certain inventory policies based on recent trends, including sales, usage and forecasted usage of specific inventory items. As a result, we expect that certain inventory to be held beyond one year. As of June 30, 2016, approximately $7.3 million of raw material inventory was classified as non-current inventory and included within other assets on the accompanying consolidated balance sheet. To reflect the result of this change, for consistency we reclassified approximately $7.7 million of raw material inventory as of December 31, 2015 from current assets to non-current and included within other assets on the consolidated balance sheet.

Property, Plant and Equipment, Net

Property, plant and equipment, net consists of the following:

	Estimated Useful Lives	June 30, 2016	December 31, 2015
		(in thousands)	
Machinery and equipment	1.5 to 7 years	$ 22,575	$ 21,785
Leasehold improvements	3 to 10 years	8,923	8,891
Office equipment, furniture and fixtures	5 to 7 years	2,105	2,105
Purchased software	1 to 7 years	8,986	7,575
		42,589	40,356
Less: accumulated depreciation		(28,054)	(25,258)
		$ 14,535	$ 15,098

Long-Term Investment

Long-term investment consists of an investment in Valtech Cardio, Ltd.

As of June 30, 2016, we have invested approximately $49.4 million in Valtech Cardio, Ltd ("Valtech"), an early-stage, privately held company headquartered in Or Yehuda, Israel specializing in the development of devices for mitral and tricuspid valve repair and replacement. Our investment is carried in long-term investments and other assets and consists of the following:

	June 30, 2016	December 31, 2015
	(in thousands)	
Preferred Stock	$10,495	$ 10,495
Convertible Promissory Notes Receivable, due July 10, 2017	8,320	7,125
Convertible Promissory Notes Receivable, due February 1, 2019	30,613	—
	$49,428	$ 17,620

In October 2013, we invested $10 million in Valtech in the form of a convertible promissory note with an interest rate of 6% per annum (the "2013 Note"), which, along with net accrued interest, has since been converted to Valtech equity pursuant to the terms of the 2013 Note.

In July 2015, we invested an additional $5 million in Valtech in the form of a convertible promissory note with an interest rate of 6% per annum.

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

On September 1, 2015, we entered into a Business Combination Agreement (the "BCA") by and among the Company, Valtech, HW Global, Inc. ("Holdco"), HW Merger Sub, Inc., Valor Merger Sub Ltd. and Valor Shareholder Representative, LLC, pursuant to which we and Valtech proposed to effect a strategic combination of our respective businesses under Holdco, subject to certain closing conditions. Effective January 28, 2016, we terminated the BCA pursuant to the terms of the BCA by delivering written notice to the other parties. After entering into the BCA and pursuant to the terms of the BCA, we loaned Valtech an aggregate principal amount of $3 million in interim funding at an interest rate of 6% per annum in $1 million increments in each of November 2015, December 2015 and January 2016. In connection with the termination provisions of the BCA, we loaned Valtech an additional $30 million on February 1, 2016 also in the form of a convertible promissory note with an interest rate of 6% per annum. We have no current contractual obligations to further fund Valtech.

Upon maturity, each of the convertible promissory notes become due and payable in cash or Valtech preferred stock, at the option of Valtech, pursuant to terms of the convertible promissory notes. If the convertible promissory notes become due and payable upon an event of default (as defined in the notes), we determine whether the notes are paid in cash or Valtech preferred stock.

Our investment in Valtech was deemed to be realizable as of June 30, 2016. The fair value of this investment has not been estimated as of June 30, 2016 and December 31, 2015 as no impairment indicators were identified.

Other Assets

Other assets consist of the following:

	June 30, 2016	December 31, 2015
	(in thousands)	
Long-term inventory	7,287	7,739
Long-term receivables	3,659	2,539
Security deposits	2,407	2,586
Other assets	—	980
	$13,353	$ 13,844

Other Accrued Liabilities

Other accrued liabilities consist of the following:

	June 30, 2016	December 31, 2015
	(in thousands)	
Accrued payroll and other employee costs	$12,031	$ 14,068
Accrued field action	4,175	8,503
Accrued warranty	5,505	6,116
Accrued material purchases	967	4,107
Accrued professional fees	2,940	2,685
Accrued research and development costs	1,335	2,191
Accrued restructuring costs	1,329	1,955
Accrued VAT	1,286	1,238
Other accrued expenses	5,457	5,026
	$35,025	$ 45,889

Accrued payroll and other employee costs

Accrued payroll and other employee costs included estimated year-end employee bonuses of approximately $5.2 million and $8.0 million at June 30, 2016 and December 31, 2015, respectively.

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Accrued Warranty

Certain patient accessories sold with the HVAD System are covered by a limited warranty ranging from one to two years. Estimated warranty obligations are recorded as an expense when the related revenue is recognized and are included in cost of revenue on our condensed consolidated statements of operations. Factors that affect the estimated warranty liability include the number of units sold, historical and anticipated rates of warranty claims, cost per claim, and vendor-supported warranty programs. We periodically assess the adequacy of our recorded warranty liabilities and adjust the amounts as necessary. The amount of the liability recorded is equal to the estimated costs to repair or otherwise satisfy claims made by customers.

The following table summarizes the change in our warranty liability for the six months ended June 30, 2016 and 2015:

	2016	2015
	(in thousands)	
Beginning balance	$ 6,116	$ 4,685
Accrual for warranty expense	637	2,097
Warranty costs incurred during the period	(1,248)	(1,381)
Ending balance	$ 5,505	$ 5,401

Accrued Field Action Costs

The costs to repair or replace products associated with field actions and voluntary service campaigns are recorded when they are determined to be probable and reasonably estimable as a cost of revenue. Costs associated with field actions are not included in our warranty liability. The following table summarizes the change in field action liability for the six months ended June 30, 2016 and 2015:

	2016	2015
	(in thousands)	
Beginning balance	$ 8,503	$ 1,888
Accrual for field action costs	3,339	470
Field action costs incurred during the period	(7,667)	(1,746)
Ending balance	$ 4,175	$ 612

In February 2015, we expanded a 2013 voluntary field safety corrective action, by initiating a voluntary medical device recall of certain older controllers distributed in the U.S. during the ADVANCE and ENDURANCE clinical trial periods. The action had been initiated in certain foreign markets around the end of 2014. The affected controllers exhibit a higher susceptibility to electrostatic discharge than newer, commercial controllers. This recall was ongoing as of June 30, 2016.

In September 2015, we announced planned field actions to replace certain older AC adapters in use outside the United States and older batteries with new, more reliably designed product improvements. We also announced plans to implement a controller software update intended to improve controller performance reliability. These actions began on January 7, 2016 following requisite regulatory approvals. Recall costs incurred during the six months ended June 30, 2016 were associated with these actions.

In March 2016, we announced a planned field action related to the anticipated replacement of certain controllers based upon the potential for the power or driveline connectors to become loose. During the six months ended June 30, 2016, the Company recorded a total charge of $3.3 million related to this planned field action. The Company's estimated liability for replacements is based upon assumptions which it considers reasonable in light of known circumstances.

As further discussed in Note 13, on July 12, 2016 the Company adopted a voluntary controller replacement plan pursuant to which it will introduce a new and improved HVAD System controller to be implemented effective once the new controller attains applicable regulatory approvals. The program is expected to result in a controller replacement liability of approximately $24 million to $27 million for prospective replacement of HVAD controllers in the field beginning in the third or fourth quarter of 2016.

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Accrued Restructuring Costs

The following table summarizes changes in our accrued restructuring costs for the six months ended June 30, 2016:

	Facility Leases (in thousands)
Beginning balance	$ 1,955
Restructuring charges	—
Payments	(358)
Adjustments to estimated obligations	(310)
Change in fair value	42
Ending balance	$ 1,329

The restructuring obligations reflected above resulted from the closure of CircuLite, Inc.'s former headquarters in Teaneck, New Jersey, which we ceased to occupy in 2014. The Teaneck operating lease runs through September 2020. The remaining obligation as of June 30, 2016 reflects recent events including entry into a sublease agreement for approximately 43% of the leased space, taking into consideration the applicable sublet terms, and a termination payment made to the landlord related to the recapture of approximately 57% by the landlord which became effective on July 15, 2016. The termination payment of approximately $0.9 million was accrued as of June 30, 2016 and included in selling, general and administrative expenses on our condensed consolidated statements of operations. This obligation was paid during July 2016. (*see* Note 4 for significant inputs in determining estimate).

Note 4. Fair Value Measurements

FASB ASC 820 – *Fair Value Measurements and Disclosures*, defines fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. FASB ASC 820 requires disclosures about the fair value of all financial instruments, whether or not recognized, for financial statement purposes. Disclosures about the fair value of financial instruments are based on pertinent information available to us as of the reporting dates. Accordingly, the estimates presented in the accompanying condensed consolidated financial statements are not necessarily indicative of the amounts that could be realized on disposition of the financial instruments.

FASB ASC 820 specifies a hierarchy of valuation techniques based on whether the inputs to those valuation techniques are observable or unobservable. Observable inputs reflect market data obtained from independent sources, while unobservable inputs reflect market assumptions. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurement) and the lowest priority to unobservable inputs (Level 3 measurement).

The three levels of the fair value hierarchy are as follows:

Level 1 – Quoted prices for identical instruments in active markets.

Level 2 – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 – Instruments with primarily unobservable value drivers.

We review the fair value hierarchy classification on a quarterly basis. Changes in the ability to observe valuation inputs may result in a reclassification of levels of certain securities within the fair value hierarchy. There were no transfers between Level 1, Level 2 and Level 3 during the six months ended June 30, 2016 and 2015.

The carrying amounts reported on our condensed consolidated balance sheets for cash and cash equivalents, accounts receivable, accounts payable and other accrued liabilities approximate their fair value based on the short-term maturity of these instruments. Investments are considered available-for-sale as of June 30, 2016 and December 31, 2015 and are carried at fair value.

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

The following tables represent the fair value of our financial assets and financial liabilities measured at fair value on a recurring basis and which level was used in the fair value hierarchy at the respective dates.

	Carrying Value	Fair Value	Fair Value Measurements at the Reporting Date Using		
			Level 1	Level 2	Level 3
	(in thousands)				
As of June 30, 2016					
Assets					
Short-term investments	$ 55,981	$ 55,981	$ —	$ 55,981	$ —
Long-term investments	—	—	—	—	—
Liabilities					
Convertible senior notes	192,107(1)	240,732	—	240,732	—
Contingent consideration	13,510	13,510	—	—	13,510
Royalties	839	839	—	—	839
Lease exit costs	1,329	1,329	—	—	1,329

	Carrying Value	Fair Value	Fair Value Measurements at the Reporting Date Using		
			Level 1	Level 2	Level 3
	(in thousands)				
As of December 31, 2015					
Assets					
Short-term investments	$ 68,531	$ 68,531	$ —	$ 68,531	$ —
Long-term investments	980	980	—	980	—
Liabilities					
Convertible senior notes	187,089(1)	200,351	—	200,351	—
Contingent consideration	12,330	12,330	—	—	12,330
Royalties	918	918	—	—	918
Lease exit costs	1,955	1,955	—	—	1,955

(1) The carrying amount of our convertible senior notes is net of unamortized discount and deferred financing costs. *See* Note 7 (Debt) for more information.

Our Level 2 financial assets and liabilities include available-for-sale investments and our convertible senior notes. The fair value of our available-for-sale investments and our convertible senior notes was determined using quoted prices (including trade data) for the instruments in markets that are not active. The fair value of our convertible senior notes is presented for disclosure purposes only.

Financial assets and liabilities are considered Level 3 when their fair values are determined using pricing models, discounted cash flow methodologies or similar techniques, and at least one significant model assumption or input is unobservable. Our Level 3 financial liabilities include the following:

- **Contingent consideration** – Determining the fair value of the contingent consideration related to our acquisition of CircuLite in December 2013 requires significant management judgment or estimation. The estimated fair value is calculated using the income approach, with significant inputs that include various revenue assumptions, discount rates and applying a probability to each outcome. Material changes in any of these inputs could result in a significantly higher or lower fair value measurement. The fair value of the contingent consideration is remeasured at the estimated fair value at each reporting period. Actual amounts paid may differ from the obligations recorded.
- **Royalties** – Royalties represent future royalty payments to be made over the next 14 years pursuant to agreements related to intellectual property licensed or acquired by World Heart Corporation, which we acquired in August 2012. Determination of fair value requires significant management judgment or estimation. The royalty payment obligations were valued using a discounted cash flow model, the future minimum royalty payment amounts and discount rates commensurate with our market risk and the terms of the obligations.

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

- **Lease exit costs** – In the first quarter of 2014, we ceased the use of CircuLite's former headquarters in Teaneck, New Jersey, which was subject to an operating lease that runs through the end of 2020, and we recorded a liability equal to the estimated fair value of the remaining lease payments as of the cease-use date. The fair value was estimated based upon the discounted present value of the remaining lease payments, considering future estimated sublease income, estimated broker fees and required tenant improvements. This estimated fair value requires management judgment. The fair value of this liability is remeasured at estimated fair value at each reporting period. Actual amounts paid may differ from the obligation recorded.

The following table summarizes the change in fair value, as determined by Level 3 inputs, of the contingent consideration for the six months ended June 30, 2016:

	Contingent Consideration (in thousands)
Beginning balance	$ 12,330
Payments	—
Change in fair value	1,180
Ending balance	$ 13,510

The change in the fair value of the contingent consideration in the six months ended June 30, 2016 resulting from accretion of the liability due to the effect of the passage of time on the fair value measurement. Adjustments associated with the change in fair value of contingent consideration are presented on a separate line item on our condensed consolidated statements of operations. Potential valuation adjustments will be made in future accounting periods as additional information becomes available, including, among other items, progress toward developing the CircuLite System, as well as revenue and milestone targets as compared to our current projections, with the impact of these adjustments being recorded in our condensed consolidated statements of operations.

The following table summarizes the change in fair value, as determined by Level 3 inputs, of the royalties for the six months ended June 30, 2016:

	Royalties (in thousands)
Beginning balance	$ 918
Payments	(110)
Change in fair value	31
Ending balance	$ 839

The expense associated with the change in fair value of the royalty payment obligations is included in research and development expenses on our condensed consolidated statements of operations.

The following table summarizes the change in fair value, as determined by Level 3 inputs, of the lease exit costs for the six months ended June 30, 2016:

	Lease Exit Costs (in thousands)
Beginning balance	$ 1,955
Adjustments	(310)
Payments	(358)
Change in fair value	42
Ending balance	$ 1,329

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

The restructuring obligations reflected above resulted from the closure of CircuLite's former headquarters in Teaneck, New Jersey, which we ceased to occupy in 2014. The Teaneck operating lease runs through September 2020. The remaining obligation as of June 30, 2016 reflects recent events including entry into a sublease agreement for approximately 43% of the leased space, taking into consideration the applicable sublet terms, and a termination payment made to the landlord related to the recapture of approximately 57% by the landlord which became effective on July 15, 2016. The termination payment of approximately $0.9 million was accrued as of June 30, 2016 and included in selling, general and administrative expenses on our condensed consolidated statements of operations. This obligation was paid during July 2016.

Potential valuation adjustments will be made in future accounting periods as additional information becomes available,, with the impact of these adjustments being recorded in our condensed consolidated statements of operations.

The following table presents quantitative information about the inputs and valuation methodologies used for our fair value measurements classified in Level 3 of the fair value hierarchy as of June 30, 2016:

	Valuation Methodology	Significant Unobservable Input	Weighted Average (range, if applicable)
Contingent consideration	Probability-weighted income approach	Milestone dates	2020 to 2023
		Discount rate	17.0% to 24.0%
		Probability of occurrence	50%
Royalties	Discounted cash flow	Discount rate	4.8% to 7.8%
Lease exit costs	Discounted cash flow	Sublease start date	October 1, 2016
		Sublease rate	$31.00/square foot
		Discount rate	3.5%

Assets That Are Measured at Fair Value on a Nonrecurring Basis

Non-marketable equity investments and non-financial assets such as intangible assets, goodwill and property, plant, and equipment, are evaluated for impairment annually or when indicators of impairment exist and are measured at fair value only if an impairment charge is recorded. In the six months ended June 30, 2016 and 2015, we recorded impairment charges of zero and $1.1, respectively, million related to certain property, plant, and equipment. *See* Note 3 for more information. Non-financial assets such as identified intangible assets acquired in connection with our acquisitions are measured at fair value using Level 3 inputs, which include discounted cash flow methodologies, or similar techniques, when there is limited market activity and the determination of fair value requires significant judgment or estimation.

Note 5. Investments

We have cash investment policies that limit investments to investment-grade-rated securities. At June 30, 2016 and December 31, 2015, all of our investments were classified as available-for-sale and carried at fair value. At June 30, 2016 and December 31, 2015, our short-term and long-term investments had maturity dates of less than twenty-four months.

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

The amortized cost and fair value of our investments, with gross unrealized gains and losses, were as follows:

	Amortized Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Aggregate Fair Value
		(in thousands)		
At June 30, 2016				
Short-term investments:				
Corporate debt	$ 30,963	$ 11	$ (45)	$ 30,929
U.S. government agency debt	15,000	7	—	15,007
Certificates of deposit	10,045	—	—	10,045
Total short-term investments	$ 56,008	$ 18	$ (45)	$ 55,981
Long-term investments:				
Certificates of deposit	$ —	$ —	$ —	$ —
Total long-term investments	$ —	$ —	$ —	$ —

	Amortized Cost Basis	Gross Unrealized Gains	Gross Unrealized Losses	Aggregate Fair Value
		(in thousands)		
At December 31, 2015				
Short-term investments:				
Corporate debt	$ 32,666	$ —	$ (100)	$ 32,566
U.S. government agency debt	25,000	—	(60)	24,940
Certificates of deposit	11,025	—	—	11,025
Total short-term investments	$ 68,691	$ —	$ (160)	$ 68,531
Long-term investments:				
Certificates of deposit	$ 980	$ —	$ —	$ 980
Total long-term investments	$ 980	$ —	$ —	$ 980

For the six months ended June 30, 2016 and 2015, we did not have any realized gains or losses on our investments. At June 30, 2016 and December 31, 2015, the number of available-for-sale investments that had been in a continuous loss position for more than twelve months was five and thirteen, respectively. As of June 30, 2016, a total of four individual securities had been in an unrealized loss position for twelve months or less and the losses were determined to be temporary. We regularly review our investment portfolio to determine if any security is other-than-temporarily impaired, which would require us to record an impairment charge in the period any such determination is made. In making this judgment, we evaluate, among other things, the duration and extent to which the fair value of a security has been less than its amortized cost, the financial condition of the issuer, the time to maturity of the investment and our intent to sell the security prior to maturity where we would not be able to recover its amortized cost basis.

Note 6. Goodwill, In-Process Research and Development and Other Intangible Assets, Net

Goodwill

The carrying amount of goodwill and the change in the balance for the six months ended June 30, 2016 and 2015 is as follows:

	2016	2015
	(in thousands)	
Beginning balance	$61,233	$61,390
Additions	—	—
Impairment	—	—
Foreign currency translation impact	20	(136)
Ending balance	$61,253	$61,254

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

In-Process Research and Development

The carrying value of our in-process research and development assets, which relate to the development and potential commercialization of certain acquired technologies, consisted of the following at June 30, 2016 and December 31, 2015:

	June 30, 2016	December 31, 2015
	(in thousands)	
CircuLite System technology	$10,800	$ 10,800

In-process research and development has an indefinite life. At the time the economic life becomes determinable (upon project completion or abandonment) the amount will be amortized over its expected remaining life.

Other Intangible Assets

Other intangible assets, net consisted of the following:

	June 30, 2016	December 31, 2015
	(in thousands)	
Patents	$ 8,121	$ 7,424
Purchased intangible assets		
Acquired technology rights	9,925	9,925
	18,046	17,349
Less: Accumulated amortization – Patents	(1,826)	(1,551)
Less: Accumulated amortization – Purchased intangible assets	(3,408)	(2,753)
	$12,812	$ 13,045

Our other intangible assets are amortized using the straight-line method over their estimated useful lives as follows:

Patents	15 years
Purchased intangible assets	
Acquired technology rights	6 to 16 years

Amortization expense for each of the three months ended June 30, 2016 and 2015 was $0.5 million, respectively. Amortization expense for each of the six months ended June 30, 2016 and 2015 was $1.0.

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Note 7. Debt

At June 30, 2016 and December 31, 2015, we had outstanding convertible debt as follows:

	June 30, 2016	December 31, 2015
	(in thousands)	
Principal amount of the 3.5% convertible senior notes, due 2017	$ 42,471	$ 42,471
Deferred financing costs	(3,400)	(3,652)
Unamortized discount	(4,595)	(5,994)
	$ 34,476	$ 32,825
Equity component	$ 7,629	$ 7,629
Principal amount of the 1.75% convertible senior notes, due 2021	$202,366	$ 202,366
Deferred financing costs	(246)	(321)
Unamortized discount	(44,489)	(47,781)
	$157,631	$ 154,264
Equity component	$ 47,400	$ 47,400

Interest expense related to our convertible debt consisted of contractual interest due on the principal amount, amortization of the discount and amortization of the portion of the deferred financing costs allocated to the long-term debt component and was included in interest expense in our condensed consolidated statements of operations. For the three and six months ended June 30, 2016 and 2015, interest expense related to our convertible debt was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
Coupon rate	$ 1,257	$ 1,284	$ 2,514	$ 2,542
Amortization of discount	2,371	2,125	4,692	4,193
Amortization of deferred financing costs	165	132	327	242
	$ 3,793	$ 3,541	$ 7,533	$ 6,977

3.5% Convertible Senior Notes

On December 15, 2010, we completed the sale of 3.5% convertible senior notes due December 15, 2017, unless earlier repurchased by us or converted (the "2017 Notes") for an aggregate principal amount of $143.75 million, pursuant to the terms of an indenture dated December 15, 2010 (the "Indenture") and a supplemental indenture (the "First Supplemental Indenture"), both filed with the SEC as exhibits to our Current Report on Form 8-K on December 15, 2010. The 2017 Notes are senior unsecured obligations of the Company. The 2017 Notes bear interest at a rate of 3.5% per annum, payable semi-annually in arrears on June 15 and December 15 of each year.

In May 2015, we entered into separate, privately negotiated, exchange agreements (the "Exchange") with certain holders of our outstanding 2017 Notes. The general terms of exchange agreements were filed with the SEC on May 7, 2015 as an exhibit to our Current Report on Form 8-K. Pursuant to these agreements, we exchanged $101.3 million aggregate principal amount of the 2017 Notes for $118.2 million principal amount of 1.75% convertible senior notes due 2021 (see further discussion below). We did not receive any proceeds related to the Exchange.

Pursuant to the terms of the Indenture and First Supplemental Indenture, the 2017 Notes are convertible at an initial conversion rate of 10 shares of our common stock per $1,000 principal amount of 2017 Notes, which corresponds to an initial conversion price of $100.00 per share of our common stock. The conversion rate is subject to adjustment from time to time upon the occurrence of certain events.

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

The 2017 Notes mature on December 15, 2017, unless earlier repurchased by us or converted. Prior to June 15, 2017, holders may convert their 2017 Notes at their option only upon satisfaction of one or more of the conditions specified in the First Supplemental Indenture relating to (i) the sale price of our common stock, (ii) the trading price per $1,000 principal amount of 2017 Notes or (iii) specified corporate events. On or after June 15, 2017, until the close of business of the business day immediately preceding the date the 2017 Notes mature, holders may convert their 2017 Notes at any time, regardless of whether any of the foregoing conditions have been met. Upon conversion, we will pay or deliver, as the case may be, cash, shares of our common stock or a combination thereof, at our election.

Based on the initial conversion rate of 10 shares of our common stock per $1,000 principal amount of 2017 Notes, which corresponds to an initial conversion price of $100.00 per share of our common stock, the number of shares issuable upon conversion of the 2017 Notes is 424,710. The value of these shares, based on the closing price of our common stock on June 30, 2016 of $57.75 per share, was approximately $24.5 million. The fair value of our 2017 Notes as presented in Note 4 was $40.4 million at June 30, 2016.

1.75% Convertible Senior Notes

In May 2015, we issued $84.2 million principal amount of 1.75% convertible senior notes due December 15, 2021 (the "2021 Notes"), unless earlier repurchased, redeemed or converted (the "2021 Notes") pursuant to the terms of the Indenture and a second supplemental indenture (the "Second Supplemental Indenture"), which was filed with the SEC on May 19, 2015 as an exhibit to our Current Report on from 8-K. Combined with the 2021 Notes issued in connection with the Exchange described above, the aggregate principal amount issued under the 2021 Notes was $202.4 million. The Exchange resulted in the retirement of outstanding 2017 Notes with a carrying value of $83.1 million, the write-off of unamortized debt issuance costs of $1.0 million and settlement of $10.7 million related to the conversion feature embedded in the 2017 Notes. The 2021 Notes offered in the Exchange had a fair value of $88.0 million, which resulted in a loss on extinguishment of debt of $16.6 million in the three months ended June 30, 2015.

The net proceeds from the issuance of the 2021 Notes amounted to $75.5 million, net of deferred issuance costs paid as of September 30, 2015. In connection with the issuance of the 2021 Notes, we incurred costs of approximately $5.2 million. The 2021 Notes are senior unsecured obligations of the Company and bear interest at a rate of 1.75% per annum, payable semi-annually in arrears on June 15 and December 15 of each year.

Pursuant to the terms of the Indenture and the Second Supplemental Indenture, the 2021 Notes are convertible at an initial conversion rate of 10 shares of our common stock per $1,000 principal amount of 2021 Notes, which corresponds to an initial conversion price of $100.00 per share of our common stock. The conversion rate is subject to adjustment from time to time upon the occurrence of certain events.

The 2021 Notes mature on December 15, 2021 unless earlier repurchased, redeemed or converted. Prior to the close of business on the business day immediately preceding June 15, 2021, holders may convert their 2021 Notes at their option only under the following circumstances related to: (i) the sale price of our common stock, (ii) the trading price per $1,000 principal amount of 2021 Notes or (iii) specified corporate events, or (iv) if we call the 2021 Notes for redemption, until the close of business on the business day immediately preceding the redemption date. On or after June 15, 2021 until the close of business on the scheduled trading day immediately preceding the maturity date, holders may convert their 2021 Notes at any time, regardless of whether any of the foregoing conditions has been met.

Based on the initial conversion rate of 10 shares of our common stock per $1,000 principal amount of 2021 Notes, which corresponds to an initial conversion price of $100.00 per share of our common stock, the number of shares issuable upon conversion of the 2021 Notes is 2,023,660. The value of these shares, based on the closing price of our common stock on June 30, 2016 of $57.75 per share, was approximately $116.9 million. The fair value of our 2021 Notes as presented in Note 4 was $200.3 million at June 30, 2016.

Accounting for Debt Transactions

In accordance with accounting guidance for debt with conversion and other options, we separately account for the liability and equity components of the Convertible Notes by allocating the proceeds between the liability component and the embedded conversion option, or equity component, due to our ability to settle the Convertible Notes in cash, common stock or a combination of cash and common stock, at our option. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The allocation was performed in a manner that reflected our non-convertible debt borrowing rate for similar debt. The equity component of the Convertible Notes was recognized as a debt discount and represents the difference between the proceeds from the issuance of the Convertible Notes and the fair value of the liability of the Convertible Notes on their respective dates of issuance. The excess of the principal amount of the liability component over its carrying

amount, or debt discount, is amortized to interest expense using the effective interest method over the life of the Convertible Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification. Additionally, we allocated the costs related to the issuance of the Convertible Notes on the same percentage as the long-term debt and equity components, such that a portion of the costs is allocated to the long-term component and the equity component included in additional paid-in-capital. These deferred financing costs are being amortized to interest expense over the life of the Convertible Notes using the effective interest method.

Note Treatment in Medtronic Merger

On June 27, 2016, we announced our entry into a Merger Agreement to be acquired by Medtronic (as summarized in Note 1 above). In connection with the announcement of the Merger Agreement, the Company has issued a notice to the registered holders of, and the trustee for, its 3.50% Convertible Senior Notes due 2017 (the "2017 Convertible Notes") and its 1.75% Convertible Senior Notes due 2021 (the "2021 Convertible Notes" and, together with the 2017 Convertible Notes, the "Convertible Notes") pursuant to the requirements of the supplemental indentures (the "Supplemental Indentures") and related base indenture (as amended and supplemented by the Supplemental Indentures, the "Indenture") governing the Convertible Notes, notifying the holders of, among other items, the Merger Agreement, the anticipated date of the expected Fundamental Change and Make-Whole Fundamental Change (each as defined in the Supplemental Indentures) as a result of the consummation of the transaction, the anticipated convertibility of the Convertible Notes in connection with such Fundamental Change, the right of holders of the Convertible Notes to require the Company to repurchase such holder's Convertible Notes in the event of a Fundamental Change and the Company's intention to enter into a supplemental indenture with respect to the Convertible Notes on or about the Effective Time.

Note 8. Stockholders' Equity

On January 30, 2014, we filed a shelf registration statement with the SEC on Form S-3. This shelf registration statement allows us to offer and sell from time to time, in one or more series or issuances and on terms that we will determine at the time of the offering any combination and amount of the securities described in the prospectus contained in the registration statement or in the prospectus supplement filed with respect to a particular offering. An aggregate of 530,816 shares of our common stock were registered for issuance pursuant to various prospectus filings on January 30, 2014 in connection with our acquisition of CircuLite. As of June 30, 2016, there remained 248,872 shares of our common stock reserved for potential issuance in connection with future contingent milestone payments under the terms of the merger agreement.

In the six months ended June 30, 2016, we issued 147,182 shares of our common stock upon the vesting of restricted stock units pursuant to stockholder approved equity plans. There were no options exercised during this period.

In the six months ended June 30, 2015, we issued an aggregate of 1,429 shares of our common stock upon the exercise of stock options and an aggregate of 107,896 shares of our common stock upon the vesting of restricted stock units.

Note 9. Share-Based Compensation

We allocate share-based compensation expense to cost of revenue, selling, general and administrative expense and research and development expense based on the award holder's employment function. For the three and six months ended June 30, 2016 and 2015, we recorded share-based compensation expense as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(In thousands)			
Cost of revenues	$ 446	$ 547	$ 940	$ 985
Selling, general and administrative	2,160	3,683	4,814	7,132
Research and development	1,602	2,516	2,841	4,605
	$ 4,208	$ 6,746	$8,595	$12,722

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

Deferred tax benefits attributed to our share-based compensation expense are not recognized in the accompanying condensed consolidated financial statements because we are in a net operating loss position and a full valuation allowance is maintained for all net deferred tax assets. We receive a tax deduction for certain stock option exercises during the period the options are exercised, and for the vesting of restricted stock units during the period the restricted stock units vest. For stock options, the amount of the tax deduction is generally for the excess of the fair market value of our shares of common stock over the exercise price of the stock options at the date of exercise. For restricted stock units, the amount of the tax deduction is generally for the fair market value of our shares of common stock at the vesting date. Excess tax benefits are not included in the accompanying condensed consolidated financial statements because we are in a net operating loss position and a full valuation allowance is maintained for all net deferred tax assets.

Equity Plans

We have issued share-based awards to employees, non-executive directors and outside consultants through various approved plans and outside of any formal plan. New shares are issued upon the exercise of share-based awards.

Upon receipt of stockholder approval on May 31, 2012, we adopted the HeartWare International, Inc. 2012 Incentive Award Plan ("2012 Plan"). The 2012 Plan provides for the grant of incentive stock options, non-qualified stock options, restricted stock, restricted stock units, performance awards, dividend equivalent rights, deferred stock, deferred stock units, stock payments and stock appreciation rights (collectively referred to as "Awards"), to our directors, employees and consultants. At our 2015 Annual Meeting of Stockholders held on June 4, 2015, our stockholders approved an amendment to the 2012 Plan to increase the number of shares of our common stock available for issuance by 1.1 million shares. Under the terms of the 2012 Plan, as amended, the total number of shares of our common stock reserved for issuance under Awards is 2,475,000, provided that the total number of shares of our common stock that may be issued pursuant to "Full Value Awards" (Awards other than options, stock appreciation rights or other Awards for which the holder pays the intrinsic value existing as of the date of grant whether directly or by forgoing a right to receive a payment from the Company) is 2,375,000. As of June 30, 2016, 421,745 shares have been issued upon vesting of Awards issued under the 2012 Plan and Awards with respect to 902,975 shares were issued and outstanding under the 2012 Plan. Subsequent to adoption of the 2012 Plan, no new Awards will be granted under our prior plans. Any outstanding Awards under the prior plans will continue to be subject to the terms and conditions of the plan under which they were granted.

Stock Options

Each option allows the holder to subscribe for, and be issued, one share of our common stock at a specified price, which is generally the quoted market price of our common stock on the date the option is issued. Options generally vest on a pro-rata basis on each anniversary of the issuance date within three or four years of the date the option is issued. Options may be exercised after they have vested and prior to the specified expiry date provided applicable exercise conditions are met, if any. The expiry date can be for periods of up to ten years from the date the option is issued.

The fair value of each option is estimated on the date of grant using the Black-Scholes option pricing model based on the assumptions established at that time. In the six months ended June 30, 2016 and 2015, we issued 158,940 and 7,000 stock options, respectively.

Information related to options granted under all of our plans at June 30, 2016 and activity in the six months then ended is as follows (certain amounts in U.S.$ were converted from AU$ at the then period-end spot rate):

Options	Number of Options (in thousands)	Weighted Average Exercise Price	Weighted Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2015	111	$ 49.20		
Granted	159	33.24		
Exercised	—	—		
Forfeited	(15)	34.63		
Expired	—	—		
Outstanding at June 30, 2016	255	39.20	7.01	$ 10,721
Exercisable at June 30, 2016	102	47.08	3.09	$ 1,982

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

The aggregate intrinsic values at June 30, 2016 noted in the table above represent the number of in-the-money options outstanding or exercisable multiplied by the closing price of our common stock traded on NASDAQ less the weighted-average exercise price at period end.

The total intrinsic value of options exercised in the six months ended June 30, 2016 and 2015 was $0 and approximately $0.1 million, respectively. Cash received from options exercised in the six months ended June 30, 2016 and 2015 was $0 and $0.3 million, respectively.

At June 30, 2016, there was approximately $1.6 million of unrecognized compensation expense, net of estimated forfeitures, related to non-vested options. This expense is expected to be recognized over a weighted-average period of 1.6 years.

Restricted Stock Units

Each restricted stock unit ("RSU") represents a contingent right to receive one share of our common stock. RSUs generally vest on a pro-rata basis on each anniversary of the issuance date over three or four years or vest in accordance with performance-based criteria. The RSUs with performance-based vesting criteria vest in one or more tranches contingent upon the achievement of predetermined milestones related to the development of our products, the achievement of certain prescribed clinical and regulatory objectives, the achievement of specific financial performance measures or similar metrics. There is no consideration payable on the vesting of RSUs issued under the plans. Upon vesting, the RSUs are exercised automatically and settled in shares of our common stock.

Information related to RSUs at June 30, 2016 and activity in the six months then ended is as follows:

Restricted Stock Units	Number of Units (in thousands)	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2015	623		
Granted	310		
Vested/Exercised	(147)		
Forfeited	(55)		
Expired	—		
Outstanding at June 30, 2016	731	1.72	$ 42,195

The aggregate intrinsic value at June 30, 2016 noted in the table above represents the closing price of our common stock traded on NASDAQ multiplied by the number of RSUs outstanding.

At June 30, 2016, 114,022 of the RSUs outstanding were subject to performance-based vesting criteria as described above.

The total intrinsic value of RSUs vested in the six months ended June 30, 2016 and 2015 was approximately $4.9 million and $9.3 million, respectively.

The fair value of each RSU award equals the closing price of our common stock on the date of grant. The weighted-average grant date fair value per share of RSUs granted in the six months ended June 30, 2016 and 2015 was $33.28 and $88.96, respectively.

At June 30, 2016, we had approximately $21.5 million of unrecognized compensation expense related to non-vested RSU awards, net of estimated forfeitures. This expense is expected to be recognized over a weighted-average period of 1.8 years.

Note 10. Net Loss Per Share

Basic net loss per common share is computed by dividing net loss for the period by the weighted-average number of common shares outstanding for each respective period. Diluted net loss per common share adjusts basic net loss per common share for the dilutive effects of share-based awards as determined under the treasury stock method, our convertible senior notes as determined

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

under the if-converted method, and other potentially dilutive instruments only in the periods in which the effect is dilutive. Due to our net loss for all periods presented, all potentially dilutive instruments were excluded because their inclusion would have been anti-dilutive. The following instruments have been excluded from the calculation of diluted net loss per share, as their effect would be anti-dilutive.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(In thousands)			
Common shares issuable upon:				
Conversion of convertible senior notes	2,449	2,449	2,449	2,449
Exercise or vesting of share-based awards	986	873	986	873

Note 11. Business Segment, Geographic Areas and Major Customers

For financial reporting purposes, we have one reportable segment which designs, manufactures and markets medical devices for the treatment of advanced heart failure. Products are distributed to customers located in the United States through our clinical trials and as commercial products, as commercial products to customers in Europe and other countries and under special access in certain other countries. Product sales attributed to a country or region are based on the location of the customer to whom the products are sold. Long-lived assets are primarily held in the United States.

Product sales by geographic location were as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)			
United States	$40,984	$42,922	$ 74,332	$ 85,111
Germany	10,602	13,072	21,275	25,813
International, excluding Germany	17,134	17,575	28,187	32,666
	$68,720	$73,569	$123,794	$143,590

As a significant portion of our revenue is generated outside of the United States, we are dependent on favorable economic and regulatory environments for our products in Europe and other countries outside of the United States. The government of Turkey experienced a recent coup attempt, the impact of which cannot be assessed at this time. Sales to customers in Turkey account for approximately 2-3% of our worldwide sales, or approximately 6-8% of our international sales outside Germany.

The “Brexit” referendum, whereupon Britain voted to leave the European Economic Community (EU), the future impact of which cannot be assessed at this time. Sales to customers in Britain also account for approximately 2-3% of our worldwide sales, or approximately 6-8% of our international sales outside Germany.

For the three and six months ended June 30, 2016 and 2015, no customer exceeded 10% of product sales individually.

Note 12. Commitments and Contingencies

We received a warning letter from the FDA, dated June 2, 2014, following an inspection of our Miami Lakes, Florida facility conducted in January 2014. The FDA letter cited four categories for us to address: (1) procedures for validating device design, including device labeling; (2) procedures for implementing corrective and preventive action (“CAPA”); (3) maintaining records related to investigations; and (4) validation of computer software used as part of production or quality systems. The warning letter did not require any action by physicians or patients and did not restrict use of our devices.

We sent the FDA our initial response to the warning letter within the required fifteen business days of receipt and committed to undertaking certain quality system improvements and providing the FDA with periodic updates. Since 2014 and continuing in 2016, we implemented systemic changes and organizational enhancements to address the four warning letter items and related quality systems. We have established teams to review and address the items cited by the FDA and have engaged external subject matter experts to assist in assessment and remediation efforts. As we continue to evaluate our quality systems, it is possible that we may need to take additional actions including the possibility of voluntary product recalls when necessary to ensure patient safety and effective performance of the HVAD System.

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

At June 30, 2016, we had purchase order commitments of approximately $41.5 million related to product costs, supplies, services and property, plant and equipment purchases. Many of our materials and supplies require long lead times. Our purchase order commitments reflect materials that may be received up to one year from the date of order.

In addition, we have entered into employment agreements with all of our executive officers. These contracts, which may be amended from time to time, do not have a fixed term and are constructed on an at-will basis. Some of these contracts provide executives with the right to receive certain additional payments and benefits if their employment is terminated including after a change of control, as defined in these agreements.

From time to time we invest in certain development-stage entities in connection with research activities. Certain contingent milestone payments in connection with these arrangements have not been accrued in the accompanying condensed consolidated financial statements as the amounts are indeterminate at this time.

The taxation and customs requirements, together with other applicable laws and regulations of certain foreign jurisdictions, can be inherently complex and subject to differing interpretation by local authorities. We are subject to the risk that either we have misinterpreted applicable laws and regulations, or that foreign authorities may take inconsistent, unclear or changing positions on local law, customs practices or rules. In the event that we have misinterpreted any of the above, or that foreign authorities take positions contrary to ours, we may incur liabilities that may differ materially from the amounts accrued in the accompanying condensed consolidated financial statements.

Contingent Consideration and Milestone Payments

In December 2013, we acquired CircuLite using a combination of cash, stock and post-acquisition milestone and royalty payments. The post-acquisition payments are payable based upon the achievement of CircuLite-related revenue and certain specified performance milestones over periods ranging from 8-10 years subsequent to the acquisition date. The maximum amount of the aggregate post-acquisition payments could be $300 million. As of June 30, 2016, the fair value of the contingent consideration was estimated to be $13.5 million (*see* Note 4).

License and Development Agreements

From time to time, we license rights to technology or intellectual property from third parties. These licenses may require us to make upfront payments as well as development or other payments upon successful completion of preclinical, clinical, regulatory or revenue milestones. In addition, these agreements may require us to pay royalties on sales of products arising from the licensed technology or intellectual property. Because the achievement of these milestones is not reasonably estimable, we have not recorded a liability in the accompanying consolidated financial statements for any of these contingencies.

Litigation

From time to time we may be involved in litigation or other contingencies arising in the ordinary course of business. Except as set forth below, based on the information presently available, management believes there are no contingencies, claims or actions, pending or threatened, the ultimate resolution of which will have a material adverse effect on our financial position, liquidity or results of operations.

On January 22, 2016, the St. Paul Teachers' Retirement Fund Association filed a putative class action complaint (the "Complaint") in the United States District Court for the Southern District of New York against the Company on behalf of all persons and entities who purchased or otherwise acquired shares of the Company from June 10, 2014 through January 11, 2016 (the "Class Period"). The Complaint was amended on June 29, 2016 and claims the Company and one of our executives violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 by making false and misleading statements about, among other things, the Company's response to the June 2014 FDA warning letter, the development of the MVAD System and the acquisition of Valtech. The Complaint seeks to recover damages on behalf of all purchasers or acquirers of the Company's stock during the Class Period. The Company intends to vigorously defend itself against these claims. Because of the many questions of fact and law that may arise, the outcome of this legal proceeding is uncertain at this point. As a result we cannot reasonably estimate a range of loss for this action and accordingly have not accrued any liability associated with this action.

HEARTWARE INTERNATIONAL, INC.
NOTES TO THE CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)
(unaudited)

In accordance with FASB ASC 450, *Contingencies*, we accrue loss contingencies including costs of settlement, damages and defense related to litigation to the extent they are probable and reasonably estimable. Otherwise, we expense these costs as incurred. If the estimate of a probable loss is a range and no amount within the range is more likely, we accrue the minimum amount of the range.

Note 13. Subsequent Events

We have evaluated events and transactions that occurred subsequent to June 30, 2016 through the date the financial statements were issued, for potential recognition or disclosure in the accompanying condensed consolidated financial statements. Except for those items noted below, we did not identify any events or transactions that should be recognized or disclosed in the accompanying condensed consolidated financial statements.

On July 25, 2016, HeartWare submitted for European regulatory approval of its next-generation controller, and plans to submit the new controller for approval in the United States in August 2016 with other jurisdictions to follow. The new controller is expected to be available for shipment following the Company's receipt of regulatory marketing approvals which may take up to one year to complete.

Upon the approval of its new controller in each jurisdiction, the Company intends to enact a voluntary plan to replace existing controllers in the field on a free-of-charge basis. The new controller is designed to provide enhancements over the Company's current controller, and is expected to result in improved performance.

As of July 25, 2016, if the next generation controller is approved, the Company estimates that it will incur a charge of approximately $24 million to $27 million under the controller replacement program, representing the estimated replacement cost of existing controllers in the field. This charge will be recognized upon the first regulatory approval of the new controller, which is expected to occur prior to December 31, 2016. Also, effective with the regulatory submission, the Company will defer approximately 7% of the average per-system selling price of an HVAD System to account for the implied controller replacement included in ongoing sale arrangements. The deferred revenue will be recognized in income when the new replacement controller is shipped to customers in the future.

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

The following discussion and analysis of our financial condition and results of operations should be read together with our unaudited interim condensed consolidated financial statements and related notes appearing elsewhere in this Quarterly Report on Form 10-Q. Certain abbreviated key terms have the meanings defined elsewhere in this Quarterly Report on Form 10-Q.

Overview

HeartWare is a medical device company that develops and manufactures miniaturized implantable heart pumps, or ventricular assist devices, to treat patients suffering from advanced heart failure. We have one operating segment, which designs, manufactures and markets our medical devices. We are headquartered in Framingham, Massachusetts and have facilities in Miami Lakes, Florida, Arden Hills, Minnesota and Hannover, Germany.

About Heart Failure

Heart failure is a chronic disease that results in the heart's pumping power being weaker than normal. In a healthy person, the left ventricle of the heart pumps oxygenated blood into the aorta and the blood is then circulated throughout the body until it returns through the venous system to the right side of the heart, which then pumps the blood into the lungs where it is re-oxygenated. If the left ventricle is not working properly, the oxygenated blood is not fully cleared from the lungs and the blood is not circulated effectively. If the muscle of the left ventricle is damaged or is not working efficiently, the ventricle will tend to compensate by working harder in an effort to supply adequate blood flow into the aorta. The increased effort generally results in dilation or enlargement of the ventricle, rather than increased blood flow. This dilation then makes it harder for the heart to contract effectively, which results in even lower blood flow and increased effort and further dilation of the ventricle. This progressive, degenerative process generally continues until the patient becomes debilitated and eventually dies from inadequate clearing of the lungs and inadequate flow of oxygenated blood throughout the body. The inadequate lung clearance or lung congestion is why the advanced stages of heart failure are called congestive heart failure, or CHF.

The HeartWare Ventricular Assist System

HeartWare currently manufactures and sells the HeartWare Ventricular Assist System (the "HVAD System"), which includes a ventricular assist device ("VAD") or blood pump, patient accessories and surgical tools, and is designed to provide circulatory support for patients in the advanced stage of heart failure. The core of the HVAD System is a proprietary continuous flow blood pump, the HVAD pump, which is a full-output device capable of pumping up to 10 liters of blood per minute. The HVAD System is designed to be implanted adjacent to the heart, avoiding abdominal surgery.

In November 2012, we received approval from the FDA for the HVAD System as a bridge-to-heart-transplantation in patients with end-stage heart failure. The HVAD System has been available in the European Union since receiving CE marking in 2009. In May 2012, we received an expanded European label for long-term use of the HVAD System in all patients at risk of death from refractory, end-stage heart failure. As of June 30, 2016, there have been over 11,000 implants of the HVAD System in patients at 340 health care sites in 47 countries.

Bridge-to-Transplant

FDA approval for a bridge-to-transplant ("BTT") indication was based on the results of our pivotal ADVANCE clinical trial, an FDA-approved Investigational Device Exemption ("IDE") study designed to evaluate the HVAD System as a bridge-to-heart-transplantation for patients with end-stage heart failure, as well as a Continued Access Protocol ("CAP"). Under ADVANCE, 140 patients at 30 hospitals in the U.S. received the HeartWare investigational device between August 2008 and February 2010. The ADVANCE study achieved 94% survival at six months and successfully met its primary endpoint of establishing non-inferiority between the investigational device and comparator arm of the study, which was derived from contemporaneous patients from the Interagency Registry for Mechanically Assisted Circulatory Support ("INTERMACS") ($p<0.0001$). Four supplemental allotments of patients were granted by the FDA under a CAP, encompassing more than 250 additional patients.

To help assure the continued safety and effectiveness of an approved device, FDA requires a post-approval study ("PAS") as a condition of approval to assess device performance in a real-world setting. HeartWare's PAS is a two-year registry study consisting of 600 patients who received an HVAD post approval and an additional 600 control patients derived from a contemporaneous group of patients entered into the INTERMACS database, receiving a continuous flow, intracorporeal left VAD ("LVAD"). The data for both arms of the study will be entered into the INTERMACS registry by the implanting centers. Other post-approval commitments include the transfer of patients from the ADVANCE IDE study into a post-approval trial as well as an obligation to continue training sites in accordance with an approved training program.

Destination Therapy

In May 2012, we completed enrollment in our clinical trial named "ENDURANCE" for a destination therapy indication for the HVAD System. Designed to enroll up to 450 patients at 50 U.S. hospitals, this non-inferiority study is a randomized, controlled, unblinded, multicenter clinical trial to evaluate the use of the HVAD System as a destination therapy in advanced heart failure patients. The study population was selected from patients with end-stage heart failure who have not responded to standard medical management and who are ineligible for heart transplantation. Patients in the study were randomly selected to receive either the HVAD System or, as part of a control group, an alternative ventricular assist device approved by the FDA for destination therapy, in a 2:1 ratio. Each patient receiving the HVAD System or control VAD was followed to the primary endpoint at two years and will undergo subsequent follow-up for a five-year period post implant. In April 2015, we announced that ENDURANCE had achieved its primary endpoint.

In August 2015, we completed enrollment of ENDURANCE2, a supplemental trial to study the clinical benefits of enhanced management of mean arterial pressure in patients with an HVAD System. In ENDURANCE2, HeartWare enrolled 310 patients receiving the HVAD System, as well as 155 control patients using a 2:1 randomization consistent with the original ENDURANCE protocol. HeartWare intends to incorporate the data from both ENDURANCE and ENDURANCE2 into an anticipated Premarket Approval Supplement Application seeking approval of the HVAD System for a destination therapy indication.

Other Clinical Activities

In the fourth quarter of 2013, HeartWare received approval from the Japanese Pharmaceuticals and Medical Devices Agency to commence a clinical study in Japan for market authorization for a BTT indication for the HVAD System. Enrollment was completed in August 2014 with six patients at five clinical sites. All patients reached the primary endpoint and we are currently preparing the submission for market authorization for a BTT indication in Japan.

In addition, in the fourth quarter of 2013, HeartWare received conditional approval from the FDA for a prospective, controlled, unblinded, multicenter clinical trial to evaluate the thoracotomy implant technique for the HVAD System. We began enrollment in this study in January 2015 and completed enrollment in April 2016.

MVAD System

Beyond the HVAD System, we are developing our next-generation miniaturized device, known as the MVAD System. The MVAD System is based on the same technology platform as the HVAD System, but adopts an axial flow, rather than a centrifugal flow configuration. The MVAD pump is less than one-half the size of the HVAD pump and can provide partial or full support. The MVAD System is designed to allow for a variety of configurations and surgical placements with the goal of further reducing surgical invasiveness while producing superior clinical results.

In July 2015, we initiated a multicenter, prospective, non-randomized, single-arm CE Mark trial to evaluate the clinical safety and performance of the MVAD System for the treatment of advanced heart failure. In September 2015, we voluntarily paused the MVAD CE Mark clinical trial to address an MVAD controller manufacturing issue. Subsequent to that action, during the fourth quarter of 2015 and in consultation with study investigators, we began evaluating MVAD System performance and reported adverse events in certain clinical trial patients, including events that showed evidence of pump thrombus. We are currently evaluating various aspects of the MVAD System design to determine whether changes should be made. Should design changes be implemented, initiation of a new trial would likely be required. The timetable for updating affected regulatory filings and restarting clinical implants cannot be reliably projected at this time.

CircuLite

On December 1, 2013, we acquired CircuLite, Inc., the developer of the CircuLite Circulatory Support System, a partial-support system designed to treat less-sick, ambulatory, patients with chronic heart failure who are not yet inotrope-dependent. The CircuLite Surgical System is designed for long-term support and is intended to reduce the heart's workload while improving blood flow to vital

organs. The CircuLite System experienced issues that arose after its commercial release and caused the loss of its CE marking in the European Union in March 2014. In January 2015, we discontinued development of the CircuLite micro pump and have focused our efforts on a version of our MVAD pump for our partial-assist program. Thus, delays to the development and regulatory approval of the MVAD System will affect the timing of the development and regulatory approval of the CircuLite System. The next-generation endovascular system, which is expected to be implanted collaboratively by cardiologists and surgeons in a hybrid catheterization ("cath") lab setting, offers an interventional approach to circulatory support. The CircuLite Circulatory Support System would offer less-invasive, and ultimately interventional, options to patients with earlier-stage heart failure.

FDA Warning Letter

We received a warning letter from the FDA, dated June 2, 2014, following an inspection of our Miami Lakes, Florida facility conducted in January 2014. The FDA letter cited four categories for us to address: (1) procedures for validating device design, including device labeling; (2) procedures for implementing corrective and preventive action (CAPA); (3) maintaining records related to investigations; and (4) validation of computer software used as part of production or quality systems. The warning letter did not require any action by physicians or patients and did not restrict the use of our devices.

We sent the FDA our initial response to the warning letter within the required fifteen business days of receipt and committed to undertaking certain quality system improvements and providing the FDA with periodic updates. Since 2014 and continuing in 2016, we implemented systemic changes and organizational enhancements to address the four warning letter items and related quality systems. We have established teams to review and address the items cited by the FDA and have engaged external subject matter experts to assist in assessment and remediation efforts. As we continue to evaluate our quality systems, it is possible that we may need to take additional actions including the possibility of voluntary product recalls when necessary to ensure patient safety and effective performance of the HVAD System.

Termination of Valtech Business Combination Agreement

On September 1, 2015, we entered into a Business Combination Agreement (the "BCA") by and among the Company, Valtech, HW Global, Inc. ("Holdco"), HW Merger Sub, Inc., Valor Merger Sub Ltd. and Valor Shareholder Representative, LLC, pursuant to which we and Valtech proposed to effect a strategic combination of our respective businesses under Holdco, subject to certain closing conditions. Effective January 28, 2016, we terminated the BCA pursuant to the terms of the BCA by delivering written notice to the other parties. After entering into the BCA and pursuant to the terms of the BCA, we loaned Valtech an aggregate principal amount of $3 million in interim funding at an interest rate of 6% per annum in $1 million increments in each of November 2015, December 2015 and January 2016. In connection with the termination provisions of the BCA, we loaned Valtech an additional $30 million on February 1, 2016 also in the form of a convertible promissory note with an interest rate of 6% per annum. We have no current contractual obligations to further fund Valtech.

Pending Transaction with Medtronic

On June 27, 2016, we announced that we entered into an agreement to be acquired by Medtronic summarized in Note 1 of Notes to Condensed Consolidated Financial Statements. If the Merger is consummated, we will become a wholly-owned subsidiary of Medtronic. Accordingly this Quarterly Report on Form 10-Q, which assumes we remain a standalone business, should be read with the understanding that, should the Merger be completed, Medtronic will have the power to control the conduct of our business.

Amended and Restated Bylaws

On June 26, 2016, the Company board amended and restated our bylaws (the "Bylaws") with immediate effect. The Bylaws were amended and restated to provide that unless the Company consents in writing to the selection of an alternative forum, the sole and exclusive forum for (i) any derivative action or proceeding brought on behalf of the Company, (ii) any action asserting a claim of breach of a fiduciary duty owed by any director, officer or other employee of the Company to the Company or the Company's stockholders, (iii) any action asserting a claim arising pursuant to any provision of the DGCL or the Company's Certificate of Incorporation (the "Certificate") or Bylaws, (iv) any action to interpret, apply, enforce or determine the validity of the Certificate or the Bylaws or (v) any action asserting a claim governed by the internal affairs doctrine shall be the Court of Chancery of the State of Delaware, or, if the Court of Chancery of the State of Delaware does not have jurisdiction, the Superior Court of the State of Delaware.

Summary of Recent Financial Performance

Second quarter 2016 total revenue improved by 25% compared to the first quarter of 2016, including sequential improvements of 23% and 28%, in U.S. and International sales, respectively. Revenue in the U.S. reflected a rebound in bridge-to-transplantation activity following relatively light implant volumes in the first quarter, and international revenue improved as a result on an increase in implant activity in key regions outside of Germany, while German implant activity was relatively stable compared to the first quarter of 2016. These results are indicative of volatility we may experience in any given quarter due to variability in patient implants, as well as factors including competitive launches and clinical trial activities, and are not necessarily indicators of long-term trends.

Total revenue decreased 7% to $68.7 million for the quarter ended June 30, 2016 compared to $73.6 million during the second quarter of 2015. U.S. revenue decreased by 5% on a unit sales decline of 5%, while international revenue decreased by 19% corresponding to a decrease in international unit sales of 10%. Comparative second quarter revenue was impacted by completion of enrollment in our ENDURANCE2 clinical trial in August 2015, increased competition from a competitor's international launch of a new device and continuing enrollment of a competitor's U.S. IDE study for its new device. Currency changes favorably impacted total revenue by $0.2 million, or approximately 0.3%, during the second quarter of 2016.

A total of 715 HVAD Systems were sold during the second quarter of 2016, compared to 578 units sold during the first quarter of 2016 and 773 units sold in the second quarter of 2015, reflecting the ongoing commercial launch of a competitive product internationally and clinical trials in the U.S. Due to these activities we anticipate that our quarterly revenue and market share may be subject to greater volatility in the near-term. As of June 30, 2016, we had 134 customers in the United States and 196 customers internationally.

We realized an increase in gross margin percentage, to 65.3% in the second quarter of 2016 compared to 58.2% in the first quarter of 2016. This increase compared to the first quarter of 2016 was primarily a result of increased sales and a $2.3 million field action charge related to the anticipated replacement of certain controllers that was recorded in the first quarter. Our gross margin percentage of sales for the second quarter of 2016 decreased compared to 65.7% in the second quarter of 2015 and was primarily attributable to a decrease in sales.

Combined selling, general, administrative, research and development expenses in the second quarter of 2016 increased to $51.3 million, compared to $47.3 million in the first quarter of 2016. The majority of the increase over the first quarter of 2016 was due to $2.7 million of Medtronic-related transaction expenses. Combined operating expenses decreased $4.9 million compared to $56.2 million in the second quarter of 2015, reflecting our intention to narrow the focus of research and development investments with an emphasis on making corrections to MVAD, further enhancing HVAD's pump and peripherals performance and early submission for a PMA approval of HVAD for destination therapy.

Second quarter operating expenses included $0.6 million of expense associated with a change in the estimated fair value of contingent consideration obligations related to our acquisition of CircuLite, and $0.3 million of acquired intangible asset amortization compared to $2.2 million and $0.4 million, respectively in the second quarter of 2015.

These summary results are more fully described in *Results of Operations* below.

Critical Accounting Policies and Estimates

We prepare our financial statements in accordance with accounting principles generally accepted in the United States. We are required to adopt various accounting policies and to make estimates and assumptions in preparing our financial statements that affect the reported amounts of our assets, liabilities, revenue and expenses. On an ongoing basis, we evaluate our estimates and assumptions. We base our estimates on our historical experience to the extent practicable and on various other assumptions that we believe are reasonable under the circumstances and at the time they are made. If our assumptions prove inaccurate or if our future results are not consistent with our historical experience, we may be required to make adjustments in our policies that affect our reported results. Our significant accounting policies are disclosed in Note 3 to the Consolidated Financial Statements included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015 ("2015 Annual Report on Form 10-K") filed with the Securities and Exchange Commission on February 26, 2016. During the six months ended June 30, 2016, there were no significant changes to any of our significant accounting policies.

Our most critical accounting policies and estimates include: revenue recognition, inventory capitalization and valuation, accounting for share-based compensation, measurement of fair value, valuation of tax assets and liabilities, reserves, long-lived assets, intangible assets and goodwill, and contingent consideration. We also have other key accounting policies that are less subjective and, therefore, their application is less subject to variations that would have a material impact on our reported results of operations. There have been no material changes to our critical accounting policies and estimates from the information provided in Part II, Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, included in our 2015 Annual Report on Form 10-K.

Results of Operations

Three and six months ended June 30, 2016 and 2015

Revenue, net

In the three and six months ended June 30, 2016 and 2015, we generated revenue through commercial sales and clinical trials.

	Three Months Ended June 30,			Six Months Ended June 30,		
	2016	2015	Change	2016	2015	Change
	(in thousands)			(in thousands)		
United States	$40,984	$42,922	(5)%	$ 74,332	$ 85,111	(13)%
International	27,736	30,647	(10)%	49,462	58,479	(15)%
Total	$68,720	$73,569	(7)%	$123,794	$143,590	(14)%

Total revenue was $68.7 million for the quarter ended June 30, 2016, reflecting a 5% decrease in revenue in the United States due to completion of the Company's ENDURANCE2 clinical trial in the third quarter of 2015 and increased competition from a competitor's clinical trial, as well as a 10% decrease in our international revenue due, in part, to increased competition from a competitor's launch of a new device. Currency changes favorably impacted total revenue growth by approximately $0.2 million, or 0.3%, during the second quarter of 2016.

Our U.S. revenue was $41.0 million for the quarter ended June 30, 2016 compared to $42.9 million during the quarter ended June 30, 2015. A total of 371 pumps were sold in the U.S. during the second quarter of 2016 compared to 391 pumps sold in the same period of 2015. While U.S. revenue trailed the prior year quarter due clinical trial and competitive reasons, revenue in the U.S. reflected a rebound in bridge-to-transplantation activity following relatively light implant volume in the first quarter. U.S. revenue in the period ended June 30, 2015 included revenue from 45 HVAD Systems sold under the Company's ENDURANCE2 clinical trial.

Our international revenue was $27.7 million for the quarter ended June 30, 2016 compared to $30.6 million during the quarter ended June 30, 2015. A total of 344 pumps were sold internationally during the second quarter of 2016 compared to 382 pumps sold in the same period of 2015. While international revenue trailed the prior year quarter primarily due to competitive European market conditions, international revenue for the second quarter of 2016 increased compared to the first quarter of 2016, as market activity increased in Europe.

In the second quarter ended June 30, 2016, approximately 40% of our net revenue was denominated in foreign currencies including principally the Euro and British pound, which was relatively unchanged compared to the same period in 2015. Movements in foreign currency exchange rates have had an effect on our reported revenue amounts in the past and could have a significant favorable or unfavorable impact on our reported revenue amounts in the future.

We intend to generate and grow commercial revenue from product sales as we further expand our sales and marketing efforts on a global basis. Future product sales are dependent on many factors, including perception of product performance, competition and market acceptance among physicians, patients, health care payers and the medical community as well as our capacity to meet customer demand by manufacturing sufficient quantities of our products.

Cost of Revenue

Cost of revenue includes costs associated with manufacturing and distributing our products and consists of direct materials, labor and overhead expenses allocated to the manufacturing process, provisions for excess or obsolete inventory, and shipping costs. Cost of revenue totaled approximately $46.8 million and $47.3 million in the six months ended June 30, 2016 and 2015, respectively.

Gross profit and gross margin percentage are as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2016	2015	2016	2015
	(in thousands)		(in thousands)	
Gross profit	$44,894	$48,341	$76,947	$96,322
Gross margin %	65.3%	65.7%	62.2%	67.1%

The decrease in gross margin percentage for the six months ended June 30, 2016, compared to the same period in 2015, was primarily a result of field action costs of $3.2 million, and decreased sales volume.

Selling, General and Administrative

Selling, general and administrative expenses include costs associated with selling and marketing our products and the general corporate administration of the Company. These costs are primarily related to salaries and wages and related employee costs, travel, marketing, external consultants and contractors, legal and accounting fees and general infrastructure costs, and include all operating costs not associated with or otherwise classified as research and development costs or cost of revenue.

	For the Three Months Ended June 30,			Six Months Ended June 30,		
	2016	2015	Change	2016	2015	Change
	(in thousands)			(in thousands)		
Selling, general and administrative expenses	$ 22,780	$ 22,247	2%	$44,254	$44,176	0%
% of operating expenses, excluding changes in fair value of contingent consideration	45%	41%		45%	41%	

The increase of $0.5 million for the three months ended June 30, 2016 as compared to the three months ended June 30, 2015 is primarily due to $2.7 million of Medtronic-related transaction costs and $1.0 million of increased personnel-related costs, partially offset by a $0.9 million reduction in expenses associated with the suspension of the medical device excise tax, $1.5 million reduction in stock-based compensation expense and a reduction in all other expenses of $0.7 million.

The increase of $0.1 million for the six months ended June 30, 2016 as compared to the six months ended June 30, 2015 includes $2.7 million of Medtronic-related transaction costs and $2.1 million of personnel-related costs. Offsetting expense decreases include approximately $0.7 million of CircuLite-related restructuring charges in 2015 resulting from lease exit costs, contract termination costs, severance costs and asset impairment charges, non-cash share-based compensation expense of $2.3 million and a $1.8 million reduction in expenses associated with the suspension of the medical device excise tax. All other operating expenses increased by approximately $0.2 million.

Research and Development

Research and development expenses are the direct and indirect costs associated with developing our products prior to commercialization, including the costs of operating clinical trials, and are expensed as incurred. These expenses fluctuate based on project-level activity and consist primarily of salaries and wages and related employee costs of our research and development, clinical and regulatory staffs, external research and development costs, and materials and expenses associated with clinical trials. Research and development expenses also include most costs associated with our compliance with FDA regulations. Additional costs include travel, facilities and overhead allocations.

	For the Three Months Ended June 30,			Six Months Ended June 30,		
	2016	2015	Change	2016	2015	Change
	(in thousands)			(in thousands)		
Research and development expenses	$ 27,878	$ 31,702	-12%	$53,099	$62,969	-16%
% of operating expenses, excluding changes in fair value of contingent consideration	55%	59%		55%	59%	

The net decrease of $3.8 million for the three months ended June 30, 2016 as compared to the three months ended June 30, 2015 resulted from a decrease in overall research and development project expenses of $1.6 million, clinical trial costs of $1.4 million and share-based compensation of $0.9 million. All other expenses net to a decrease of 0.1 million. In general, these decreases reflect our intention to narrow the focus of research and development investments with an emphasis on making corrections to MVAD, further enhancing HVAD's pump and peripherals performance and working toward early submission for a PMA approval of HVAD for destination therapy.

The net decrease of $9.9 million for the six months ended June 30, 2016 as compared to the six months ended June 30, 2015 resulted primarily from decreases in overall research and development project expenses of $4.3 million, clinical trial costs of $1.9 million, non-cash share-based compensation expense of $1.8 million and restructuring costs of $2.2 million. All other expenses resulted in an increase of $0.3 million. The restructuring charges associated with the CircuLite acquisition were $0 and $2.2 million in the six months ended June 30, 2016 and 2015, respectively. The charges recorded in 2015 included fixed asset impairment, contract termination fees, severance costs and lease exit costs in connection with our decision to cease activities at our facility in Aachen, Germany.

We expect that research and development expenses will continue to represent a significant portion of our operating expenses for the foreseeable future as we continue to incur substantial development costs related to our next-generation products, including the Pal controller, the MVAD System, the CircuLite System and certain early research initiatives. We also expect to incur substantial costs for clinical trials for the HVAD System in new markets and expanded indications and for the MVAD System both in Europe and the United States, as well as ongoing clinical trial expenses associated with bridge-to-transplant post-approval study requirements and ongoing patient follow-up related to the ENDURANCE and LATERAL clinical trials.

Change in Fair Value of Contingent Consideration

On December 1, 2013, we acquired CircuLite, Inc. using a combination of cash and stock. In addition to initial consideration paid at closing, the former CircuLite security-holders may be entitled to receive additional shares of HeartWare common stock (or cash, in certain cases, at our discretion) upon the achievement of certain specified performance milestones and royalty payments. We calculate the estimated fair value of the contingent consideration on a quarterly basis.

In the three months ended June 30, 2016, we recorded a $0.6 million charge for the increase in the estimated fair value of the contingent consideration since March 31, 2016. In the six months ended June 30, 2016, we recorded a $1.2 million adjustment for the increase in the estimated fair value of the contingent consideration since December 31, 2015. The change in the fair value of the contingent consideration in the three and six months ended June 30, 2016 was due to the effect of the passage of time on the fair value measurement.

In the three months ended June 30, 2015, we recorded a $2.2 million adjustment for the increase in the estimated fair value of the contingent consideration since March 31, 2015. In the six months ended June 30, 2015, we recorded a $4.3 million adjustment for the increase in the estimated fair value of the contingent consideration since December 31, 2014. The change in the fair value of the contingent consideration in the three and six months ended June 30, 2015 was due to accretion of the liability due to the passage of time.

Determining the estimated fair value of the contingent consideration requires significant management judgment or estimation. The estimated fair value is calculated using the income approach, with significant inputs that include various revenue assumptions, discount rates and applying a probability to each outcome. Material changes in any of these inputs could result in a significantly higher or lower fair value measurement. Potential valuation adjustments will be made in future accounting periods as additional information becomes available, including, among other items, progress toward developing the CircuLite System, as well as revenue and milestone targets as compared to our current projections. Adjustments associated with changes in the estimated fair value of the contingent consideration are presented on a separate line item on our consolidated statements of operations.

Foreign Exchange

We generate a substantial portion of our revenue and collect receivables in foreign currencies. Fluctuations in the exchange rate of the U.S. dollar against the Euro, British Pound and Australian dollar can result in foreign currency exchange gains and losses that may significantly affect our financial results. Continued fluctuation of these exchange rates could result in financial results that are not comparable from quarter to quarter. The “Brexit” referendum, whereupon Britain voted to leave the European Economic Community (EU), caused the British Pound to fall approximately 10% against the U.S. dollar. This decline may have an ongoing negative impact on our United Kingdom sales, which comprised approximately 7% of our first half 2016 international revenues.

In the three months ended June 30, 2016, our net foreign exchange loss totaled approximately $1.4 million, compared to a net gain of approximately $0.8 million in the same period of 2015.

In the six months ended June 30, 2016, our net foreign exchange loss totaled approximately $0.5 million, compared to net foreign exchange losses of approximately $2.9 million in the same period of 2015.

In 2016 and 2015, the majority of our realized and unrealized foreign exchange gains and losses resulted from the settlement of certain balance sheet accounts, primarily accounts receivable that were denominated in foreign currencies, and the remeasurement to U.S. dollars at period end of certain balance sheet accounts, denominated in foreign currencies, primarily the Euro. We expect to continue to realize foreign exchange gains and losses for the foreseeable future as a significant portion of our sales is denominated in foreign currencies. We do not currently utilize foreign currency contracts to manage foreign exchange risks.

Interest Expense

Interest expense primarily consists of interest incurred on the principal amount of our convertible senior notes issued in December 2010 and May 2015, amortization of the related discount and amortization of the portion of the deferred financing costs allocated to the debt component. The discount on the convertible senior notes and the deferred financing costs are being amortized to interest expense through the maturity dates of the convertible senior notes using the effective interest method.

In the three months ended June 30, 2016, interest expense was approximately $3.8 million, which included $1.3 million of interest incurred on the principal amount of the convertible notes and $2.5 million of non-cash amortization of the discount and deferred financing costs.

In the three months ended June 30, 2015, interest expense was approximately $3.5 million, which included $1.3 million of interest incurred on the principal amount of the convertible notes and $2.2 million of non-cash amortization of the discount and deferred financing costs.

In the six months ended June 30, 2016, interest expense was approximately $7.5 million, which included $2.5 million of interest incurred on the principal amount of the convertible notes at the stated coupon rates and $5.0 million of non-cash amortization of the discount and deferred financing costs.

In the six months ended June 30, 2015, interest expense was approximately $7.0 million, which included $2.6 million of interest incurred on the principal amount of the convertible notes at the stated coupon rates and $4.4 million of non-cash amortization of the discount and deferred financing costs.

Investment Income, net

Investment income is primarily derived from the outstanding Valtech Convertible Notes, financial investments and cash and short-term deposit accounts held in the U.S. The amortization of premium on our financial investments is also included in investment income, net. Investment income, net was approximately $0.9 million and $1.6 million, respectively, in the three and six months ended June 30, 2016, compared to $0.1 million and $0.3 million, respectively, in the same period in the prior year, the increase of which is primarily due to net interest related to the outstanding Valtech Convertible Notes. We continue to experience low interest rates on our deposits and available-for-sale investments.

Income Taxes

We are subject to taxation in the United States and jurisdictions outside of the United States. These jurisdictions have different marginal tax rates. Foreign earnings are considered to be permanently reinvested in operations outside the U.S. and therefore are not subject to U.S. income taxes until repatriated. As of December 31, 2015, we had no unrepatriated foreign earnings. We have incurred significant U.S. losses since inception, however, changes in issued capital and share ownership, as well as other factors, may limit our ability to utilize any net operating loss carry-forwards, and therefore a 100% valuation allowance has been recorded against our net deferred tax assets in the United States and Australia. For the three and six months ended June 30, 2016, our tax provision includes estimated foreign taxes in jurisdictions where wholly owned subsidiaries may be subject to current taxes.

Liquidity and Capital Resources

As of June 30, 2016, our cash and cash equivalents combined with short-term available-for-sale investments were approximately $185.0 million as compared to $243.6 million at December 31, 2015.

Following is a summary of our cash flow activities for the six months ended June 30, 2016 and 2015:

	Six Months Ended June 30,	
	2016	2015
	(in thousands)	
Net cash used in operating activities	$ (25,387)	$ (2,501)
Net cash (used in) provided by investing activities	(20,628)	2,842
Net cash provided by financing activities	—	75,659
Effect of exchange rate changes on cash and cash equivalents	209	2,276
Net (decrease) increase in cash and cash equivalents	$ (45,806)	$ 78,276

Cash Used in Operating Activities

For the six months ended June 30, 2016, cash used in operating activities included a net loss of approximately $28.3 million, adjustments for non-cash items totaling $19.4 million and cash used in working capital of $16.5 million. The net loss was driven by normal operating activities including the sale of the HVAD System in the United States and abroad, a charge for the increase in the fair value of contingent consideration, interest expense and foreign exchange losses. Adjustments for non-cash items primarily consisted of $8.6 million of share-based compensation, $4.1 million of depreciation and amortization on long-lived assets, $4.7 million of amortization of the discount on our convertible notes and $1.2 million for the increase in the fair value of contingent consideration related to the CircuLite acquisition. The decrease in cash from changes in working capital primarily included $11.7 million for the decrease in accrued liabilities driven by various field actions and payout of 2015 bonuses, an increase in accounts receivable of $3.1 million primarily due to increased revenues, and an increase in prepaid expenses and other assets of $3.6 million due to inventory prepayments and long-term receivables. These amounts were partially offset by a decrease in inventories of $2.3 million.

For the six months ended June 30, 2015, cash used in operating activities included a net loss of approximately $41.9 million, adjustments for non-cash items totaling $44.2 million and cash used in working capital of $4.8 million. The net loss was driven by normal operating activities including the sale of the HVAD System in the United States and abroad, the loss on extinguishment of long-term debt, a charge for the increase in the fair value of contingent consideration, interest expense and foreign exchanges losses. Adjustments for non-cash items primarily consisted of $12.7 million of share-based compensation, $4.4 million of depreciation and amortization on long-lived assets, $4.2 million of amortization of the discount on our convertible notes, $4.3 million for the increase in the fair value of contingent consideration related to the CircuLite acquisition and $1.1 million for the impairment of fixed assets. The decrease in cash from changes in working capital included $4.9 million for the decrease in accrued liabilities, $2.4 million for the payment of trade accounts payable, and an increase in prepaid expenses and other assets of $0.4 million. These amounts were partially offset by decreases in accounts receivable and inventory totaling $2.7 million.

Cash Used in Investing Activities

In the six months ended June 30, 2016, net cash used in investing activities included loans to Valtech aggregating $31.0 million, net maturities of securities aggregating $13.2 million, $2.4 million to acquire property, plant and equipment and $0.7 million for intellectual property.

In the six months ended June 30, 2015, net cash provided by investing activities included maturities of available-for-sale securities (net of purchases) aggregating $5.5 million. This amount was partially offset by cash usages of $2.1 million to acquire property, plant and equipment and $0.8 million for intellectual property.

Cash Provided by Financing Activities

In the six months ended June 30, 2015, cash provided by financing activities was primarily the result of the net cash proceeds from the issuance of our 1.75%, 2021 Notes. In May 2015, we issued our 1.75%, 2021 Notes with an aggregate principal amount of $202.4 million in exchange for a portion of our outstanding 3.5%, 2017 Notes with an aggregate principal amount $101.3 million and net cash proceeds of approximately $75.5 million, after paying offering costs. Interest on the 2021 Notes is payable semiannually in arrears on June 15 and December 15 of each year, beginning on December 15, 2015. The 2021 Notes will mature on December 15, 2021, unless earlier repurchased by the Company, converted, or redeemed.

The exercise of stock options in the six months ended June 30, 2016 and 2015 resulted in cash proceeds of approximately $0 million and $0.03 million, respectively.

Operating Capital and Capital Expenditure Requirements

We have incurred operating losses to date and anticipate that we will continue to consume cash and incur substantial net losses as we expand our sales and marketing capabilities, develop new products and seek regulatory approvals for expanded indications of the HVAD System in the United States. For the remainder of 2016, cash on hand is expected to be used primarily to fund our ongoing operations, including:

- expanding our sales and marketing capabilities on a global basis;
- growing market penetration, particularly in the U.S.;
- continued product development, including development of the MVAD pump and Pal controller;
- preclinical and clinical costs relating to the MVAD pump, and clinical trials related to expanded indications of the HVAD System;
- post-approval monitoring related to the HVAD System;
- regulatory and other compliance functions, including activities to enhance our quality systems in response to the warning letter we received from the FDA in June 2014;
- replacement of product in the field as a result of ongoing and potential future field actions;
- responding to litigation claims;
- expand work-in-process and finished goods inventory to support ongoing operations;
- strategic activities intended to expand our access to new technologies;
- transaction costs associated with Medtronic merger
- planned investments in infrastructure to support our growth; and
- general working capital.

Our convertible notes bear interest at a rate of 1.75% or 3.5% per annum, payable semi-annually in arrears on June 15 and December 15 of each year. To date, all interest payments have been paid on a timely basis. Based on the outstanding principal amount of our convertible senior notes at June 30, 2016, the next semi-annual interest payment is due on December 15, 2016 and will be approximately $2.5 million. This amount is expected to be paid from cash on hand if the notes are not earlier redeemed.

We believe cash on hand and investment balances as of June 30, 2016 are sufficient to support our planned operations for at least the next twelve months. At June 30, 2016, approximately $3.9 million of our cash on hand was held in foreign locations, including Australia, Germany and the United Kingdom. To date, the Company has not had unremitted foreign earnings and has not incurred U.S. federal and state income taxes related to repatriated earnings. As our operations in our foreign subsidiaries grow, we may generate foreign earnings. Any repatriation of those earnings to the United States would likely result in us incurring federal and state income taxes. We currently plan to permanently reinvest any earnings of our foreign subsidiaries.

Because of the numerous risks and uncertainties associated with the development of medical devices, we are unable to estimate the exact amounts of capital outlays and operating expenditures necessary to maintain regulatory approvals, fund commercial expansion, and develop and obtain regulatory approvals for new products. Our future capital requirements will depend on many factors, including but not limited to the following:

- implementation of systemic improvements necessary to satisfactorily address the observations cited in the June 2, 2014 warning letter we received from the FDA;
- commercial acceptance of our products and our response to competitive pressures;
- reimbursement of our products by governmental agencies and third-party payers;
- costs to manufacture and ensure regulatory compliance of our products;
- expenses required to operate multiple clinical trials;
- further product research and development for next-generation products and expanding indications for our products as well as efforts to sustain and implement incremental improvements to existing products;
- expanding our sales and marketing capabilities on a global basis;

- broadening our infrastructure in order to meet the needs of our growing operations, including regulatory compliance;
- replacement of product in the field as a result of ongoing and potential future field actions;
- expenses related to funding and integrating strategic investments, acquisitions and collaborative arrangements;
- payment, if the moratorium is lifted, of the 2.3% excise tax on gross revenue from the sale of our medical devices in the United States imposed by the Patient Protection and Affordable Care Act;
- payment of our convertible notes upon maturity, if not converted or refinanced; and
- complying with the requirements related to being a public company in the U.S.

Contractual Obligations

With the exception of the items discussed below during the six months ended June 30, 2016, there were no material changes outside the ordinary course of business to material contractual obligations provided in Part II, Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, and included in our 2015 Annual Report on Form 10-K filed with the SEC on February 26, 2016.

Pending Transaction with Medtronic

On June 27, 2016, we announced that we entered into an agreement to be acquired by Medtronic summarized in Note 1 of Notes to Condensed Consolidated Financial Statements.

Amendments to Employment Agreements

On June 26, 2016, the Company and Heartware, Inc., the Company's wholly-owned subsidiary, entered into letter amendments ("Letter Amendments") to the employment agreements with each of the Company's senior officers. Pursuant to the Letter Amendments, the amount of severance payable to each senior officer if he or she is terminated without "Cause" or for "Good Reason" coincident with or within 18 months after a "Change in Control" (each as defined in the applicable employment agreement) is calculated based on the officer's current base salary plus current target annual cash bonus assuming 100% corporate and individual achievement. Prior to the letter amendments, the amount payable upon such a termination of employment was calculated based on current base salary plus the amount most recently paid as an annual bonus. This description is qualified in its entirety by reference to the copies of the Letter Amendments filed as Exhibits 10.1, 10.2, 10.3, 10.4, 10.5, 10.6, and 10.7 to the Company's Current Report on Form 8-K filed with the SEC on June 27, 2016.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Market risk represents the risk of changes in the value of market-risk-sensitive instruments caused by fluctuations in interest rates, foreign exchange rates and commodity prices. Changes in these factors could cause fluctuations in our results of operations and cash flows.

Interest Rate Risk

Our exposure to interest rate risk is currently confined to interest earnings on our cash and cash equivalents that are invested in highly liquid money market funds, short-term time deposits, short-term bank notes and short-term commercial paper. The primary objective of our investment activities is to preserve our capital to fund operations. We also seek to generate reasonable income from our investments without assuming significant risk. We do not presently use derivative financial instruments in our investment portfolio. Our cash and investments policy emphasizes liquidity and preservation of principal over other portfolio considerations.

If interest rates rise, the market value of our investment portfolio may decline, which could result in a loss if we choose or are forced to sell an investment before its scheduled maturity. We do not utilize derivative financial instruments to manage interest rate risks.

Our convertible senior notes do not bear interest rate risk as the notes were issued with a fixed interest rate of 3.5% and 1.75% per annum.

Foreign Currency Rate Fluctuations

We conduct business in foreign countries. For U.S. reporting purposes, we translate all assets and liabilities of our non-U.S. entities at the period-end exchange rate and revenue and expenses at the average exchange rates in effect during the periods. The net effect of these translation adjustments is shown in the accompanying condensed consolidated financial statements as a component of stockholders' equity.

We generate a significant portion of our revenue and collect receivables in foreign currencies. Fluctuations in the exchange rate of the U.S. dollar against major foreign currencies, including the Euro, British Pound and Australian dollar, can result in foreign currency exchange gains and losses that may significantly impact our financial results. These foreign currency transaction and translation gains and losses are presented as a separate line item on our condensed consolidated statements of operations. Continued fluctuation of these exchange rates could result in financial results that are not comparable from quarter to quarter. We do not currently utilize foreign currency contracts to mitigate the gains and losses generated by the re-measurement of non-functional currency assets and liabilities but do hold cash reserves in currencies in which those reserves are anticipated to be expended.

Market Risk

As a significant portion of our revenue is generated outside of the United States, we are dependent on favorable economic and regulatory environments for our products in Europe and other countries outside of the United States. Recently events in Turkey, which accounts for 2-3% our worldwide sales, where the government experienced a recent coup attempt and Britain, which also accounts for 2-3% of our worldwide sales, where the "Brexit" referendum resulted in Britain voting to leave the European Economic Community (EU), may have future impacts which cannot be assessed at this time.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of the Chief Executive Officer and Chief Financial Officer, carried out an evaluation required by the Securities Exchange Act of 1934, as amended (the "Exchange Act"), of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rule 13a-15(e) of the Exchange Act, as of June 30, 2016. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of June 30, 2016, our disclosure controls and procedures were effective to provide reasonable assurance that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized, and reported within the time periods specified in the SEC's rules and forms and to provide reasonable assurance that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosures.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting during the fiscal quarter ended June 30, 2016, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Controls and Procedures

Our management, including the Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Thus, misstatements due to error or fraud may occur and not be detected. These inherent limitations include the realities that judgments in decision-making can be faulty, and that breakdowns can occur because of simple error or mistake. Additionally, controls can be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of controls.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Except for the matter discussed below, the Company is not a party to any material pending legal proceedings at the date of filing of this Quarterly Report on Form 10-Q.

On January 22, 2016, the St. Paul Teachers' Retirement Fund Association filed a putative class action complaint (the "Complaint") in the United States District Court for the Southern District of New York against the Company on behalf of all persons and entities who purchased or otherwise acquired shares of the Company from June 10, 2014 through January 11, 2016 (the "Class Period"). The Complaint was amended on June 29, 2016 and claims the Company and one of our executives violated Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 by making false and misleading statements about, among other things, the Company's response to the June 2014 FDA warning letter, the development of the MVAD System and the acquisition of Valtech. The Complaint seeks to recover damages on behalf of all purchasers or acquirers of the Company's stock during the Class Period. The Company intends to vigorously defend itself against these claims. Because of the many questions of fact and law that may arise, the outcome of this legal proceeding is uncertain at this point. As a result we cannot reasonably estimate a range of loss for this action and accordingly have not accrued any liability associated with this action.

ITEM 1A. RISK FACTORS

The following risk factors are either risk factors related to the proposed acquisition of the Company by Medtronic, new risk factors, or have been modified since our most recent annual report. In addition to the information set forth in this report you should carefully consider the risk factors described in Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015 filed with the SEC on February 26, 2016.

Failure to complete, or delays in completing, the transaction with Medtronic announced on June 27, 2016.

On June 27, 2016, Medtronic, Inc. ("Medtronic"), a Minnesota corporation, Medtronic Acquisition Corp. ("Purchaser"), a Delaware corporation and a wholly-owned subsidiary of Medtronic, and HeartWare entered into an Agreement and Plan of Merger (the "Merger Agreement") pursuant to which Medtronic would acquire HeartWare. A copy of the Merger Agreement was filed as Exhibit 2.1 to HeartWare's Current Report on Form 8-K, which was filed with the SEC on June 27, 2016. Pursuant to the Merger Agreement, on July 26, 2016, Medtronic and Purchaser commenced a tender offer to purchase all of the outstanding shares of HeartWare common stock at a price of $58.00 per share (the "Offer Price"), paid to the holder in cash, without interest upon the terms and subject to the conditions set forth in the Offer to Purchase dated July 26, 2016 and in the related Letter of Transmittal (the "Offer").

The Merger Agreement provides that, among other matters, as soon as practicable after the acquisition of shares of common stock pursuant to the Offer, and the satisfaction or waiver of certain conditions in the Merger Agreement, Purchaser will merge with and into HeartWare with HeartWare surviving as a wholly owned subsidiary of Parent pursuant to Delaware General Corporation Law ("DGCL") Section 251(h) (the "Merger"). Because the Merger will be governed by Section 251(h) of the DGCL, no stockholder vote will be required to consummate the Merger. HeartWare does not expect there to be a significant period of time between the consummation of the Offer and the consummation of the Merger. At the effective time of the Merger (the "Effective Time"), each share of HeartWare common stock issued and outstanding immediately prior to the Effective Time (other than Shares (i) owned by the Company as treasury stock, (ii) owned by Parent or Purchaser, or (iii) held by a holder who is entitled to demand and properly demands appraisal for such shares of common stock in accordance with Section 262 of the DGCL shall, by virtue of the Merger and without any action on the part of the holder thereof, be automatically cancelled and converted into the right to receive an amount in cash, payable to the holder thereon, without any interest thereon, equal to the Offer Price, on the terms and conditions set forth in the Merger Agreement. The Offer is described in a Tender Offer Statement on Schedule TO filed by Medtronic and Purchaser with the SEC on July 26, 2016. Also on July 26, 2016, HeartWare filed a Schedule 14D-9 containing, among other this, the HeartWare board's recommendation that all holders of HeartWare common stock accept the Offer, tender their shares of common stock pursuant to the Offer and, if required by applicable law, adopt the Merger Agreement and approve the Merger related to the Offer. Investors and security holders are urged to carefully read these documents and the other documents relating to the transactions contemplated by the Merger Agreement when they become available because these documents will contain important information relating to the Offer and related transactions. Investors and security holders may obtain a free copy of these documents, and other annual, quarterly and special reports and other information filed with the SEC by HeartWare or Medtronic for no charge, at the SEC's website at www.sec.gov or by contacting HeartWare's investor relations department at HeartWare International, Inc., 500 Old Connecticut Path, Framingham, MA 01701, Attention: Investor Relations.

At the Effective Time, (i) each outstanding and unexercised option granted under an equity plan of the Company (whether vested or unvested) will be automatically cancelled and the option holder will be entitled to receive a cash payment from the Company in an amount equal to the product of the excess, if any, of the Merger Consideration over the exercise price of each such option and the number of unexercised shares subject to such option immediately prior to the Effective Time, less any required withholding of taxes and (ii) each outstanding restricted stock units granted under an equity plan of the Company will be automatically cancelled, and the holder of the restricted stock unit will be entitled to receive a cash payment in an amount equal to the product of the Merger Consideration and the number of shares underlying such restricted stock unit as of immediately prior to the Effective Time (assuming achievement of all performance milestones in the case of restricted stock units that are subject to performance-based vesting), less any required withholding of taxes.

The Offer is not subject to a financing condition. The Offer is conditioned upon, among other things, (a) there being validly tendered pursuant to the Offer and not properly withdrawn prior to the Expiration Date a number of shares of HeartWare common stock that when added to the shares already owned by Medtronic, Purchaser or any wholly owned subsidiaries of their ultimate parent constitutes a majority of the then outstanding shares of HeartWare common stock (the "Minimum Condition"), and (b) approvals under applicable antitrust laws in Austria, Germany and Spain being obtained. The Offer was also conditioned on the waiting period under the Hart-Scott-Rodino Antitrust Improvements Act of 1976, as amended, having expired or been terminated. The applicable waiting period expired on July 25, 2016. The "Expiration Date" means the end of the day, immediately after 11:59 p.m. Eastern time on August 22, 2016, which is the date that is 20 business days following the commencement of the Offer, unless the Offer is extended in accordance with the terms of the Merger Agreement.

The Merger Agreement includes customary representations, warranties and covenants of HeartWare and Medtronic. HeartWare has agreed to operate its business and the business of its subsidiaries in the ordinary course of business consistent with past practices through the Effective Time. The Merger Agreement provides for the Company to pay a termination fee of approximately $27.5 million to Medtronic if HeartWare terminates the Merger Agreement under certain conditions defined in the Merger Agreement.

The summary of the Merger Agreement and the descriptions of the terms and conditions to the Offer contained in the Offer to Purchase do not purport to be complete and are qualified in their entirety by reference to the Merger Agreement and the Offer.

We cannot assure at this time that the parties will be able to complete the Offer and Merger as contemplated under the Merger Agreement or at all. Risks related to the pending status of the transaction, and/or failure to complete the transaction, include the following:

• The possibility that the Merger might not be consummated, and the risks and costs to the Company in such event, including the diversion of management and employee attention and the potential disruptive effect on business and customer relationships, stock price and ability to attract and retain key management personnel and employees;

• The Company will remain liable for significant transaction costs, including legal, accounting, financial advisory and other costs related to the Merger, whether or not it is consummated;

• The Merger Agreement contains "no solicitation" provisions that, subject to certain limited exceptions, restrict our ability to initiate, solicit, or knowingly encourage, facilitate or engage in any negotiations, inquiries or discussions with respect to any third party proposals for the acquisition of our common stock or to pursue an unsolicited offer;

• The Company may be required to pay a termination fee of approximately $27.5 million to Medtronic if the Company terminates the Merger Agreement under certain conditions, which may deter third parties that might be interested in exploring an acquisition of the Company;

• The attention of Company management and employees may be diverted from day-to-day operations during the period up to the completion of the Merger;

• The Company's business, including both ordinary course and other transactions, may be disrupted as a result of the announcement of the Offer and Merger and the likelihood of litigation arising in connection with the Merger;

• Our ability to attract and retain key management personnel and employees may be harmed by uncertainties associated with the Merger;

• Our executive officers and members of our board may be deemed to have interests in the Merger that may be different from or in addition to those of our stockholders, generally, which may create potential conflicts of interest; and

• Under the Merger Agreement, the Company is subject to certain restrictions on the conduct of its business prior to completing the Merger, including generally requiring the Company to conduct its business only in the ordinary course, subject to specified limitations, and that the Company will not undertake various actions related to the conduct of its business without the prior written consent of Purchaser, which may delay or prevent the Company from responding to changing market and business conditions and could adversely affect our ability to conduct business as we otherwise could have done without these restrictions.

The occurrence of any of these events individually or in combination could materially and adversely affect our business, results of operations, financial condition and stock price.

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

There were no unregistered sales of our equity securities during the six months ended June 30, 2016.

ITEM 6. EXHIBITS

2.1	Agreement and Plan of Merger, dated as of June 27, 2016, by and among Medtronic, Inc., Medtronic Acquisition Corp. and HeartWare International, Inc. (incorporated by reference to Exhibit 2.1 to HeartWare's Current Report on Form 8-K filed with the SEC on June 27, 2016).
3.1	Amended and Restated Bylaws of HeartWare International, Inc., effective June 26, 2016 (incorporated by reference to Exhibit 3.1 to HeartWare's Current Report on Form 8-K filed with the SEC on June 27, 2016).
10.1	Letter Amendment between the Company and Heartware, Inc. and Douglas Godshall, dated June 26, 2016 (incorporated by reference to Exhibit 10.1 to HeartWare's Current Report on Form 8-K filed with the SEC on June 27, 2016).
10.7	Letter Amendment between Heartware, Inc. and James Schuermann, dated June 26, 2016 (incorporated by reference to Exhibit 10.7 to HeartWare's Current Report on Form 8-K filed with the SEC on June 27, 2016).
31.1	Certification by the Chief Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *
31.2	Certification by the Chief Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 *
32.1	Certification by the Chief Executive Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 **
32.2	Certification by the Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002 **
101	The following materials from the Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2016, formatted in eXtensible Business Reporting Language (XBRL): (i) Unaudited Condensed Consolidated Balance Sheets as of June 30, 2016 and December 31, 2015, (ii) Unaudited Condensed Consolidated Statements of Operations for the three and three and six months ended June 30, 2016 and 2015, (iii) Unaudited Condensed Consolidated Statements of Comprehensive Loss for the three and six months ended June 30, 2016 and 2015, (iv) Unaudited Condensed Consolidated Statement of Stockholders' Equity for the six months ended June 30, 2016, (v) Unaudited Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2016 and 2015, and (vi) Notes to Unaudited Condensed Consolidated Financial Statements.

* Filed herewith
** Furnished herewith
\+ Management contract or compensatory plan or arrangement

SIGNATURES

In accordance with the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

HEARTWARE INTERNATIONAL, INC.

Date: July 28, 2016

/s/ Douglas Godshall
Douglas Godshall
President and Chief Executive Officer
(Principal Executive Officer)

Date: July 28, 2016

/s/ Peter F. McAree
Peter F. McAree
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

EXHIBIT INDEX

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* Filed herewith
** Furnished herewith
\+ Management contract or compensatory plan or arrangement

Exhibit 31.1

CERTIFICATION BY THE CHIEF EXECUTIVE OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Douglas Godshall, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of HeartWare International, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

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

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

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

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

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

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

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

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

Date: July 28, 2016

/s/ Douglas Godshall

Douglas Godshall
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

CERTIFICATION BY THE CHIEF FINANCIAL OFFICER PURSUANT TO SECTION 302 OF THE SARBANES-OXLEY ACT OF 2002

I, Peter F. McAree, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of HeartWare International, Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

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

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

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

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

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

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

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

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

Date: July 28, 2016

/s/ Peter F. McAree

Peter F. McAree
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)

Exhibit 32.1

CERTIFICATION BY THE CHIEF EXECUTIVE OFFICER PURSUANT TO 18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of HeartWare International, Inc. (the "Company") for the quarterly period ended June 30, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned President and Chief Executive Officer of the Company hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that based on his knowledge:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: July 28, 2016

/s/ Douglas Godshall

Douglas Godshall
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 32.2

CERTIFICATION BY THE CHIEF FINANCIAL OFFICER PURSUANT TO
18 U.S.C. SECTION 1350, AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Quarterly Report on Form 10-Q of HeartWare International, Inc. (the "Company") for the quarterly period ended June 30, 2016 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), the undersigned Senior Vice President and Chief Financial Officer of the Company hereby certifies, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that based on his knowledge:

(1) the Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934, as amended; and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Date: July 28, 2016

/s/ Peter F. McAree
Peter F. McAree
Senior Vice President and Chief Financial Officer
(Principal Financial Officer)