

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, 2024
- 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: 001-41567

ProSomnus, Inc.
(Exact name of registrant as specified in its charter)

DE
(State or other jurisdiction of
incorporation or organization)

88-2978216
(I.R.S. Employer
Identification Number)

5675 Gibraltar Drive
Pleasanton, CA 94588
(Address of Principal Executive Offices)
(844) 537-5337
(Registrant's telephone number)

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

Title of Each Class	Trading symbol	Name of Exchange on which registered
Common Stock, par value \$0.0001 per share	(1)	(1)
Warrants, each whole warrant exercisable for one share of Common Stock for \$11.50 per share	(1)	(1)

(1) On April 24, 2024, the Nasdaq Stock Market LLC filed a Form 25 to delist the Company's common stock and warrants and remove such securities from registration under Section 12(b) of the Securities Exchange Act of 1934, as amended. Since April 18, 2024, the Company's Common Stock and Warrants have been traded on the over-the-counter market under the symbols "OSAP" and "OSAPW", respectively.

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

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

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

Large accelerated filer Accelerated filer
Non-accelerated filer Smaller reporting company Emerging growth company

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

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

Indicate by check mark whether the registrant has filed all documents and reports required to be filed by Sections 12, 13 or 15(d) of the Securities Exchange Act of 1934 subsequent to the distribution of securities under a plan confirmed by a court. Yes No

As of July 29, 2024, there were 17,394,064 shares of the registrant's common stock outstanding.

TABLE OF CONTENTS

PROSOMNUS, INC.

	<u>Page</u>
<u>Part I</u> <u>Financial Information</u>	1
<u>Item 1.</u> <u>Financial Statements (Unaudited)</u>	1
<u>Condensed Consolidated Balance Sheets as of June 30, 2024 and December 31, 2023</u>	1
<u>Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2024 and 2023</u>	2
<u>Condensed Consolidated Statements of Redeemable Convertible Preferred Stock and Stockholders' Deficit for the three and six months ended June 30, 2024</u>	3
<u>Condensed Consolidated Statements of Stockholders' Deficit for the three and six months ended June 30, 2023</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the six months ended June 30, 2024 and 2023</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
<u>Item 2.</u> <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	35
<u>Item 3.</u> <u>Quantitative and Qualitative Disclosures about Market Risk</u>	45
<u>Item 4.</u> <u>Controls and Procedures</u>	45
<u>Part II</u> <u>Other Information</u>	46
<u>Item 1.</u> <u>Legal Proceedings</u>	46
<u>Item 1A.</u> <u>Risk Factors</u>	46
<u>Item 2.</u> <u>Unregistered Sales of Equity Securities and Use of Proceeds</u>	47
<u>Item 3.</u> <u>Defaults Upon Senior Securities</u>	47
<u>Item 4.</u> <u>Mine Safety Disclosures</u>	47
<u>Item 5.</u> <u>Other Information</u>	47
<u>Item 6.</u> <u>Exhibits</u>	47
<u>Exhibit Index</u>	48
<u>Signatures</u>	49

PART I – FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

PROSOMNUS, INC.
(DEBTOR-IN-POSSESSION)
CONDENSED CONSOLIDATED BALANCE SHEETS
(UNAUDITED)

(In thousands, except share amounts and par value)

	June 30, 2024	December 31, 2023
ASSETS		
Current assets:		
Cash	\$ 4,605	\$ 6,363
Restricted cash	700	700
Accounts receivable, net	4,521	3,839
Inventory	1,472	2,039
Prepaid expenses and other current assets	3,592	1,369
Total current assets	14,890	14,310
Property and equipment, net	3,025	3,358
Finance lease right-of-use assets	3,346	3,265
Operating lease right-of-use assets	4,892	5,069
Other assets	250	285
Total assets	<u>\$ 26,403</u>	<u>\$ 26,287</u>
LIABILITIES, REDEEMABLE CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	\$ 2,608	\$ 4,047
Accrued expenses and other current liabilities	4,194	6,756
Equipment financing obligation	60	57
Finance lease liabilities	1,086	1,052
Operating lease liabilities	333	304
Senior Convertible Notes at fair value, current portion	—	2,125
Debtor-in-possession (DIP) Facility	11,738	—
Total current liabilities	20,019	14,341
Equipment financing obligation, net of current portion	98	129
Finance lease liabilities, net of current portion	2,144	2,009
Operating lease liabilities, net of current portion	5,044	5,221
Senior Convertible Notes at fair value, net of current portion	—	12,152
Subordinated Convertible Notes at fair value	—	18,320
Earnout and warrant liabilities	—	716
Total liabilities not subject to compromise	27,305	52,888
Liabilities subject to compromise (Note 8)	36,572	—
Total liabilities	<u>\$ 63,877</u>	<u>\$ 52,888</u>
Commitments and contingencies		
Redeemable convertible preferred stock:		
Redeemable Convertible Series A Preferred Stock, \$0.0001 par value, stated value \$1,000; 25,000 shares designated at June 30, 2024 and December 31, 2023; 9,436 shares issued and outstanding at June 30, 2024 and December 31, 2023; liquidation preference of \$14,154 at June 30, 2024 and December 31, 2023	11,555	11,555
Stockholders' deficit:		
Preferred stock, \$0.0001 par value, 1,500,000 shares authorized at June 30, 2024 and December 31, 2023; no shares issued or outstanding	—	—
Common Stock, \$0.0001 par value, 150,000,000 shares authorized at June 30, 2024 and December 31, 2023; 17,394,064 and 17,388,599 shares issued and outstanding at June 30, 2024 and December 31, 2023, respectively	2	2
Additional paid-in capital	197,598	196,731
Accumulated deficit	(246,629)	(234,889)
Total stockholders' deficit	(49,029)	(38,156)
Total liabilities, redeemable convertible preferred stock and stockholders' deficit	<u>\$ 26,403</u>	<u>\$ 26,287</u>

See accompanying notes to unaudited condensed consolidated financial statements.

PROSOMNUS, INC.
(DEBTOR-IN-POSSESSION)
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

(In thousands, except per share data)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2024	2023	2024	2023
Revenue	\$ 9,092	\$ 6,934	\$ 16,550	\$ 12,742
Operating expenses:				
Cost of revenue	4,268	3,171	8,107	5,927
Sales and marketing	2,418	3,643	4,394	6,467
General and administrative	3,482	4,480	5,968	7,833
Research and development	1,173	1,376	2,123	2,395
Total operating expenses	<u>11,341</u>	<u>12,670</u>	<u>20,592</u>	<u>22,622</u>
Net loss from operations	(2,249)	(5,736)	(4,042)	(9,880)
Other (expense) income				
Interest expense, net	(831)	(1,240)	(1,977)	(2,412)
Change in fair value of earnout liability	130	6,700	620	8,200
Change in fair value of debt	—	(802)	5,885	(2,629)
Change in fair value of warrant liability	38	2,106	96	1,264
Other expense, net	(21)	(123)	(74)	(530)
Total other (expense) income, net	<u>(684)</u>	<u>6,641</u>	<u>4,550</u>	<u>3,893</u>
Reorganization items, net	(12,248)	—	(12,248)	—
Net (loss) income	<u>\$ (15,181)</u>	<u>\$ 905</u>	<u>\$ (11,740)</u>	<u>\$ (5,987)</u>
Net (loss) income per share attributable to common stockholders				
Basic	\$ (0.87)	\$ 0.06	\$ (0.67)	\$ (0.37)
Diluted	<u>\$ (0.87)</u>	<u>\$ (0.01)</u>	<u>\$ (0.67)</u>	<u>\$ (0.37)</u>
Weighted average shares of Common Stock used in per share calculation:				
Basic	<u>17,393,524</u>	<u>16,057,630</u>	<u>17,393,253</u>	<u>16,045,110</u>
Diluted	<u>17,393,524</u>	<u>19,141,231</u>	<u>17,393,253</u>	<u>16,045,110</u>

See accompanying notes to unaudited condensed consolidated financial statements.

PROSOMNUS, INC.
(DEBTOR-IN-POSSESSION)
CONDENSED CONSOLIDATED STATEMENTS OF REDEEMABLE CONVERTIBLE PREFERRED STOCK
AND STOCKHOLDERS' DEFICIT (UNAUDITED)

For the three and six months ended June 30, 2024

(In thousands, except share data)

	Redeemable Convertible Preferred Stock Series A		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Deficit
	Shares	Amount	Shares	Amount			
Balance as of March 31, 2024	9,436	\$ 11,555	17,394,064	\$ 2	\$ 197,142	\$ (231,448)	\$ (34,304)
Stock-based compensation expense	—	—	—	—	456	—	456
Net loss	—	—	—	—	—	(15,181)	(15,181)
Balance as of June 30, 2024	<u>9,436</u>	<u>\$ 11,555</u>	<u>17,394,064</u>	<u>\$ 2</u>	<u>\$ 197,598</u>	<u>\$ (246,629)</u>	<u>\$ (49,029)</u>

	Redeemable Convertible Preferred Stock Series A		Common Stock		Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Deficit
	Shares	Amount	Shares	Amount			
Balance as of December 31, 2023	9,436	\$ 11,555	17,388,599	\$ 2	\$ 196,731	\$ (234,889)	\$ (38,156)
Issuance of shares, net	—	—	5,465	—	—	—	—
Issuance costs - ProSomnus Inc.	—	—	—	—	(3)	—	(3)
Stock-based compensation expense	—	—	—	—	870	—	870
Net loss	—	—	—	—	—	(11,740)	(11,740)
Balance as of June 30, 2024	<u>9,436</u>	<u>\$ 11,555</u>	<u>17,394,064</u>	<u>\$ 2</u>	<u>\$ 197,598</u>	<u>\$ (246,629)</u>	<u>\$ (49,029)</u>

See accompanying notes to unaudited condensed consolidated financial statements.

PROSOMNUS, INC.

(DEBTOR-IN-POSSESSION)

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' DEFICIT (UNAUDITED)

For the three and six months ended June 30, 2023

(In thousands, except share data)

	Common Stock			Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Deficit
	Shares	Amount				
Balance as of March 31, 2023	16,041,464	\$ 2	\$	190,525	\$ (217,687)	\$ (27,160)
Issuance of shares, net	16,166	—		164	—	164
Stock-based compensation expense	—	—		343	—	343
Net income	—	—		—	905	905
Balance as of June 30, 2023	<u>16,057,630</u>	<u>\$ 2</u>	<u>\$</u>	<u>191,032</u>	<u>\$ (216,782)</u>	<u>\$ (25,748)</u>

	Common Stock			Additional Paid-In Capital	Accumulated Deficit	Total Stockholders' Deficit
	Shares	Amount				
Balance as of December 31, 2022	16,041,464	\$ 2	\$	190,299	\$ (210,795)	\$ (20,494)
Issuance of shares, net	16,166	—		164	—	164
Stock-based compensation expense	—	—		569	—	569
Net loss	—	—		—	(5,987)	(5,987)
Balance as of June 30, 2023	<u>16,057,630</u>	<u>\$ 2</u>	<u>\$</u>	<u>191,032</u>	<u>\$ (216,782)</u>	<u>\$ (25,748)</u>

See accompanying notes to unaudited condensed consolidated financial statements

PROSOMNUS, INC.
(DEBTOR-IN-POSSESSION)
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)
(In thousands)

	Six Months Ended June 30,	
	2024	2023
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net loss	\$ (11,740)	\$ (5,987)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	735	361
Amortization of assets obtained under finance leases	578	397
Amortization of operating right-of-use assets	177	202
Noncash research and development	—	100
Noncash interest	1,174	1,517
Allowance for credit losses	2	72
Stock-based compensation	870	570
Change in fair value of earnout liability	(620)	(8,200)
Change in fair value of debt	(5,885)	2,629
Change in fair value of warrant liability	(96)	(1,264)
Loss on disposal of property and equipment	—	117
Right-of-use asset impairment	—	335
Shares issued for services received	—	164
Non-cash reorganization items, net	10,081	—
Changes in operating assets and liabilities:		
Accounts receivable, net	(684)	(790)
Inventory	567	(670)
Prepaid expenses and other current assets	(2,223)	456
Other assets	35	(21)
Accounts payable	(1,439)	(29)
Accrued expenses and other current liabilities	(1,719)	2,118
Operating lease liabilities	(148)	134
Net cash used in operating activities	(10,335)	(7,789)
CASH FLOWS FROM INVESTING ACTIVITIES:		
Purchases of property and equipment	(436)	(1,212)
Net cash used in investing activities	(436)	(1,212)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of debtor-in-possession (DIP) Facility	9,500	—
Principal payments on finance lease obligations	(459)	(658)
Payment of deferred financing cost	—	(62)
Principal payments on equipment financing obligation	(28)	(20)
Net cash provided by (used in) financing activities	9,013	(740)
Net change in cash and restricted cash	(1,758)	(9,741)
Cash and restricted cash at beginning of period	7,063	15,916
Cash and restricted cash at end of period	\$ 5,305	\$ 6,175
Supplemental disclosure of cash flow information:		
Cash paid for taxes	\$ 28	\$ —
Cash paid for interest	\$ 564	\$ 657
Cash paid for Reorganization items, net	\$ 1,377	\$ —
Supplemental disclosure of noncash investing and financing activities:		
ROU assets obtained in exchange for finance lease obligations	\$ 628	\$ 1,274
Roll-up of Senior Secured Convertible Notes to debtor-in-possession (DIP) Facility	\$ 2,000	\$ —

See accompanying notes to unaudited condensed consolidated financial statements.

PROSOMNUS, INC.
(DEBTOR-IN-POSSESSION)
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)

NOTE 1 — DESCRIPTION OF THE BUSINESS

Company Organization

ProSomnus, Inc., and its wholly owned subsidiaries, ProSomnus Holdings, Inc. and ProSomnus Sleep Technologies, Inc. (collectively, the “Company”) is an innovative medical technology company that develops, manufactures, and markets its proprietary line of precision intraoral medical devices for treating and managing patients with obstructive sleep apnea (“OSA”).

The Company is located in Pleasanton, California and was incorporated as a Delaware company on May 3, 2022. Its accounting predecessor company, ProSomnus Sleep Technologies, Inc. was incorporated as a Delaware company on March 2, 2016.

On December 6, 2022, Lakeshore Acquisition I Corp. (“Lakeshore”) consummated a series of transactions that resulted in the combination (the “Business Combination”) of Lakeshore with ProSomnus Holdings, Inc. and its wholly-owned subsidiary, ProSomnus Sleep Technologies, Inc., pursuant to an Agreement and Plan of Merger (the “Merger Agreement”), dated May 9, 2022. Pursuant to the “Merger Agreement”, Lakeshore merged with and into ProSomnus Holdings, and changed its name to ProSomnus, Inc.

The transaction was accounted for as a reverse recapitalization with ProSomnus Sleep Technologies, Inc. being the accounting acquirer and Lakeshore as the acquired Company for accounting purposes. Accordingly, all historical financial information presented in the consolidated financial statements represents the accounts of ProSomnus Sleep Technologies, Inc.

Chapter 11 Filing

The Company and certain of its existing affiliates and subsidiaries (collectively, the “Debtors”), as defined in Restructuring Support Agreement (“RSA”), filed voluntary petitions for relief (the “Chapter 11 Cases”) on May 7, 2024 (the “Petition Date”) under Chapter 11 of Title 11 of the United States Bankruptcy Code (the “Bankruptcy Code”), as amended in the United States Bankruptcy Court for the District of Delaware (the “Bankruptcy Court”). At that time, the Debtors’ certain senior subordinate secured debtor-in-possession term loan agreement (the “DIP Credit Agreement”) with the lenders from time-to-time party thereto (the “DIP Lenders”) and Wilmington Savings Fund Society, FSB, as administrative agent and collateral agent, on the terms and conditions set forth therein, was subject to approval by the Bankruptcy Court. On May 9, 2024, the Bankruptcy Court issued an order approving the DIP Credit Agreement on an interim basis and set the final hearing to approve the DIP Credit Agreement on a final basis for June 5, 2024. On June 5, 2024, the Bankruptcy Court entered an order approving the DIP Credit Agreement on a final basis.

At a hearing held before the Bankruptcy Court on June 26, 2024, the Bankruptcy Court determined that the Debtors’ *Disclosure Statement for Amended Joint Chapter 11 Plan of Reorganization of ProSomnus, Inc. and its Debtor Affiliates* (the “Plan”), including all exhibits and schedules thereto, contains adequate information and that the Debtors are authorized to solicit votes on, and pursue confirmation of, the Plan. Additionally, the Bankruptcy Court established, among other things, the confirmation hearing date for the Plan and set various deadlines associated with such confirmation hearing, including, but not limited to, the deadline for filing objections to the confirmation of the Plan.

The Debtors and their subsidiaries continue to operate their businesses as “debtors-in-possession” under the jurisdiction of the Bankruptcy Court and in accordance with the applicable provisions of the Bankruptcy Code and orders of the Bankruptcy Court. The Chapter 11 Cases are being jointly administered by the Bankruptcy Court under the lead case *In re ProSomnus, Inc.*, Case No. 24-10972 (JTD). As debtors-in-possession, the Debtors are generally permitted to continue to operate as ongoing businesses and pay debts and honor obligations arising in the ordinary course of business after the Petition Date. However, the Debtors generally may not pay third-party claims or creditors in connection with obligations arising before the Petition Date or engage in transactions outside the ordinary course of business without the approval of the Bankruptcy Court. Under the Bankruptcy Code, third-party actions to collect pre-Petition Date indebtedness owed by the Debtors, as well as most litigation pending against the Debtors as of the Petition Date, are generally subject to an automatic stay. However, under the Bankruptcy Code, certain legal proceedings, such as those involving the assertion of a

governmental entity's police or regulatory powers, may not be subject to the automatic stay and may continue unless otherwise ordered by the Bankruptcy Court.

Among other requirements, the Chapter 11 Cases must comply with the priority scheme established by the Bankruptcy Code, under which certain post-Petition Date and secured or "priority" pre-Petition Date liabilities generally need to be satisfied before general unsecured creditors and shareholders are entitled to receive any distributions.

Events of Default

The Chapter 11 Cases constituted an event of default that accelerated the Company's obligations under substantially all of its then-outstanding debt instruments. However, Section 362 of the Bankruptcy Code stays creditors from taking any action to enforce the related financial obligations, and creditors' rights of enforcement with respect to the debt instruments are subject to the applicable provisions of the Bankruptcy Code. Refer to Note 9 for additional information.

Restructuring Support Agreement

On May 7, 2024, the Company voluntarily entered into a Restructuring Support Agreement ("RSA") with (i) certain of its existing Debtors, affiliates and subsidiaries (as set forth in the RSA, and together with the Company, the "Company Parties"); and (ii) certain sponsoring Senior Noteholders and Subordinated Noteholders (the "Sponsoring Noteholders").

As set forth in the RSA, the Company Parties and the Sponsoring Noteholders have agreed to the principal terms of a voluntary restructuring of the Company Parties (the "Restructuring") and the Plan. Although the Company Parties intend to pursue the Restructuring in accordance with the terms set forth in the RSA, there can be no assurance that the Company Parties will be successful in completing the Restructuring, whether on the same or different terms than those provided in the RSA.

The RSA contemplates a comprehensive financial restructuring of the Company's existing capital structure. Among other terms, the RSA provides for the following:

- The Company Parties may receive an aggregate of \$20.0 million in potential capital, including through a debtor-in-possession facility and a potential new-money equity capital raise, while also retaining existing amounts due to customers, critical vendors, equipment lenders, and trade creditors; more specifically:
 - The Sponsoring Noteholders have committed to provide the DIP Credit Agreement, which will consist of (i) \$7.0 million in new money debtor-in-possession loans and (ii) the "roll-up" of (a) \$4.0 million of obligations under the prepetition bridge notes (the "2024 Bridge Notes") as defined in the RSA, and (b) \$2.0 million of obligations under the Senior Secured Notes (as defined in the RSA), in each case, on the terms set forth in the Definitive Documents (as defined in the RSA). The DIP Credit Agreement is expected to provide the Company Parties with sufficient liquidity to complete the Restructuring. The new money portion of the DIP Credit Agreement will be available in two draws, with \$2.5 million available upon interim approval of the DIP Credit Agreement by the Bankruptcy Court;
 - General Unsecured Claims will be paid in the ordinary course of business during and after the restructuring;
 - On the Plan Effective Date as defined in the RSA, (the "Plan Effective Date"), the Company expects to consummate a new-money equity capital raise in an amount of at least \$9.0 million, which will be offered for participation by the Sponsoring Noteholders and certain other third-party investors, subject to other terms as set forth in the RSA;
- On the Plan Effective Date, ProSomnus Sleep Technologies, Inc. (as reorganized, "Reorganized ProSomnus") will issue a single class of equity interests that will be distributed pro rata to the Subordinated Secured Noteholders (as defined in the RSA), subject to dilution on account of the management incentive plan, the New Money Common Equity (as defined in the RSA), and certain other fees, premiums, and/or other terms as set forth in the RSA;
- Following the Plan Effective Date, Reorganized ProSomnus may establish a customary management equity incentive plan;
- On the Plan Effective Date, there will be no recovery for holders of other equity interests in the Company Parties; and

[Table of Contents](#)

- Confirmation of the Plan is anticipated, but not guaranteed, to occur within 90 days of filing the Chapter 11 Cases.

In accordance with the RSA, each Sponsoring Noteholder agreed, among other terms, to:

- So long as its vote was properly solicited in accordance with the United States Code (the “Code”), vote to accept the Plan;
- Negotiate the Definitive Documents in good faith; and
- Not take any action inconsistent with the RSA and the RSA term sheet or the confirmation and consummation of the Plan.

In accordance with the RSA, the Company Parties agreed, among other terms, to:

- Support and complete the Restructuring Transactions (as defined in the RSA) contemplated under the RSA, the RSA term sheet, and the Plan Related Documents (as defined in the RSA);
- Negotiate the Definitive Documents in good faith;
- Take all necessary and appropriate actions in furtherance of the Restructuring;
- Complete the Restructuring; and
- Comply with certain milestone for the Chapter 11 Cases (as defined in the RSA).

Certain of the transactions described in the foregoing shall be subject to approval by the Bankruptcy Court pursuant to the Chapter 11 Cases.

The financial restructuring and other transactions contemplated in the RSA will be implemented and consummated through, among other terms:

1. The funding of the Senior Bridge Notes (as defined below) by an ad hoc group of holders of the Company’s Senior Notes (as defined in the RSA) and Subordinated Notes (as defined in the RSA) that hold and control, in the aggregate, 100% of the Company’s issued and outstanding 2022 Senior Convertible Notes (as defined in the RSA), 100% of the issued and outstanding 2023 Senior Convertible Exchange Notes (as defined in the RSA), 94.95% of the Company’s issued and outstanding 2022 Subordinated Convertible Notes (as defined in the RSA), and 100% of the Company’s issued and outstanding 2023 Subordinated Convertible Exchange Notes (as defined in the RSA);
2. The voluntary commencement of the Chapter 11 Cases;
3. The funding of the DIP Credit Agreement by the Sponsoring Noteholders, which included a post-emergence commitment by the Sponsoring Noteholders and third-party investors to purchase equity in the reorganized Debtors on terms sufficient to ensure the feasibility of the Plan, which will be in form and substance acceptable to the Sponsoring Noteholders in their sole discretion; and
4. A financial restructuring of the existing capital structure of the Company Parties pursuant to the Plan, which shall be consistent with the terms set forth herein (unless otherwise agreed by the Company Parties and Sponsoring Noteholders) and otherwise reasonably acceptable to the Company Parties and Sponsoring Noteholders, to be implemented through the Chapter 11 Cases, as provided in the RSA and the RSA term sheet.

DIP Credit Agreement

The DIP Credit Agreement was approved by the Bankruptcy Court on May 9, 2024, on an interim basis, with a final hearing set for June 5, 2024. On June 5, 2024, the Bankruptcy Court approved the DIP Credit Agreement on a final basis.

Under the DIP Credit Agreement, the DIP Lenders, as described above. The funds will be used to (a) finance the Chapter 11 Cases, (b) make other court-approved payments, and (c) provide working capital for the Debtors. As of June 30, 2024, the Debtors had borrowed \$9.5 million, including rolled-up pre-bankruptcy bridge funding. The obligations are secured by liens on most of the Debtors' assets are senior to the Company's subordinated notes but junior to the senior notes, some of which are held by the DIP Lenders.

The borrowings under the DIP Credit Agreement are due on November 7, 2024, or upon certain termination events, with an interest rate of the prime rate plus 9.00%, with an exit fee of 10.00%. The proceeds are designated for payroll, key suppliers, critical sales incentives, and restructuring, as per the approved budget. Any expense over \$0.2 million requires approval from the majority of the Sponsoring Noteholders. The DIP Credit Agreement also includes a minimum liquidity requirement of \$1.5 million. The DIP Credit Agreement, including all accrued interest and fees, will be equitized upon the Plan Effective Date. The DIP Credit Agreement includes typical negative covenants, restricting additional indebtedness, asset liens, investments, mergers, and dividends, with exceptions. It also has customary representations, warranties, affirmative covenants, and default events, including the dismissal or conversion of the Chapter 11 Cases, trustee appointments, and other events affecting the DIP Lenders' rights.

Some DIP Lenders participated in the Company's Series A Convertible Preferred Stock offering in September 2023. One DIP Lender is affiliated with Spring Mountain Capital, where Jason Orchard, a Company board member, is a Managing Director.

2024 Bridge Notes

The Sponsoring Noteholders provided the Company with pre-petition bridge notes (the "Senior Bridge Notes") as follows:

1. On April 17, 2024, the Company authorized and issued the 2024 Senior Bridge Notes up to the aggregate principal amount of \$5.0 million pursuant to those certain Consents to New Note Issuance and Related Indenture Amendments, dated as of April 17, 2024, among the Company and the Sponsoring Noteholders and issued under the 2022 Senior Indenture (the "Bridge Indenture Amendment").
2. Principal payments for the 2024 Senior Bridge Notes are due on January 1, April 1, July 1 and October 1 of each year, commencing with October 1, 2024, until the earlier of December 6, 2025 or the 2024 Senior Bridge Notes no longer being outstanding.
3. Interest payments for the 2024 Senior Bridge Notes are due on January 1, April 1, July 1 and October 1 of each year, beginning on July 1, 2024, on each Conversion Date (as defined in the Bridge Indenture Amendment), as to that principal amount then being converted), on each Optional Redemption Date (as defined in the Bridge Indenture Amendment), as to that principal amount then being redeemed), and on the Maturity Date (as defined in the Senior Bridge Notes); provided, however, that the interest otherwise payable on April 1, 2024 and July 1, 2024 may instead be paid on October 1, 2024. Interest will accrue from April 17, 2024. No Senior Bridge Notes remain outstanding as of June 30, 2024.

Bankruptcy Accounting

As a result of the Chapter 11 Cases, the Company has applied the provisions of Accounting Standards Codification Topic 852, *Reorganizations* ("ASC 852") in preparing the accompanying Unaudited Condensed Consolidated Financial Statements. ASC 852 requires that, for periods including and after the filing of a Chapter 11 petition, the Condensed Consolidated Financial Statements distinguish transactions and events that are directly associated with the reorganization from the ongoing operations of the business.

Accordingly, for periods beginning with the second quarter of 2024, pre-petition unsecured and undersecured claims related to the Debtors that may be impacted by the bankruptcy reorganization process have been classified as "Liabilities subject to compromise" in the accompanying Condensed Consolidated Balance Sheets as of June 30, 2024. Liabilities subject to compromise include pre-petition liabilities for which there is uncertainty about whether such pre-petition liabilities could be impaired as a result of the Chapter 11 Cases. Liabilities subject to compromise are recorded at the expected amount of the total allowed claim, even if they may ultimately be settled

[Table of Contents](#)

for different amounts. Refer to Note 8 for further details. The determination of how liabilities will ultimately be settled or treated cannot be made until approved by the Bankruptcy Court. Therefore, the amounts presented in Note 8 are preliminary and may be subject to future adjustments as a result of, among other things, the possibility of occurrence of certain Bankruptcy Court actions, further developments with respect to disputed claims, any rejection by the Company of executory contracts, and/or any payments by the Company of amounts classified as “Liabilities subject to compromise,” which may be allowed in certain limited circumstances.

Amounts are also subject to adjustments if the Company makes changes to its assumptions or estimates related to claims as additional information becomes available to the Company, including, without limitation, those related to the expected amounts of allowed claims, the value of any collateral securing claims and the secured status of claims. Such adjustments may be material. Additionally, as a result of the Chapter 11 Cases, the Company may sell or otherwise dispose of or liquidate assets or settle liabilities for amounts other than those reflected in the accompanying Unaudited Condensed Consolidated Financial Statements. The possibility or occurrence of any such actions could materially impact the amounts and classifications of such assets and liabilities reported in the Company’s Condensed Consolidated Balance Sheets and could have a material adverse effect on the Company’s business, financial condition, results of operations and cash flows.

Reorganization Items

As a result of filing the Chapter 11 Cases, the Debtors have incurred and will continue to incur significant costs associated with the bankruptcy proceedings and reorganization under the Plan. These costs, primarily related to legal and professional fees, are expected to substantially impact the Company’s financial results.

From the Petition Date through [June 30, 2024], the Company incurred \$12.2 million in pre-petition reorganization costs. In accordance with applicable accounting guidance, costs associated with the bankruptcy proceedings have been recorded as Reorganization items, net within the Company’s Condensed Consolidated Statements of Operations for the three and six months ended June 30, 2024. Refer to Note 7 for further details.

During the six months ended June 30, 2024 and 2023, the Company’s cash flows included net cash outflows of \$1.4 million and nil, respectively, related to amounts classified or expected to be classified as Reorganization items, net, which primarily consisted of payments for professional fees and bankruptcy related expenses.

Automatic Stay

Subject to certain specific exceptions under the Bankruptcy Code, the Chapter 11 Cases automatically stayed most judicial or administrative actions against the Debtors and efforts by creditors to collect on or otherwise exercise rights or remedies with respect to pre-Petition Date claims. Absent an order from the Bankruptcy Court, substantially all of the Debtors’ pre-petition liabilities are subject to settlement under the Bankruptcy Code.

Executory Contracts

Pursuant to the terms of the Plan, all executory contracts and unexpired leases of the Debtors shall be assumed as of the Plan Effective Date, unless otherwise determined to be rejected by the Sponsoring Noteholders, subject to the consent of the Company, which consent shall not be unreasonably withheld.

Delisting of our Common Stock from NASDAQ

As previously disclosed, the Company was notified by the Nasdaq Global Market (“Nasdaq”) that the Company was not in compliance with Nasdaq’s minimum market value of listed securities of \$50.0 million, Nasdaq’s minimum market value of publicly held shares of \$15.0 million, or Nasdaq’s minimum bid price requirement of \$1.00, each of which was required for continued listing on Nasdaq. Due to such noncompliance, Nasdaq notified the Company that it would be subject to delisting. After the Company requested an appeal hearing, which stayed the delisting action, the Company continued to evaluate its options to remain listed on Nasdaq and ultimately determined to withdraw the hearing request. Thereafter, the Company received a letter from Nasdaq which stated that trading of its common stock and warrants would be suspended at the open of business on April 18, 2024. On April 25, 2024, Nasdaq filed a Form 25 with the SEC notifying the SEC of Nasdaq’s determination to remove the Company’s securities from listing on Nasdaq. The delisting was effective 10 days after the filing of the Form 25.

NOTE 2 — BASIS OF ACCOUNTING AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements were prepared in accordance with generally accepted accounting principles in the United States of America (“U.S GAAP”). Certain information and footnote disclosures required for annual financial statements have been condensed or excluded in accordance with SEC rules and regulations and GAAP applicable to interim unaudited financial statements. Accordingly, the condensed consolidated financial statements do not include all of the information and footnotes required by GAAP for audited annual financial statements. In the opinion of management, the condensed consolidated financial statements reflect all adjustments of a normal and recurring nature that are considered necessary for a fair presentation of the results for the interim periods presented. These unaudited condensed consolidated financial statements and the accompanying notes should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2023 filed with the SEC on March 27, 2024.

The results of operations for the three and six months ended June 30, 2024 are not necessarily indicative of the results to be expected for the year ending December 31, 2024 or any future periods. The condensed consolidated balance sheet as of December 31, 2023 has been derived from audited financial statements at that date but does not include all of the information required by GAAP for complete financial statements.

Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. Intercompany balances and transactions have been eliminated in consolidation.

Liquidity and Management’s Plans

The Company has incurred recurring losses from operations and recurring negative cash flows from operating activities. The Company expects operating losses and negative cash flows from operations to continue for the foreseeable future.

In accordance with ASC Subtopic 205-40, *Presentation of Financial Statements-Going Concern* (“ASC 205-40”), the Company has the responsibility to evaluate whether conditions and/or events raise substantial doubt about the Company’s ability to meet its obligations as they become due within one year after the date that the financial statements are issued. Management considered the Company’s current financial condition and liquidity sources, including cash and managed accessibility, forecasted future cash flows and the Company’s obligations due one year from the issuance date of the financial statements. As a result of the Chapter 11 Cases, the realization of assets and the satisfaction of liabilities are subject to significant uncertainty. While operating as a debtor-in-possession entity pursuant to the Bankruptcy Code, the Company may sell, or otherwise dispose of or liquidate, assets or settle liabilities, subject to the approval of the Bankruptcy Court or as otherwise permitted in the ordinary course of business, for amounts other than those reflected in the accompanying unaudited Interim Consolidated Financial Statements. Further, the Chapter 11 plan is likely to materially change the amounts and classifications of assets and liabilities reported in the Company’s unaudited Interim Condensed Consolidated Balance Sheet as of June 30, 2024 and going forward. In performing this evaluation, management concluded that under the standards of ASC 205-40, substantial doubt exists about the Company’s ability to continue as a going concern due to the risks and uncertainties surrounding the Chapter 11 Cases, the defaults under the Company’s debt agreements and the Company’s financial condition. The Company’s future plans, including those in connection with the Chapter 11 Cases, are not yet finalized, fully executed or approved by the Bankruptcy Court, and therefore cannot be deemed probable of mitigating this substantial doubt within 12 months of the date of issuance of these financial statements. The Company’s condensed consolidated financial statements included herein do not include any adjustments related to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue as a going concern and instead have been prepared assuming that the Company will continue as a going concern and contemplating the realization of assets and the satisfaction of the Company’s liabilities and commitments incurred in the normal course of business.

The accompanying condensed consolidated financial statements have been prepared in accordance with U.S. GAAP assuming that the Company will continue as a going concern. The financial statements do not include any adjustments to reflect the possible future

[Table of Contents](#)

effects on the recoverability and classification of assets or the amounts and classification of liabilities that may result should the Company be unable to continue as a going concern.

Management's Plans Related to Going Concern

The Company's ability to continue as a going concern depends principally on its ability to successfully exit the Chapter 11 Cases, including the completion of the financings proposed within the RSA. Upon the successful exit from the Chapter 11 Cases, the Company's ability to continue as a going concern will depend upon its ability to execute on its plans to achieve revenue growth forecast, control operating costs, and obtain additional financing. The Company's successful exit from the Chapter 11 Cases, the outcome of such exit, and the Company's post exit operating plans are subject to many factors currently unknown and there can be no assurance that the current operating plan or cash flow break-even plan will be achieved in the time frame anticipated by the Company.

In addition to the Chapter 11 Cases, based on the Company's current level of expenditures and future cash flow projections, the Company believes its current unrestricted cash balance will not be sufficient for the Company to continue operations as a going concern for at least one year from the issuance date of these condensed consolidated financial statements. Additionally, the indentures governing the Company's Senior Convertible Notes and Subordinated Convertible Notes (as defined below and, collectively the "Convertible Notes") contain monthly and quarterly financial covenants. Failure to comply with the covenants or obtain a waiver and extension from the holders of each series of our Convertible Notes could result in an event of default under each of the indentures governing the Convertible Notes and result in an acceleration of the Convertible Notes. The Company believes these factors raise substantial doubt about its ability to continue as a going concern.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and disclosure of contingent assets and liabilities. Though macroeconomic factors such as inflation, exchange rate fluctuations and concerns about an economic downturn present additional uncertainty, the Company continues to use the best information available to form its critical accounting estimates. Actual results could differ from these estimates, and such differences could materially affect the results of operations reported in future periods. The Company's significant estimates in these consolidated financial statements relate to the fair values, and the underlying assumptions used to formulate such fair values, of its Series A Preferred Stock, Convertible Notes, earn-out liability, and warrants. Estimates also include the provision for credit losses, warranty and earned discount accruals, measurements of tax assets and liabilities and stock-based compensation.

Concentrations, Credit Risk and Market Risk

Financial instruments that potentially subject the Company to a concentration of credit risk principally consist of accounts receivable and cash.

The Company sells its products to customers primarily in North America and Europe. To reduce credit risk, management performs periodic credit evaluations of its customers' financial condition. No customers exceeded more than 10% of the Company's accounts receivables or revenue as of and for the six months ended June 30, 2024 and December 31, 2023.

The Company maintains its cash in bank accounts which, at times, may exceed federally insured limits as guaranteed by the Federal Deposit Insurance Corporation ("FDIC"). As of June 30, 2024 and December 31, 2023, the Company had \$5.1 million and \$6.8 million in excess of the FDIC insured limit, respectively. The Company's investment policy, which is predicated on capital preservation and liquidity, limits investments to instruments denominated and payable in U.S. dollars. The Company believes its credit risk is mitigated due to the high quality of the banks in which it places its deposits. Historically, the Company has not experienced significant credit losses from financial instruments.

Fair Value of Financial Instruments

The accounting standard for fair value measurements provides a framework for measuring fair value and requires expanded disclosures regarding fair value measurements. Fair value is defined as the price that would be received for an asset or the exit price that would be paid to transfer a liability in the principal or most advantageous market in an orderly transaction between market participants on the measurement date.

This accounting standard establishes a fair value hierarchy, which requires an entity to maximize the use of observable inputs, where available. The following summarizes the three levels of inputs that may be used to measure fair value:

Level 1 Inputs — The valuation is based on quoted prices in active markets for identical instrument.

Level 2 Inputs — The valuation is based on observable inputs such as quoted prices for similar instruments in active markets, quoted prices for identical or similar instruments in markets that are not active, and model — based valuation techniques for which all significant assumptions are observable in the market.

Level 3 Inputs — The valuation is based on unobservable inputs that are supported by minimal or *no* market activity and that are significant to the fair value of the instrument. Level 3 valuations are typically performed using pricing models, discounted cash flow methodologies, or similar techniques that incorporate management’s own estimates of assumptions that market participants would use in pricing the instrument, or valuations that require significant management judgment or estimation.

Changes in fair value measurements categorized within Level 3 of the fair value hierarchy are analyzed each period based on changes in estimates or assumptions and recorded as appropriate.

The Company’s financial instruments consist primarily of cash, accounts receivable (net of allowance for doubtful accounts), accounts payable and accrued expenses, long-term debt instruments, earnout and warrant liabilities.

The carrying amounts of financial instruments such as cash, restricted cash, accounts receivable, prepaid expenses and other current assets, accounts payable, and accrued expenses approximate the related fair values due to the short-term maturities of these instruments. The carrying value of the Company’s equipment financing obligation is considered to approximate its fair value because the interest rate is comparable to current rates for financing available to the Company. Under the fair value option as prescribed by FASB Accounting Standards Codification (“ASC”) 825, *Financial Instruments*, The Company has elected to record the Company’s convertible debt instruments at fair value. The Company’s earnout and warrant liabilities are presented at fair value on the Condensed Consolidated Balance Sheets.

During the second quarter of 2024, in accordance with ASC 852, the Company adjusted the carrying amounts of all unsecured and potentially undersecured debt instruments to equal the expected amount of the allowed claim by expensing (within Reorganization items, net in the Condensed Consolidated Statements of Operations) \$10.1 million and increasing the liability to the expected amount of the allowed claim. As of June 30, 2024, the entire carrying amount the Company’s debt, as well as any related remaining accrued and unpaid interest that existed as of the Petition Date, is included in the “Liabilities subject to compromise” line in the Condensed Consolidated Balance Sheets.

As of June 30, 2024, the fair value of the Earnout liability and Warrant liability was zero. These fair values represent Level 3 measurements, as defined in ASC 820. Therefore, there were no instruments measured at fair value as of that date for these liabilities. Refer to Notes 10 and 13 for the rollforward of the Warrant liability and Earnout liability, respectively.

[Table of Contents](#)

The following tables provide a summary of the financial instruments that are measured at fair value on a recurring basis (in thousands):

	December 31, 2023			
	Fair Value	Level 1	Level 2	Level 3
Senior Convertible Notes	\$ 14,277	\$ —	\$ —	\$ 14,277
Subordinated Convertible Notes	18,320	—	—	18,320
Earnout liability	620	—	—	620
Warrant liability	96	—	—	96

A financial instrument's level within the fair value hierarchy is based on the lowest level of input that is significant to the fair value measurement.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity of three months or less when purchased to be cash and cash equivalents. At June 30, 2024 and December 31, 2023, the Company had no cash equivalents.

Restricted Cash

The Company's restricted cash as of June 30, 2024 and December 31, 2023 of \$0.7 million consisted of a letter of credit on hand with the Company's financial institution as collateral for an office lease.

Impairment of Long-Lived Assets

The Company's long-lived assets primarily include property and equipment and finance and operating right-of-use assets. The Company reviews long-lived assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured at the amount by which the carrying amount of the asset exceeds the fair value of the assets. Assets to be disposed of are reported at the lower of carrying amount or the fair value less costs to sell. During 2023, the Company moved to its new headquarters and principal manufacturing facility. Upon moving, the Company expensed a total of \$0.3 million relating to the carrying value of the remaining leasehold improvements and amounts due under the remaining lease term of the previous facility. The right-of-use asset and leasehold improvements charge was recorded in other expense, net in the consolidated statements of operations for the year ended December 31, 2023.

Senior and Subordinated Convertible Notes

Prior to the Petition Date, the Company accounted for its Notes, as derivatives in accordance with, ASC 815, *Derivatives and Hedging*, depending on the nature of the derivative instrument. ASC 815 requires each contract that is not a derivative in its entirety be assessed to determine whether it contains embedded derivatives that are required to be bifurcated and accounted for as a derivative financial instrument. The embedded derivative is bifurcated from the host contract and accounted for as a freestanding derivative if the combined instrument is not accounted for in its entirety at fair value with changes in fair value recorded in earnings, the terms of the embedded derivative are not clearly and closely related to the economic characteristics of the host contract, and a separate instrument with the same terms as the embedded derivative would qualify as a derivative instrument. Embedded derivatives are measured at fair value and remeasured at each subsequent reporting period, and recorded within Convertible Notes, net on the accompanying Condensed Consolidated Balance Sheets and changes in fair value recorded in other expense within the Condensed Consolidated Statements of Operations. Debt discounts under these arrangements are amortized to interest expense using the interest method over the earlier of the term of the related debt or their earliest date of redemption.

The Company has analyzed the redemption, conversion, settlement, and other derivative instrument features of its Convertible Notes.

- The Company identified that the (i) redemption features, (ii) Lender's Optional Conversion feature, (iii) Lender's Optional Conversion upon Merger Event feature and (iv) additional interest rate upon certain events feature meet the definition of a derivative. The Company analyzed the scope exception for all the above features under ASC 815-10-15-74(a).
- Based on the further analysis, the Company identified that the (i) Lender's Optional Conversion feature, (ii) Lender's Optional Conversion upon Merger Event feature and (iii) additional interest rate upon certain events feature, do not meet the settlement criteria to be considered indexed to equity. The Company concluded that each of these features should be classified as a derivative liability measured at fair value with the changes in fair value in the Condensed Consolidated Statement of Operations.
- The Company also identified that the redemption features are settled in cash and do not meet the indexed to equity and the equity classification scope exception, thus, they must be bifurcated from the Convertible Notes and accounted for separately at fair value on a recurring basis reflecting the changes in fair value in the Condensed Consolidated Statement of Operations.

The Company determined the Convertible Notes contained multiple embedded derivatives that are required to be bifurcated, two of which are conversion features.

As per ASC 815, the fair value election is allowable provided the debt was not issued at a substantial premium. The Company concluded that the Convertible Notes were not issued at a premium and hence the Company elected the fair value option under ASC 815-15-25. The Company elected to record changes in fair value through the Condensed Consolidated Statement of Operations as a fair value adjustment of the convertible debt at each reporting period (with the portion of the change that results from a change in the instrument-specific credit risk recorded separately in other comprehensive income, if applicable). The Company has elected to separately present interest expense related to the Convertible Notes within the Condensed Consolidated Statement of Operations. Thus, the multiple embedded derivatives do not need to be separately bifurcated and fair valued. As of December 31, 2023, the Convertible Notes are reflected at their respective fair values on the Condensed Consolidated Balance Sheets.

During the second quarter of 2024, in accordance with ASC 852, the Company adjusted the carrying amounts of all unsecured and potentially undersecured debt instruments to equal the expected amount of the allowed claim.

Warrants

The Company accounts for warrants as either equity-classified or liability-classified instruments based on an assessment of the warrant's specific terms and applicable authoritative guidance in ASC 480, *Distinguishing Liabilities from Equity* ("ASC 480") and ASC 815, *Derivatives and Hedging* ("ASC 815"). The assessment considers whether the warrants are freestanding financial instruments pursuant to ASC 480, meet the definition of a liability pursuant to ASC 480, and whether the warrants meet all of the requirements for equity classification under ASC 815, including whether the warrants are indexed to the Company's own Common Stock, par value \$0.0001 ("Common Stock"), among other conditions for equity classification. This assessment, which requires the use of professional

[Table of Contents](#)

judgment, is conducted at the time of warrant issuance and as of each subsequent reporting period end date while the warrants are outstanding.

For issued or modified warrants that meet all of the criteria for equity classification, the warrants are required to be recorded as a component of additional paid-in capital at the time of issuance. For issued or modified warrants that do not meet all the criteria for equity classification, the warrants are required to be recorded at their initial fair value on the date of issuance, and then remeasured at fair value at each balance sheet date thereafter. Changes in the estimated fair value of the liability classified warrants are recognized as other income or expense on the Condensed Consolidated Statement of Operations.

Revenue Recognition

The Company creates customized precision milled intraoral medical devices and recognizes revenue upon meeting the following criteria:

- Identifying the contract with a customer: Customers submit an order in the form of a prescription and oral scan to the Company.
- Identifying the performance obligations within the contract: The sole performance obligation is the delivery of a completed customized intraoral device.
- Determining the transaction price: Prices are determined by standardized pricing sheets and adjusted for discounts, allowances and remakes.
- Allocating the transaction price to the performance obligations: The full transaction price is allocated to the completed intraoral device as it is the only element in the transaction.
- Recognizing revenue as the performance obligation is satisfied at a point in time: revenue is recognized upon transfer of control which occurs upon shipment of the product.

The Company does not require collateral or any other form of security from customers. Inbound shipping and handling costs related to sales are billed to customers. The Company charges for inbound shipping/handling and the costs are classified as Cost of Revenue. Outbound shipping costs are not billed to customers and are included in sales and marketing expenses. Taxes collected from customers and remitted to governmental authorities are excluded from revenue.

Standalone selling price for the various intraoral device models are determined using the Company's standard pricing sheet. The Company invoices customers upon shipment of the product and invoices are due within 30 days. Amounts that have been invoiced are recorded in accounts receivable and revenue as all revenue recognition criteria have been met. The Company does not have a financing component related to its revenue arrangements.

The Company utilizes the practical expedient which permits expensing of costs to obtain a contract when the expected amortization period is one year or less. Accordingly, the Company expenses employee sales commissions when incurred as the period over which the sales commission asset that would have been recognized is less than one year.

Leases

The Company assesses at contract inception whether a contract is, or contains, a lease. Generally, the Company determines that a lease exists when (1) the contract involves the use of a distinct identified asset, (2) the Company obtains the right to substantially all economic benefits from use of the asset, and (3) the Company has the right to direct the use of the asset. A lease is classified as a finance lease when one or more of the following criteria are met: (1) the lease transfers ownership of the asset by the end of the lease term, (2) the lease contains an option to purchase the asset that is reasonably certain to be exercised, (3) the lease term is for a major part of the remaining useful life of the asset, (4) the present value of the lease payments equals or exceeds substantially all of the fair value of the asset or (5) the asset is of such a specialized nature that it is expected to have no alternative use to the lessor at the end of the lease term. A lease is classified as an operating lease if it does not meet any of these criteria.

[Table of Contents](#)

At the lease commencement date, the Company recognizes a right-of-use (“ROU”) asset and a lease liability for all leases, except short term leases with an original term of twelve months or less. The ROU asset represents the right to use the leased asset for the lease term. The lease liability represents the present value of the lease payments under the lease. The ROU asset is initially measured at cost, which primarily comprises the initial amount of the lease liability, less any lease incentives received. All ROU assets are periodically reviewed for impairment in accordance with standards that apply to long-lived assets. The lease liability is initially measured at the present value of the lease payments, discounted using an estimate of the Company’s incremental borrowing rate for a collateralized loan with the same term as the underlying leases for operating leases and the implied rate in the lease agreement for finance leases.

Lease payments included in the measurement of lease liabilities consist of (1) fixed lease payments for the noncancelable lease term, (2) fixed lease payments for optional renewal periods where it is reasonably certain the renewal option will be exercised, and (3) variable lease payments that depend on an underlying index or rate, based on the index or rate in effect at lease commencement. The Company’s real estate operating lease agreement requires variable lease payments that do not depend on an underlying index or rate established at lease commencement. Such payments and changes in payments are recognized in operating expenses when incurred.

Lease expense for operating leases consists of the fixed lease payments recognized on a straight-line basis over the lease term plus variable lease payments as incurred. Lease expense for finance leases consists of the amortization of assets obtained under finance leases on a straight-line basis over the lease term and interest expense on the lease liability based on the discount rate at lease commencement.

Net Loss per Share Attributable to Common Stockholders

Basic net income (loss) per share attributable to Common Stockholders is calculated by dividing the net income (loss) attributable to Common Stockholders by the weighted average number of shares of Common Stock outstanding during the period, without consideration of potentially dilutive securities.

Diluted net income (loss) per share is computed by dividing the net income (loss) attributable to common stockholders by the weighted-average number of shares of common stock and potentially dilutive securities outstanding for the period. For the purposes of the diluted net income (loss) per share calculation, common stock options, RSU awards, Convertible Series A Preferred Stock, warrants to purchase common stock, earnout shares, and convertible notes are considered to be potentially dilutive securities. For the periods presented that the Company has reported a net loss, diluted net loss per common share is the same as basic net loss per common share for those periods.

Recent Accounting Pronouncements

During November 2023, the FASB issued ASU 2023-07, *Segment Reporting-Improvements to Reportable Segment Disclosures*. The new FASB guidance requires incremental disclosures related to a public entity’s reportable segments but does not change the definition of a segment, the method for determining segments, or the criteria for aggregating operating segments into reportable segments. The FASB issued the new guidance primarily to provide financial statements users with more disaggregated expense information about a public entity’s reportable segments. The ASU is effective for public entities for fiscal years beginning after December 15, 2023, and interim periods in fiscal years beginning after December 15, 2024. The guidance is effective for the Company’s 2024 Form 10-K. The Company is currently evaluating the impact of adoption on the Company’s consolidated financial statements and its related disclosures.

In December 2023, the FASB released ASU 2023-09, titled "Enhancements to Income Tax Disclosures," with the aim of improving the clarity and usefulness of income tax disclosures. The update focuses primarily on enhancing disclosures related to rate reconciliation and income taxes paid. ASU 2023-09 becomes effective for annual reporting periods starting after December 15, 2024, with early adoption permitted. While the changes prescribed by ASU 2023-09 are implemented prospectively, retrospective application is also allowed. The Company has chosen not to early adopt this standard and is currently evaluating the impact of adoption on the Company’s consolidated financial statements and its related disclosures.

The Company continues to monitor new accounting pronouncements issued by the FASB and does not believe any other accounting pronouncements issued through the date of this report will have a material impact on the Company’s consolidated financial statements.

NOTE 3 — INVENTORY

Inventory consists of the following (in thousands):

	June 30, 2024	December 31, 2023
Raw materials	\$ 1,296	\$ 1,967
Work-in-process	176	72
	<u>\$ 1,472</u>	<u>\$ 2,039</u>

NOTE 4 — PROPERTY AND EQUIPMENT

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

	June 30, 2024	December 31, 2023
Manufacturing equipment	\$ 4,324	\$ 4,042
Computers and software	1,215	1,200
Construction in progress	100	—
Leasehold improvements	846	846
	<u>6,485</u>	<u>6,088</u>
Less: accumulated depreciation	(3,460)	(2,730)
Property and equipment, net	<u>\$ 3,025</u>	<u>\$ 3,358</u>

Depreciation and amortization expense for property and equipment was \$0.4 million and \$0.2 million for the three months ended June 30, 2024 and 2023, respectively, and \$0.7 million and \$0.4 million for the six months ended June 30, 2024 and 2023.

The Company disposed property and equipment assets of \$0.7 million which had an accumulated depreciation of \$0.6 million during the six months ended June 30, 2023. The resulting \$0.1 million loss on disposal is reflected in the Condensed Consolidated Statement of Operations within other expense. During six months ended June 30, 2024, the Company did not dispose of any property and equipment.

NOTE 5 — ACCRUED EXPENSES

Accrued expenses consist of the following (in thousands):

	June 30, 2024	December 31, 2023
Compensation related accruals	\$ 1,615	\$ 3,387
Marketing programs	786	934
Interest	—	382
Warranty	465	465
Professional fees	1,206	632
Inventory purchases and freight	—	613
Other	122	343
	<u>\$ 4,194</u>	<u>\$ 6,756</u>

NOTE 6 — LEASES

The Company has entered into four equipment leases during the six months ended June 30, 2024, which have been classified as finance leases. The lease terms for these leases range from three to five years, with a total monthly lease payment of approximately

[Table of Contents](#)

\$28.0 thousand. As of June 30, 2024, the Company has recorded the right-of-use (ROU) assets and lease liability for these leases, with an aggregate amount of \$0.6 million.

On May 17, 2022, the Company signed a ten-year lease for the Company's corporate headquarters. The lease commenced on December 15, 2022 and resulted in the recognition of \$5.4 million of operating ROU asset and lease liability. The monthly payment is approximately \$0.1 million and is subject to stated annual escalations. The Company received five months of free rent.

For the corporate headquarters lease, the Company provided a \$0.3 million security deposit, which is recorded in other assets on the accompanying Condensed Consolidated Balance Sheets. The Company's largest investor initially guaranteed \$1.7 million for the lease agreement, followed by a rolling one-year guarantee. The Company replaced the guarantee with a letter of credit of \$0.7 million secured by a certificate of a deposit for the same amount that is recorded as restricted cash on the accompanying Unaudited Condensed Consolidated Balance Sheet as of June 30, 2024. On February 28, 2023, the Company vacated its previous corporate office premises with a remaining lease term of approximately ten months. Since there was no new cash inflow generated or expected from the sale or sublease of property and leasehold improvements at the location, the Company recorded an impairment loss on the ROU operating lease assets and leasehold improvements of \$0.3 million and \$0.1 million, respectively. The Company also accrued liabilities of \$0.1 million in anticipation of expected common area maintenance payments on the remainder of the lease. The impairment loss and the accrued expenses are reflected as other expense in the consolidated statements of operations as of December 31, 2023. No such impairment loss and the accrued expenses are recorded in the accompanying Unaudited Condensed Consolidated Statement of Operations for the three and six months ended June 30, 2024.

The Company's finance leases consist of various machinery, equipment, computer-related equipment, or software and have remaining terms from less than one year to five years.

The components of the Company's lease cost, weighted average lease terms and discount rates are presented in the tables below (in thousands, except lease term and discount rate):

	Three months ended June 30,		Six months ended June 30,	
	2024	2023	2024	2023
Operating lease expense:				
Operating lease cost	\$ 223	\$ 223	\$ 447	\$ 488
Finance lease expense:				
Amortization of assets obtained under finance leases	313	216	578	397
Interest on lease liabilities	86	78	176	156
Variable lease expense	19	—	22	—
Total expense	\$ 641	\$ 517	\$ 1,223	\$ 1,041

	June 30,	December 31,
	2024	2023
Operating leases:		
Weighted average remaining lease term (in years)	8.75	9.0
Weighted average discount rate	10.00 %	10.00 %
Finance leases:		
Weighted average remaining lease term (in years)	3.17	3.0
Weighted average discount rate	10.65 %	10.21 %

	Six Months Ended June 30,	
	2024	2023
Supplemental cash flow information related to operating leases was as follows (in thousands):		
Operating cash flows from operating leases	\$ 418	\$ 152
Operating cash flows from finance leases (interest)	181	156
Financing cash flows from finance leases (principal portion)	459	658

[Table of Contents](#)

Right-of-use assets consisted of the following (in thousands):

	June 30, 2024	December 31, 2023
Manufacturing equipment	\$ 5,583	\$ 5,237
Computers and software	686	700
Leasehold improvements	218	218
Total	6,487	6,155
Less accumulated amortization	(3,141)	(2,890)
ROU assets for finance leases	3,346	3,265
ROU assets for operating leases	4,892	5,069
Total ROU assets	<u>\$ 8,238</u>	<u>\$ 8,334</u>

At June 30, 2024, the following table presents maturities of the Company's finance and operating lease liabilities (in thousands):

Six Months Ended June 30, 2024	Finance		Operating	
2024 (remaining 6 months)	\$	681	\$	419
2025		1,286		861
2026		983		887
2027		430		914
2028		333		941
Thereafter		15		4,056
Total minimum lease payments		3,728		8,078
Less amount representing interest		(498)		(2,701)
Present value of minimum lease payments		3,230		5,377
Less current portion		(1,086)		(333)
Lease obligations, less current portion	<u>\$</u>	<u>2,144</u>	<u>\$</u>	<u>5,044</u>

NOTE 7—REORGANIZATION ITEMS, NET

Reorganization items incurred as a result of the Chapter 11 Cases are presented separately in the accompanying Unaudited Condensed Consolidated Statement of Operations for the three and six months ended June 30, 2024 and are summarized below (in thousands):

	Amount	
Professional fees	\$	2,126
Other bankruptcy-related costs		41
Debt value accounting adjustment		10,081
Total	<u>\$</u>	<u>12,248</u>

NOTE 8— LIABILITIES SUBJECT TO COMPROMISE

As discussed in Note 1, since the Petition Date, the Company has been operating as debtor-in-possession under the jurisdiction of the Bankruptcy Court and in accordance with provisions of the Bankruptcy Code. On the Company's accompanying unaudited Condensed Consolidated Balance Sheets, the line "Liabilities subject to compromise" reflects the expected allowed amount of the pre-Petition Date claims that have at least a possibility of not being repaid at the full claim amount.

[Table of Contents](#)

Liabilities subject to compromise at June 30, 2024 consisted of the following (in thousands):

	June 30, 2024
Senior Convertible Notes	\$ 15,500
Subordinated Convertible Notes	21,072
Total	\$ 36,572

NOTE 9 — DEBT

Equipment Financing Obligation

At June 30, 2024, the Company's future principal maturities under the equipment financing obligations are summarized as follows (in thousands):

Six Months Ended June 30, 2024	Amount
2024 (remaining 6 months)	\$ 29
2025	64
2026	65
Total principal maturities	158
Less: current portion	(60)
Equipment financing obligation, net of current portion	<u>\$ 98</u>

Convertible Debt Agreements

Senior Convertible Notes

On December 6, 2022, the Company entered into the Indenture for Senior Secured Convertible Notes due December 6, 2025, dated December 6, 2022 by and among the Company, ProSomnus Holdings and ProSomnus Sleep Technologies, as guarantors, and Wilmington Trust, National Association, as trustee and collateral agent (as amended, the "Senior Indenture"), and issued Senior Secured Convertible Notes, due December 6, 2025 (the "Existing Senior Convertible Notes"), with an aggregate principal amount of \$17.0 million, pursuant to the senior securities purchase agreement, dated August 26, 2022. In connection with the closing of the offering of the Existing Senior Convertible Notes, the Company issued 36,469 shares of Common Stock and 169,597 warrants (the "Existing Senior Convertible Notes Warrants") to purchase Common Stock. The Existing Senior Convertible Notes Warrants entitle the note holders to purchase shares of Common Stock, subject to adjustment, at a purchase price per share of \$11.50. The debt bears interest at 9% per annum. Interest is payable in cash quarterly.

On June 29, 2023, the Company entered into the [First Supplemental Indenture, dated as of June 29, 2023, by and among the Company, ProSomnus Holdings and ProSomnus Sleep Technologies, as guarantors, and Wilmington Trust, National Association](#) (the "First Senior Supplemental Indenture"). The First Senior Supplemental Indenture, among other things, (i) effects certain changes to the minimum EBITDA and minimum revenue financial covenants (ii) requires mandatory redemption of the Existing Senior Convertible Notes in consecutive quarterly installments equal to \$0.8 million in the aggregate on January 1, April 1, July 1 and October 1 of each year, commencing October 1, 2024, until the earlier of the maturity date of the Existing Senior Convertible Notes or the date the Existing Senior Convertible Notes are no longer outstanding, and (iii) corrects an error in the definition of Conversion Rate.

On September 20, 2023, the Company entered into the Second Supplemental Indenture (the "Second Senior Supplemental Indenture") to the Senior Indenture, by and among the Company, ProSomnus Holdings and ProSomnus Sleep Technologies, as guarantors, and Wilmington Trust, National Association, as trustee and collateral agent. The Second Senior Supplemental Indenture amends the Senior Indenture to, among other things, permit the sale of the securities underlying the convertible debt (the "Securities") and the Exchanges.

As a result of the Bankruptcy Court issued Automatic Stay and in accordance with ASC 852, the Company has accrued interest expense on the Senior Convertible Notes only up to the Petition Date. The outstanding principal amount, along with accrued and unpaid interest, was reclassified as liabilities subject to compromise as of June 30, 2024.

Subordinated Convertible Notes

On December 6, 2022, the Company entered into that certain Indenture for Subordinated Secured Convertible Notes due April 6, 2026, dated December 6, 2022 by and among the Company, ProSomnus Holdings and ProSomnus Sleep Technologies, as guarantors, and Wilmington Trust, National Association, as trustee and collateral agent (as amended, the “Subordinated Indenture”), and issued the Subordinated Secured Convertible Notes due April 6, 2026 (“Existing Subordinated Convertible Notes” and, together with the Existing Senior Convertible Notes, the “Existing Convertible Notes”), with an aggregate principal amount of approximately \$17.5 million, pursuant to the previously disclosed Subordinated Securities Purchase Agreement, dated August 26, 2022. In connection with the closing of the offering, the Company issued 290,244 shares of Common Stock and 1,745,310 warrants (“Subordinated Convertible Notes Warrants” and, together with the Senior Convertible Notes Warrants, the “Convertible Notes Warrants”) to purchase Common Stock to certain Convertible Debt holders. The debt has an interest rate of Prime Rate plus an additional 9% per annum with a term of 3 years. Interest is due quarterly in cash or in kind at the option of the Company.

On June 6, 2023, in accordance with the Subordinated Indenture, the conversion rate of the Subordinated Convertible Notes increased from approximately 86.95665 shares of common stock per \$1,000 of the sum of the principal amount of the Subordinated Convertible Notes to approximately 192.3808 shares of common stock per \$1,000 of the sum of the principal amount of the Subordinated Convertible Notes.

On June 29, 2023, the Company entered into the [First Supplemental Indenture, dated as of June 29, 2023, by and among the Company, ProSomnus Holdings and ProSomnus Sleep Technologies, as guarantors, and Wilmington Trust, National Association](#) (the “First Subordinated Supplemental Indenture”), which, among other things, (i) effects certain changes to the minimum EBITDA and minimum revenue financial covenants and (ii) corrects an error in the definition of Conversion Rate.

On September 8, 2023, the Company issued 230,494 shares of Common Stock in connection with a notice of conversion from a holder of the Company’s Subordinated Convertible Notes, pursuant to which such holder irrevocably exercised its right to convert \$1.0 million principal amount. The Company recorded the fair value of the principal amount and accrued interest converted of \$0.9 million as Common Stock and additional paid-in capital.

On September 20, 2023, the Company entered into the Second Supplemental Indenture (the “Second Subordinated Supplemental Indenture”) to the Subordinated Indenture, pursuant to which the Company issued the Existing Subordinated Convertible Notes. The Second Subordinated Supplemental Indenture amends the Subordinated Indenture to, among other things, permit the sale of the Securities and the Exchanges.

On December 6, 2023, in accordance with the Subordinated Indenture, the conversion rate of the Subordinated Convertible Notes increased from approximately 192.3808 shares of common stock per \$1,000 of the sum of the principal amount of the Subordinated Convertible Notes to approximately 222.22222 shares of common stock per \$1,000 of the sum of the principal amount of the Subordinated Convertible Notes.

The Convertible Notes include the following embedded features:

Embedded Feature	Nature	Description
Optional redemption – Election of Company	Redemption feature (embedded call option)	At any time after the later of (i) the eighteen-month anniversary of the initial issue date and (ii) the date that the Senior Debt is no longer outstanding, if the daily volume weighted-average price of the Company’s Common Stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days exceeds \$18.00, the Company may redeem a portion of or all of the principal amount (including accrued and unpaid interest), plus any liquidated damages and any other amounts due in respect of the Notes redeemable in cash.
Mandatory redemption – Events of Default	Redemption feature (embedded contingent call option)	The Company is required to prepay all of the outstanding principal balance and accrued and unpaid interest upon bankruptcy-related events of default.
Lenders’ Optional redemption – Events of Default	Redemption feature (embedded contingent call option)	Holders of at least 25% aggregate principal amount of the Notes can require the Company to pay all of the outstanding principal balance and accrued and unpaid interest upon any event of default that is not bankruptcy related.
Lender’s Optional Conversion	Conversion feature	At each Lenders’ option, subject to specific conditions, it may convert all or any portion of its Notes at an initial conversion rate, which is reduced (and only reduced) at various dates and subject to certain adjustments to the conversion rate in the case of specified events. If a note is converted, the Company will adjust the conversion rate to account for any accrued and unpaid interest on such note plus any Make-Whole Amount related to such note.
Lenders’ Optional Conversion Upon Merger Event	Other feature	Upon a merger event, Note holders of each \$1,000 principal amount of Notes are entitled to convert such notes plus accrued interest, plus the Make-Whole Amount related to the in kind and amount of reference property that a holder of a number of shares of Common Stock equal to the conversion rate in effect immediately prior to such event would have owned or been entitled to receive upon such event.
Additional interest rate upon certain non-credit related events	Other feature	Upon an event of default, additional interest will be incurred. Additional interest will also be incurred if the Notes are not freely tradeable.
Ability to pay interest in kind (PIK Interest)*	Other feature	The Company has the election to pay interest in cash or in-kind.

**The PIK interest feature is only present in the Subordinated Convertible Note, and not available in the Senior Convertible Notes.*

The Company assessed the embedded features within these Convertible Note and determined the following:

- The Optional Redemption feature (1), the Mandatory redemption feature (2), and the Lender’s Optional redemption feature (3) met the definition of a derivative and were not clearly and closely related to the host contract and required separate accounting. Further, the redemption features are settled in cash and would therefore not meet the indexed to equity and equity classification scope exception. Thus, these redemption features were concluded to be embedded derivatives that should be bifurcated from the loan and accounted for separately at fair value on a recurring basis.
- The Lender’s Optional Conversion feature (4) and the Lender’s Optional Conversion Upon Merger (5) event features also met the definition of a derivative and were not clearly and closely related to the host contract and required separate accounting. The economic characteristics of the Lender’s Optional Conversion feature (4) and the Make Whole premium on Lenders’ Optional Conversion Upon Merger Event (5) were based on fair value of the underlying shares. The settlement amount of the interest make-whole is not indexed to the issuer’s equity but is based on stated interest cash flows. The

Lenders Optional Conversion Upon Merger event feature is contingent on merger event. This exercise contingency is allowable as it is not based on market or an observable index. The Company noted that features (4) and (5) did not meet the indexed to equity and equity classification scope exception. Therefore, these conversion features were concluded to be embedded derivatives that should be bifurcated from the loan and accounted for separately at fair value on a recurring basis through the consolidated statements of operations.

- The additional interest rate upon certain non-credit related events (6) are triggered based on timely filing of financial information and the tradability of the Notes, these are not related to the economic characteristics of debt. Therefore, this feature is not clearly and closely related to the debt host. The additional interest payment is settled in cash and hence did not meet the derivative scope exception. However, since the probability of the Convertibles Notes being freely tradeable or Company's failure to timely file is estimated to be less than 5%, the Company concluded that the fair value of this feature is not material. Thus, even though this additional interest feature was concluded to be an embedded derivative, it was not fair valued separately.
- The ability to pay PIK interest feature is clearly and closely related to the debt, and was not be evaluated separately as a derivative feature.

The Company determined the Notes contained multiple embedded derivatives that are required to be bifurcated, two of which are conversion features. As per ASC 815, if there is a conversion feature that is required to be bifurcated, the cash conversion feature and beneficial conversion feature guidance is not applicable to such conversion feature and the fair value election is allowable provided the debt was not issued at a substantial premium. As the proceeds received at issuance from these Convertible Notes do not exceed the principal amount that will be paid at maturing, there is no substantial premium.

Further, ASC 815-15-25 provides that if an entity has a hybrid financial instrument that would require bifurcation of embedded derivatives under ASC 815, the entity may irrevocably elect to initially and subsequently measure a hybrid financial instrument in its entirety at fair value with changes in fair value recognized in earnings. The Company elected to measure the Senior and Subordinated Convertible Notes in their entirety at fair value with changes in fair value recognized as non-operating gain or loss in the consolidated statements of operations at each balance sheet date in accordance with ASC 815-15-25.

As a result of the Bankruptcy Court issued Automatic Stay and in accordance with ASC 852, the Company has accrued interest expense on the Subordinated Convertible Notes only up to the Petition Date. The outstanding principal amount, along with accrued and unpaid interest was reclassified as liabilities subject to compromise as of June 30, 2024.

The Convertible Notes are subject to minimum revenue, cash, and EBITDA financial covenants. From July 1, 2023, the Convertible Notes require the Company to maintain a minimum cash balance of \$4.5 million on the first day of each calendar month. On March 1, 2024, the Company ceased to be in compliance with the minimum cash covenant. On March 25, 2024, the lenders agreed to (i) waive the minimum cash covenant for the period commencing on March 1, 2024 through and including June 30, 2024, provided that the Company's cash balance remains above \$2.5 million during such period; and (ii) waive any default under the indentures resulting from any breach by the Company that may have arisen up to March 1, 2024. As of June 30, 2024, the Company was not in compliance with the minimum cash covenant when the grace period lapsed, and its cash balance was below \$4.5 million.

As a result of the automatic stay issued by the Bankruptcy Court, as discussed in Note 1, and in accordance with ASC 852, the Company has accrued interest expense on the Convertible Notes only up to the Petition Date. The outstanding principal amount, along with accrued and unpaid interest was reclassified as liabilities subject to compromise as of June 30, 2024.

Financing Transaction

On September 20, 2023, the Company entered into a Securities Purchase Agreement (the "Securities Purchase Agreement"), and the transactions contemplated by the Securities Purchase Agreement, (the "Financing Transaction") with certain third-party and related party investors (the "Investors"), pursuant to which the Company issued (i) an aggregate of 10,426 shares of the Company's Series A Preferred Stock, par value \$0.0001 per share (the "Series A Preferred Stock"), for an aggregate purchase price of \$10.4 million at a per share purchase price of \$1,000, and (ii) (A) with respect to Investors that held the Existing Convertible Notes, new convertible notes on substantially similar terms to such Noteholder Investor's Existing Convertible Notes other than that such new notes will be convertible into shares of Common Stock, at a conversion price of \$1.00 per share subject to the terms and conditions of the applicable new indenture pursuant to which the applicable series of New Notes have been issued by the Company (the "New Notes"), in exchange for such

Noteholder Investor's portion of the principal amount outstanding of the Existing Convertible Notes (the "Exchanges") pursuant to exchange agreements entered into between the Company and each of the Noteholder Investors (together, the "Exchange Agreements") and/or (B) warrants to purchase shares of Common Stock at an exercise price of \$1.00 per share (such warrants, the "Transaction Warrants").

DIP Credit Agreement

As discussed in Note 1, the Company entered into a DIP Credit Agreement, approved by the Bankruptcy Court on June 5, 2024. The DIP Credit Agreement provides up to \$13.0 million, consisting of (i) \$7.0 million in new money debtor-in-possession loans and (ii) the "roll-up" of (a) \$4.0 million of obligations under the Senior Bridge Notes and (b) \$2.0 million of obligations under the Senior Secured Notes, maturing on November 7, 2024. The \$7.0 million new money DIP loans will be reduced on a dollar-for-dollar basis by the rolled-up Senior Bridge Notes amount. The interest rate is set at prime plus 9.00%, with an exit fee of 10.00%.

The DIP Credit Agreement is secured junior to the Senior Notes and senior to the Subordinated Notes. The proceeds are designated for payroll, key suppliers, critical sales incentives, and restructuring, as per the approved budget. The Company is required to maintain a minimum liquidity requirement of \$1.5 million. Bankruptcy Court approval and other standard terms in the DIP Credit Agreement are required as conditions precedent. Financial reporting requirements include weekly 13-week cash flow statements and a pre-approved budget.

As of June 30, 2024, the Company had received an aggregate of \$5.5 million in new money loans under the DIP Facility. The DIP Facility, including all accrued interest and fees, will be equitized upon the Plan Effective Date.

2024 Bridge Notes

On April 17, 2024, the Company authorized and issued the 2024 Senior Bridge Notes, a \$5.0 million bridge notes facility, and concurrently issued \$2.0 million of Senior Secured Convertible Notes to existing investors in the Company. An additional \$2.0 million of such notes were issued on April 29, 2024. These issuances were made pursuant to the Consents to New Note Issuance and Related Indenture Amendments dated April 17, 2024, and were issued under the 2022 Senior Indenture, as supplemented.

Liabilities Subject to Compromise Under Chapter 11

As of June 30, 2024, the Company had outstanding Senior Secured Convertible Notes with a face value of \$14.9 million and accrued interest of \$0.5 million. Prior to Chapter 11 Cases, the total amount owed by the Company was \$17.5 million, consisting of \$16.9 million in principal and \$0.5 million in accrued interest.

Under the uncontested Plan, \$2.0 million of the Senior Secured Convertible Notes were rolled into DIP financing, which will be converted into equity upon exit. The remaining principal and interest will be replaced with new Senior Notes, totaling \$15.5 million (face value of \$14.9 million plus accrued interest), bearing a 7% interest rate with interest paid as PIK through June 30, 2025.

The restructuring of the Senior Secured Convertible Notes, including the roll of pre-petition principal into DIP financing and the reissuance of notes with reduced features, constitutes a legal impairment, rendering the Senior Notes compromised for accounting purposes. Pursuant to ASC 852-10-45-4, the outstanding principal and accrued interest are reported at the court-approved claim amount of \$15.5 million and were reclassified as liabilities subject to compromise as of June 30, 2024. Refer to Note 8 for additional information.

As of June 30, 2024, Subordinated Secured Convertible Notes with a face value of \$20.7 million and accrued interest of \$0.4 million remain outstanding.

Under the Plan, the Subordinated Secured Convertible Notes will be cancelled upon exit from bankruptcy, and holders will receive shares of New Common Stock based on a pre-money valuation of \$7.0 million. This cancellation of debt in exchange for new equity constitutes a legal impairment, rendering the Subordinated Secured Convertible Notes compromised for accounting purposes.

Pursuant to ASC 852-10-45-4, the Senior Secured Convertible Notes with face value \$14.9 million, Subordinated Secured Convertible Notes with a face value of \$20.7 million and accrued interest of \$0.9 million are reported at June 30, 2024, at the court-

[Table of Contents](#)

approved claim amount of \$36.6 million under the caption "Liabilities subject to compromise". This reflects the liability's compromised status, as it will not be fully repaid or satisfied upon exit. (Refer to Note 8).

The following is a summary of changes in the Convertible Notes for three and six months ended June 30, 2024 and 2023 (in thousands):

	Senior Convertible Notes	Subordinated Convertible Notes
Beginning fair value, December 31, 2023	\$ 14,277	\$ 18,320
Paid-in-kind interest	—	572
Change in fair value of debt	(1,543)	(4,341)
Fair value as of March 31, 2024	12,734	14,551
Accrued interest for Senior Convertible Notes	540	—
Paid-in-kind interest for Subordinated Convertible Notes	—	363
Reclassification of accrued interest of Senior Convertible Notes to DIP Facility	303	—
Reorganization item, debt value accounting adjustment	3,923	6,158
Roll-up of Senior Secured Convertible Notes to DIP Facility	(2,000)	—
Liabilities subject to compromise as of June 30, 2024	<u>\$ 15,500</u>	<u>\$ 21,072</u>
	Senior Convertible Notes	Subordinated Convertible Notes
Beginning fair value, December 31, 2022	\$ 13,651	\$ 10,356
Paid-in-kind interest	—	724
Change in fair value of debt	827	1,000
Fair value as of March 31, 2023	14,478	12,080
Paid-in-kind interest	—	794
Change in fair value of debt	(1,550)	2,352
Ending fair value, June 30, 2023	<u>\$ 12,928</u>	<u>\$ 15,226</u>

NOTE 10 – COMMON STOCK WARRANTS

As of June 30, 2024 and December 31, 2023, the Company had 11,966,611 warrants outstanding and not exercised.

The following is a summary of the Company’s liability classified and equity classified warrant activity as of June 30, 2024:

Liability Classified Warrants	Issuance Period	Outstanding December 31, 2023	Granted	Exercised	Cancelled	Outstanding June 30, 2024	Expiration
Convertible Notes Warrants - Senior Debt	Dec-22	169,597	—	—	—	169,597	Dec-27
Convertible Notes Warrants - Subordinated Debt	Dec-22	1,745,310	—	—	—	1,745,310	Dec-27
		<u>1,914,907</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>1,914,907</u>	

Equity Classified Warrants	Issuance Period	Outstanding December 31, 2023	Granted	Exercised	Cancelled	Outstanding June 30, 2024	Expiration
Private Warrants	Dec-22	196,256	—	—	—	196,256	Dec-27
Additional Private Warrants	Dec-22	300,685	—	—	—	300,685	Dec-27
Public Warrants	Dec-22	4,100,239	—	—	—	4,100,239	Dec-27
Transaction Warrants	Sep-Oct -23	5,454,524	—	—	—	5,454,524	Sep-28
		<u>10,051,704</u>	<u>—</u>	<u>—</u>	<u>—</u>	<u>10,051,704</u>	

Estimated Fair Value of Outstanding Warrants Classified as Liabilities

The estimated fair value of outstanding warrants classified as liabilities is determined at each consolidated balance sheet date. Any decrease or increase in the estimated fair value of the warrant liability since the most recently reported balance sheet date is recorded in the Condensed Consolidated Statements of Operations as a change in fair value of warrant liability.

As of March 31, 2024, the fair value of outstanding warrants classified as liabilities was \$0.04 million. Following the Petition Date, the Company reassessed the fair value of the Company’s warrants. As a result, the Company determined that the fair value of these warrants was zero, as presented in the table below.

The changes in fair value of the outstanding warrants classified as liabilities for the three and six months ended June 30, 2024 and 2023 are as follows (in thousands):

	Convertible Notes Warrants - Senior Debt	Convertible Notes Warrants - Subordinated Debt	Total
Warrant liability, December 31, 2023	\$ 9	\$ 87	\$ 96
Change in fair value	(5)	(53)	(58)
Warrant liability, March 31, 2024	4	34	38
Change in fair value	(4)	(34)	(38)
Warrant liability, June 30, 2024	<u>\$ —</u>	<u>\$ —</u>	<u>\$ —</u>

	Convertible Notes Warrants - Senior Debt	Convertible Notes Warrants - Subordinated Debt	Total
Warrant liability, December 31, 2022	\$ 177	\$ 1,814	\$ 1,991
Change in fair value	81	762	843
Warrant liability, March 31, 2023	258	2,576	2,834
Change in fair value	(193)	(1,913)	(2,106)
Warrant liability, June 30, 2023	<u>\$ 65</u>	<u>\$ 663</u>	<u>\$ 728</u>

NOTE 11 – COMMON STOCK

The Company has authorized for issuance 150,000,000 shares of Common Stock at par value of \$0.0001 per share as of June 30, 2024 and December 31, 2023.

As discussed in Note 1, pursuant to the RSA and the Plan, holders of equity interests shall not receive any distribution and their equity interests shall be extinguished upon confirmation and effectiveness of the Plan, as approved by the Bankruptcy Court. Such equity interests include, but are not limited to, all of the Company’s outstanding preferred stock, common stock, purchase rights, warrants, stock options, and other equity or debt securities (convertible or otherwise) evidencing or creating any right or obligation to acquire or issue any of the foregoing. Upon implementation of the Plan, all such equity interests shall be cancelled and shall cease to exist, and holders thereof shall not be entitled to receive any payment or distribution in respect of such equity interests.

The Company has reserved shares of Common Stock for the following as of June 30, 2024 and December 31, 2023:

	June 30, 2024	December 31, 2023
2022 Equity Incentive Plan reserve	5,889,525	5,889,525
Reserve for earn-out shares	3,000,000	3,000,000
Reserve for exercise of Public Warrants	4,100,239	4,100,250
Reserve for exercise of Private and Additional Private Warrants	496,941	496,941
Reserve for Transaction Warrants	5,454,524	5,454,524
Reserve for exercise of SPA warrants	2,262,585	2,262,585
Reserve for convertible debt	15,761,044	15,766,509
Employee stock purchase plan	500,000	500,000
Reserve for convertible Series A Preferred Stock	9,436,000	9,436,000
Total	<u>46,900,858</u>	<u>46,906,334</u>

NOTE 12 – PREFERRED STOCK

The Company has authorized the issuance of 1,500,000 shares of preferred stock at a par value of \$0.0001 per share as of June 30, 2024 and December 31, 2023.

The Company’s Board of Directors has designated 25,000 shares of preferred stock as Series A Preferred Stock. The Series A Preferred Stock has no maturity and is not subject to any sinking fund or redemption and will remain outstanding indefinitely unless and until converted by the holder or the Company redeems or otherwise repurchases the Series A Preferred Stock.

During the six months ended June 30, 2024 and 2023 there were no issuances of preferred stock. As of June 30, 2024 and December 31, 2023, the Company had 9,436 shares of Series A Preferred Stock outstanding with a liquidation preference of \$14.2 million.

Dividends

Dividends on each share of Series A Preferred Stock are payable at the rate of 8% (the “Dividend Rate”) of the purchase price of \$1,000.00 per share (the “Stated Value”). Dividends are payable semi-annually to holders of record on March 1 and September 1 on March 15 and September 15 of each year, respectively, with the first payment date being March 15, 2024, the dividend for which reflects the period from closing through March 15, 2024.

Dividends are payable in shares of Common Stock (a “PIK Dividend”). The number of dividend shares is equal to the Stated Value of each such share of Series A Preferred Stock multiplied by the dividend rate of 8.0% per annum and divided by \$1.00, as adjusted from time to time for any stock split, stock dividend, recapitalization or otherwise, computed on the basis of a 360-day year and twelve 30-day months. Any fractional shares of a PIK Dividend will be rounded to the nearest whole share. All shares of Common Stock issued in payment of a PIK Dividend will be duly authorized, validly issued, fully paid and non-assessable. Dividends will accumulate whether or not the Company has earnings, there are funds legally available for the payment of those dividends and whether or not those dividends are declared by the Company’s Board of Directors.

Pursuant to the terms of the Certificate of Designations of Series A Preferred Stock, in the event the Company is unable to issue the PIK Dividend as scheduled, the conversion ratio of the Series A Preferred Stock into Common Stock will be adjusted to reflect the Common Stock that would have otherwise been issued. Due to the Company’s negative net stockholder’s value as of March 1, 2024, among other considerations, including applicable Delaware Law, the Company was unable to issue the March 1, 2024 PIK Dividend. As a result, the conversion ratio of the Series A Preferred Stock into Common Stock was updated in accordance with the terms of the Series A Preferred Stock.

Conversion Features

Each share of Series A Preferred Stock is convertible at any time and in the sole discretion of the holder, into shares of Common Stock at a conversion rate of \$1.00 per share (the “Conversion Rate”) plus any accrued but unissued PIK Dividends, when converted, subject to certain restrictions on conversion prior to the Company obtaining stockholder approval. If the Company issues or sells Common Stock at a price below the current conversion rate of \$1.00 per share, the conversion rate will be adjusted downward immediately following the dilutive issuance. The new conversion rate will be calculated based on a formula that takes into account the previous conversion rate, number of shares outstanding before and after issuance, and the consideration received by the Company in connection with the dilutive issuance. Certain types of agreements to sell Common Stock at market pricing will be evaluated on a quarterly basis or immediately prior to a Liquidation Event for purposes of determining if they collectively constitute a dilutive issuance.

The Company can initiate a mandatory conversion at any time when the resale of issued Common Stock is covered under an effective registration statement or can be sold without volume limitations under Rule 144 (or successor rule), as determined by the counsel to the Company. The Series A Preferred Stock will automatically convert into shares of Common Stock at the Conversion Rate, as follows: (i) 50% of the issued and outstanding Series A Preferred Stock will convert into shares of Common Stock if the Volume-weighted average price (VWAP) trading price for the shares of Common Stock are trading on a national exchange is greater than \$4.50 per share for twenty of any thirty consecutive trading days, and (ii) the remaining issued and outstanding Series A Preferred Stock will convert into shares of Common Stock if the VWAP trading price for the shares of Common Stock are trading on a national exchange greater than \$6.00 per share for twenty of any thirty consecutive trading days.

The Company analyzed the embedded conversion options for derivative accounting consideration under ASC 815-15 “Derivatives and Hedging” and determined that the conversion options are equity classified.

Voting Rights

Each Series A Preferred Stockholder of the Company is entitled to the whole number of votes equal to the number of shares of Common Stock into which such holder’s Series A Preferred Stock would be convertible on the record date for the vote or consent of stockholders at a conversion price of \$1.04 per share of Common Stock rounded to the nearest whole share.

Liquidation Preferences and Redemption Rights

The Series A Preferred Stock has senior ranking over Common Stock of the Company, and junior to the Company's indebtedness, in each case for purposes of dividends, distributions, and payments in a liquidation event.

In the event of a liquidation event, holders of Series A Preferred Stock are entitled to receive in cash out of the assets of the Company legally available, whether from capital or from earnings available for distribution to its stockholders, before any amount shall be paid to the holders of Common Stock, an amount in cash per share of Series A Preferred Stock equal to the greater of: (i) 150% of the Stated Value and (ii) the value of the per share consideration paid to the holders of the Common Stock in the Liquidation Event as if the Series A Preferred Stock held by such holder had been converted prior to the liquidation event, subject to certain exceptions as stipulated in the Company's Certificate of Designations for the Series A Preferred Stock.

The Series A Preferred Stock are redeemable upon the occurrence of any transaction or series of related transactions pursuant to which the Company effects (i) any merger or consolidation of the Company where the Company is not the surviving entity, (ii) any sale of all or substantially all of its assets, or (iii) any reclassification of the Common Stock or any compulsory share exchange pursuant to which the Common Stock is effectively converted into or exchanged for other securities, cash or property (a "Fundamental Transaction"). In the event of a Fundamental Transaction, holders of Series A Preferred Stock are entitled to receive in cash the greatest of: (i) 150% of the Stated Value, (ii) the Stated Value of Series A Preferred Stock, plus to the extent holders of Common Stock will receive cash consideration in exchange for their Common Stock in a Fundamental Transaction, cash consideration equal to the value of any accrued but unpaid dividends, and (iii) the value of the per share consideration paid to the holders of the Common Stock in the Fundamental Transaction as if the Series A Preferred Stock held by such holder had been converted prior to the Fundamental Transaction.

As part of the Company's analysis of the classification of the Series A Preferred Stock, the Company considered the guidance in ASC 480-10-S99-3A and in particular paragraphs 2 and 3f, which require preferred securities that are redeemable for cash or other assets to be classified outside of permanent equity if they are redeemable upon the occurrence of an event that is not solely within the control of the issuer. Due to the consideration payable upon a Fundamental Transaction and the liquidation preferences of the Series A Preferred Stock providing for payout on the Series A Preferred Stock prior to payment to the Common Stockholders, the Company cannot avail itself of the limited exception of paragraph ASC 480-10-S99-3A-3f. As a result, the Company concluded that the Series A Preferred Stock are subject to ASR 268, Presentation in Financial Statements of "Redeemable Preferred Stocks," and should be classified outside of permanent equity.

Pursuant to the Plan, holders of preferred shares as discussed in Note -1 shall not receive any distribution and their Equity interests shall be extinguished.

NOTE 13 - EARN-OUT SHARES

In connection with the Business Combination, certain of the Company's original stockholders are entitled to receive up to 3,000,000 Earn-out shares in three tranches:

- (1) the first tranche of 1,000,000 Earn-out shares will be issued when the volume-weighted average price per share of the Company's Common Stock is \$12.50 or greater for 20 trading days in any consecutive 30 trading day period commencing 6 months after the Closing and ending at the third anniversary of the Closing;
- (2) the second tranche of 1,000,000 Earn-out shares will be issued when the volume-weighted average price per share of the Company's Common Stock is \$15.00 or greater for 20 trading days in any consecutive 30 trading day period commencing 6 months after the Closing and ending at the third anniversary of the Closing; and
- (3) the third tranche of 1,000,000 Earn-out shares will be issued when the volume-weighted average price per share of the Company's Common Stock is \$17.50 or greater for 20 trading days in any consecutive 30 trading day period commencing 6 months after the Closing and ending at the third anniversary of the Closing.

[Table of Contents](#)

The Earn-out shares will be allocated among the Company's stockholders in proportion to the number of shares issued to them at the closing that continue to be held by them.

Due to the variability in the number of Earn-out shares at settlement which could change upon a control event, the Earn-out arrangement contains a settlement provision that violates the indexation guidance under ASC 815-40 and liability classification is required. The Company recorded the earnout liability initially at fair value, and subsequently remeasures the liability with changes in fair value recorded in the Condensed Consolidated Statement of Operations at each reporting period.

As of March 31, 2024, the fair value of the outstanding earnout liability was \$0.13 million. Following the Petition Date, the Company reassessed the fair value of the Company Earn-out shares. As a result, the Company determined that the fair value of the earnout liability was zero, as presented in the table below.

The changes in fair value of the earnout liability for the three and six months ended June 30, 2024 and 2023 are as follows (in thousands):

	Amount
Earnout liability, December 31, 2023	\$ 620
Change in fair value	(490)
Earnout liability, March 31, 2024	130
Change in fair value	(130)
Earnout liability, June 30, 2024	\$ —
	Amount
Earnout liability, December 31, 2022	\$ 12,810
Change in fair value	(1,500)
Earnout liability, March 31, 2023	11,310
Change in fair value	(6,700)
Earnout liability, June 30, 2023	\$ 4,610

NOTE 14 — STOCK-BASED COMPENSATION

During May 2023, the Company issued 20,000 shares of Common Stock to a consultant for services received. The fair value of the shares issued of \$0.2 million was recognized as a selling, general and administrative expense with a corresponding credit to additional paid-in capital.

2022 Equity Incentive Plan

During 2022, the Company established the 2022 Equity Incentive Stock Plan (the "2022 Plan"), which authorizes the issuance of incentive and nonqualified stock options and restricted stock units ("RSUs") for the acquisition of shares of Common Stock, as well as grants of restricted Common Stock units to employees, officers, directors, and consultants of the Company. The 2022 Plan provides that the exercise price of incentive stock options cannot be less than 100% of the fair market value of the Common Stock on the date of the award for participants who own less than 10% of the total combined voting power of stock of the Company, and not less than 110% for participants who own more than 10% of the Company's voting power. The vesting period for the option is outlined in percentage installments on the grant notice. The option can only be exercised to the extent that it is vested and exercisable. The grantee has the right to exercise the option until it expires or is terminated, as long as it is vested and exercisable. The stock options generally expire not more than ten years from the date of grant, who own less than 10% of the total combined voting power of stock of the Company and the expiration note more than 5 years from the date of grant, who own more than 10% of the Company's voting power.

As of June 30, 2024, there were 6,000,000 shares reserved and 5,889,525 available for future grants under the 2022 Plan.

Stock option activity for the six months ended June 30, 2024 was as follows:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value (in thousands)
Outstanding at December 31, 2023	1,562,497	\$ 4.67	9.2 years	\$ 35
Granted	—	—		
Exercised	—	—		
Cancelled	(8,186)	5.20		
Outstanding at June 30, 2024	1,554,311	\$ 4.67	8.7 years	\$ —
Exercisable at June 30, 2024	—	—		
Vested and expected to vest as of June 30, 2024	1,554,311	\$ 4.67	8.7 years	\$ —

As of June 30, 2024, unamortized compensation expense related to unvested stock options was \$2.6 million, which is expected to be recognized over a weighted average period of 2.58 years.

Dividend Rate—The expected dividend rate was assumed to be zero, as the Company had not previously paid dividends on Common Stock and has no current plans to do so.

Expected Volatility—The expected volatility was derived from the historical stock volatilities of several public companies within the Company’s industry that the Company considers to be comparable to the business over a period equivalent to the expected term of the stock option grants.

Risk-Free Interest Rate—The risk-free interest rate is based on the interest yield in effect at the date of grant for zero coupon U.S. Treasury notes with maturities approximately equal to the option’s expected term.

Expected Term—The expected term represents the period that the Company’s stock options are expected to be outstanding. The expected term of option grants that are considered to be “plain vanilla” are determined using the simplified method. The simplified method deems the term to be the average of the time-to-vesting and the contractual life of the options. For other option grants not considered to be “plain vanilla,” the Company determined the expected term to be the contractual life of the options.

Forfeiture Rate—The Company recognizes forfeitures as they occur.

The Company’s 2022 Plan has a “clawback policy” based on which the Company may recover from a participant any compensation received from any stock right (whether or not settled) or cause a participant to forfeit any such stock right in the event that the Company’s clawback policy then in effect is triggered. The Company’s clawback policy is compliant with provisions of applicable law, including the requirements set forth in Listing Rule 5608 of the corporate governance rules of the Nasdaq Stock Market.

Restricted Stock Units

During October 2023 and February 2024, the Company granted 736,250 and 2,653,067, respectively, RSUs to certain employees under the 2022 Plan. Of the RSUs granted in October 2023, 543,750 cliff vest on October 25, 2025, and the remaining 192,500 fully vested on the grant date. The RSUs granted in February 2024 vest over a period of two to three years. The board of directors of the Company has the discretion to accelerate the vesting of unvested Restricted Stock Units at any time, as per the terms of the 2022 Plan. The RSUs represent the right to receive Common Stock of the Company, but the participant has no right to payment until the RSUs vest. The vested RSUs will be paid in whole shares of Common Stock within 60 days of the vesting date. If the participant ceases to be a service provider, the unvested RSUs will be forfeited at no cost to the Company, and the participant will have no further rights under the award agreement.

RSU activity for the six months ended June 30, 2024, was as follows:

	Number of Units	Weighted-Average Exercise Price
Unvested at December 31, 2023	543,750	\$ 0.86
Granted	2,653,067	0.73
Vested	—	—
Forfeited	—	—
Unvested balance at June 30, 2024	3,196,817	\$ 0.75

The Company has recorded stock-based compensation expense for the three and six months ended June 30, 2024 and 2023 related to the grants of stock option awards to employees and nonemployees in the Condensed Consolidated Statement of Operations as follows (in thousands):

	Three months ended June 30		Six months ended June 30	
	2024	2023	2024	2023
Cost of revenue	\$ 7	\$ 7	\$ 2	\$ 7
Sales and marketing	77	39	133	66
Research and development	98	65	191	112
General and administrative	274	232	544	384
	\$ 456	\$ 343	\$ 870	\$ 569

For the six months ended June 30, 2024 and 2023, the Company recorded stock-based compensation expense related to the vested RSUs of \$0.4 million. As of June 30, 2024, unamortized compensation expense related to unvested stock options was \$2.3 million, which is expected to be recognized over a weighted average period of 1.95 years.

The Company did not recognize any tax benefits related to stock-based compensation expense during the three and six months ended June 30, 2024 and 2023.

2023 Employee Stock Purchase Plan

The Company's Board of Directors previously adopted, and the Company's stockholders approved, the Company's 2023 Employee Stock Purchase Plan (the "2023 ESPP").

The 2023 ESPP is a broad-based plan that provides employees of the Company and its designated affiliates with the opportunity to become stockholders through periodic payroll deductions that are applied towards the purchase of shares of the Company's Common Stock at a discount from the then-current market price. Subject to adjustment in the case of certain capitalization events, a total of 500,000 shares of Common Stock were available for purchase at adoption of the 2023 ESPP. The first offering period under the plan commenced on June 15, 2023. There were no shares issued under the plan for the six months ended June 30, 2024. As of June 30, 2024, 500,000 shares of Common Stock remained available for issuance under the 2023 ESPP.

The Company estimates the fair value of ESPP grants on their grant date using the Black-Scholes option pricing model. The estimated fair value of ESPP grants is amortized on a straight-line basis over the requisite service period of the grants. The Company reviews, and when deemed appropriate, updates the assumptions used on a periodic basis. The Company utilizes its estimated volatility in the Black-Scholes option pricing model to determine the fair value of ESPP grants. 2023 ESPP was terminated by the Company during the three months ended March 31, 2024. The Company refunded all cash received back to the employees prior to issuing any shares.

NOTE 15 — NET INCOME (LOSS) ATTRIBUTABLE TO COMMON STOCKHOLDERS

The following table sets forth the computation of the basic and diluted net loss per share attributable to Common Stockholders for the three and six months ended June 30, 2024 and 2023 (in thousands, except shares and per share amounts):

	Three months ended June 30,		Six months ended June 30,	
	2024	2023	2024	2023
Numerator:				
Net (loss) income attributable to common stockholders - Basic	\$ (15,181)	\$ 905	\$ (11,740)	\$ (5,987)
Interest expense and remeasurement of Senior Convertible Notes liability	—	(1,168)	—	—
Net loss attributable to common stockholders - Diluted	<u>\$ (15,181)</u>	<u>\$ (263)</u>	<u>\$ (11,740)</u>	<u>\$ (5,987)</u>
Denominator:				
Weighted-average common shares outstanding - Basic	17,393,524	16,057,630	17,393,253	16,045,110
Senior convertible notes	—	3,083,601	—	—
Weighted-average common shares outstanding - Diluted	<u>17,393,524</u>	<u>19,141,231</u>	<u>17,393,253</u>	<u>16,045,110</u>
Net (loss) income per share - Basic	\$ (0.87)	\$ 0.06	\$ (0.67)	\$ (0.37)
Net loss per share - Diluted	\$ (0.87)	\$ (0.01)	\$ (0.67)	\$ (0.37)

Diluted earnings per share reflect the potential dilution of securities that could share in the earnings of an entity. As of June 30, 2024 and 2023, earnout shares for 3,000,000 shares of common stock were excluded from diluted earnings per share as they are subject to performance or market conditions that were not achieved at the reporting date.

The potential shares of Common Stock that were excluded from the computation of diluted net loss per share attributable to Common Stockholders for the three and six ended June 30, 2024 and 2023 because including them would have been antidilutive are as follows:

	Three months ended June 30,		Six months ended June 30,	
	2024	2023	2024	2023
Outstanding RSUs	3,196,817	—	3,196,817	—
Warrants to purchase Common Stock	11,966,611	6,512,057	11,966,611	6,512,057
Options to purchase Common Stock	1,582,497	1,465,817	1,582,497	1,465,817
Senior Convertible Notes	14,959,807	—	14,959,807	3,083,601
Subordinated Convertible Notes	20,699,781	3,535,673	20,699,781	3,357,648
	<u>52,405,513</u>	<u>11,513,547</u>	<u>52,405,513</u>	<u>14,419,123</u>

NOTE 16 — SUBSEQUENT EVENTS

The Company has evaluated events that occurred subsequent to June 30, 2024 through the date these condensed consolidated financial statements were issued for matters that required disclosure or adjustment in these condensed consolidated financial statements.

On July 30, 2024, the Bankruptcy Court entered an order (the “Confirmation Order”), confirming the Plan.

Item 2. Management’s Discussion and Analysis of Financial Condition and Results of Operations

Cautionary Note on Forward-Looking Statements

This report, including, without limitation, statements under the heading “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” includes forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934, or the Exchange Act. These forward-looking statements can be identified by the use of forward-looking terminology, including the words “believes,” “estimates,” “anticipates,” “expects,” “intends,” “plans,” “may,” “will,” “potential,” “projects,” “predicts,” “continue,” or “should,” or, in each case, their negative or other variations or comparable terminology. There can be no assurance that actual results will not materially differ from expectations. Such statements include, but are not limited to:

- the outcome of ProSomnus’s Chapter 11 reorganization in the Bankruptcy Court;
- ProSomnus’s ability to meet customer, contractual, and vendor demands and provide related services;
- uncertainty of the projected financial information with respect to ProSomnus;
- ProSomnus’s ability to continue as a going concern;
- ProSomnus’s ability to expand its sales network and product lines;
- ProSomnus’s ability to maintain and grow its profit margin from sales of ProSomnus oral devices;
- ProSomnus’s ability to expand internationally;
- the roll-out of ProSomnus’s business and the timing of expected business milestones;
- ProSomnus’s ability to formulate, implement and modify effective sales, marketing, and strategic initiatives to drive revenue growth;
- expectations concerning the effectiveness of OSA treatment using ProSomnus oral devices and the potential for patient relapse after completion of treatment;
- the understanding and adoption by dentists and other healthcare professionals of ProSomnus oral devices for mild-to-moderate OSA;
- ProSomnus’s ability to attract and retain key personnel;
- the increased obligations related to being a public company;
- ProSomnus’s ability to comply with its debt covenants or successfully renegotiating such covenants;
- ProSomnus’s ability to obtain additional funding;
- ProSomnus’s plans and ability to regain compliance with the Nasdaq Listing Rules;
- the viability of ProSomnus’s intellectual property and intellectual property created in the future;
- government regulations and ProSomnus’s ability to obtain applicable regulatory approvals and comply with government regulations, including under healthcare laws and the rules and regulations of the U.S. Food and Drug Administration; and
- the outcome of any legal proceedings that may be instituted against ProSomnus.

The forward-looking statements contained in this report are based on our current expectations and beliefs concerning future developments and their potential effects on us. Future developments affecting us may not be those that we have anticipated. These forward-looking statements involve a number of risks, uncertainties (some of which are beyond our control) and other assumptions that may cause actual results or performance to be materially different from those expressed or implied by these forward-looking statements. These risks and uncertainties include, but are not limited to, those factors described under the heading “Risk Factors,” which are incorporated by reference herein. Should one or more of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, actual results may vary in material respects from those projected in these forward-looking statements. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, except as may be required under applicable law. These risks and others described under “Risk Factors” may not be exhaustive.

By their nature, forward-looking statements involve risks and uncertainties because they relate to events and depend on circumstances that may or may not occur in the future. We caution you that forward-looking statements are not guarantees of future performance and that our actual results of operations, financial condition and liquidity, and developments in the industry in which we operate may differ materially from those made in or suggested by the forward-looking statements contained in this report. In addition, even if our results or operations, financial condition and liquidity, and developments in the industry in which we operate are consistent with the forward-looking statements contained in this report, those results or developments may not be indicative of results or developments in subsequent periods.

Recent Developments

Bankruptcy Filing and Going Concern

On May 7, 2024, the Company initiated a voluntary restructuring process under Chapter 11 of the U.S. Bankruptcy Code to reorganize and strengthen its capital structure going forward, improve financial flexibility and better position the Company for long-term success. In connection with this process, the Company has secured the support of certain Senior Noteholders and Subordinated Noteholders as defined in the RSA, (the “Sponsoring Noteholders”) under a plan that is designed to deliver an aggregate of approximately \$20 million of new capital into the Company. Such Capital will support ongoing operations and the development of strategic initiatives including the Company’s next generation sensor device.

In connection with this restructuring, the Company intends to fully maintain ongoing operations, including the payment of the Company’s employees, customers, and vendors in the ordinary course of business during and after the restructuring. Importantly, the terms of this financial restructuring enable the Company to maintain normal business operations for customers and suppliers during and after this restructuring process. The Company expects customers to continue experiencing its rapid turnaround times, predictable on-time order fulfillment, and exceptional device quality and performance. ProSomnus expects to continue purchasing supplies from vendors commensurate with demand for our devices.

The Company’s Sponsoring Noteholders have agreed to the principal terms of a voluntary Restructuring and the filing of a voluntary, pre-negotiated chapter 11 plan of reorganization (the “Reorganization Plan”). The material terms of the Reorganization Plan are set forth in the Restructuring Support Agreement (“RSA”) and include, among other things: An aggregate of \$20.0 million of potential capital to the Company, comprising (i) \$11.0 million from a debtor-in-possession credit facility, which includes \$2.0 million of senior creditor roll-down, and (ii) a potential \$9.0 million new-money equity capital raise, while also honoring existing amounts due to customers, critical vendors, equipment lenders and trade creditors. Confirmation of the Reorganization Plan is anticipated, but not guaranteed, to occur within 90 days of filing the Chapter 11 Cases with the Court involving certain of the Company Parties (the “Chapter 11 Cases”). See Note 1 and Note 16 in our notes to consolidated financial statements elsewhere in this Quarterly Report on Form 10-Q for further discussion.

Our ability to continue as a going concern is principally dependent on our ability to successfully exit from the restructuring process.

Delisting of our Common Stock from NASDAQ

As previously disclosed, we were notified by the Nasdaq Global Market (“Nasdaq”) that we were not in compliance with Nasdaq’s minimum market value of listed securities, minimum market value of publicly held shares, or Nasdaq’s minimum bid price requirement of \$1.00, each of which was required for continued listing on Nasdaq. Due to such noncompliance, trading of our common stock and warrants was suspended at the open of business on April 18, 2024 and Nasdaq filed a Form 25 with the Securities and Exchange Commission to delist our common stock and warrants from Nasdaq.

Overview

We are a medical technology company focused on the development, manufacturing and marketing of precision intraoral medical devices, a new option for treating and managing patients with mild to moderate Obstructive Sleep Apnea (“OSA”). Each ProSomnus precision intraoral device is personalized based on the anatomy and treatment plan for each patient. Our patented precision devices are engineered to create unique, consistent and predictable biomechanical advantages that lead to effective, comfortable, economical and patient preferred treatment outcomes for patients with OSA.

Our ProSomnus precision intraoral devices are classified by the U.S. Food and Drug Administration (the “FDA”) as Class II medical devices for the treatment of snoring and mild to moderate OSA. We received pre-market notification and FDA clearance pursuant to Section 510(k) of the Federal Food, Drug, and Cosmetic Act (“FDCA”) for our first intraoral device in July 2014 and our devices have been commercially available in the United States since August 2014. To date, over 250,000 ProSomnus precision devices have been prescribed for patients.

Sleep apnea is a serious and chronic respiratory disease that negatively impacts a patient's sleep, health, and quality of life. OSA is the most common form of sleep apnea. OSA is a medical condition characterized by a cessation of breathing when the tongue, soft palate, and other related tissues in the back of the throat collapse and block the upper airway during sleep, temporarily decreasing the oxygen concentration in the blood. During an OSA episode, the diaphragm and chest muscles must work harder to overcome the obstruction and open the airway. These episodes disrupt the sleep cycle, reduce airflow to vital organs, stress the body, and create a negative feedback loop. If untreated, OSA increases the risk of high blood pressure, hypertension, heart failure, stroke, coronary artery disease and other life-threatening diseases. OSA is associated with a reduction in quality-of-life factors including a higher risk of motor vehicle and operator accidents, workplace errors, absenteeism and more.

Until ProSomnus, there have been few alternatives for OSA patients who refuse or fail CPAP. Historically, treatment alternatives to CPAP have consisted of surgical procedures or legacy dental products. Surgical procedures, such as hypoglossal nerve stimulation and maxillomandibular advancement, are invasive and can be, irreversible, expensive, and only suitable for a narrow range of patient types. Legacy dental products, historically, have been associated with inconsistent and unreliable performance. We believe that there is both an urgent clinical need and a strong market opportunity for a treatment alternative that is effective, non-surgical, convenient, and more economical.

ProSomnus therapy is covered by most private insurance payers, Medicare, and by a growing number of public health insurance programs offered in many countries around the world. In the United States an estimated 70% of treatments are paid for by private insurance, 25% are covered by Medicare and the remaining 5% are paid out of pocket by the patient.

Providers are typically reimbursed by private medical insurance in the range of approximately \$2,000 to \$3,500 per patient for intraoral appliance therapy and by Medicare in the range of approximately \$1,250 to \$1,800 per patient for intraoral appliance therapy. The average amount varies by insurance provider and Medicare jurisdiction. At these reimbursement levels, we believe that intraoral appliance therapy offers dentists an attractive ratio of revenue per chair time in comparison to other dental procedures.

We market and sell our precision intraoral devices to sleep medicine providers in the United States and in select countries around the world through a direct sales force. We currently have 36 direct sales representatives in the United States, Canada, and Europe. Our sales force focuses their education, promotional and sales efforts on dentists who have developed a specialty in dental sleep medicine, and the physicians who are actively treating OSA.

We generated revenue of \$9.1 million and a net loss of \$15.2 million for the three months ended June 30, 2024, compared to revenue of \$6.9 million and a net income of \$0.9 million for the three months ended June 30, 2023. We generated revenue of \$16.6 million and a net loss of \$11.7 million for the six months ended June 30, 2024, compared to revenue of \$12.7 million and a net loss of \$6.0 million for the six months ended June 30, 2023. Accumulated deficit as of June 30, 2024 was \$246.6 million.

Macroeconomic Environment

Uncertainty surrounding macroeconomic and geopolitical factors in the U.S. and globally characterized by the supply chain environment, inflationary pressure, higher interest rates, instability in the global financial markets, labor shortages, significant disruptions in the commodities' markets as a result of the military conflicts in Ukraine and the Middle East, and the introduction of or changes in tariffs or trade barriers may result in a recession, which could have a material adverse effect on our long-term business.

We maintain the majority of our cash in accounts with major U.S. financial institutions, and our deposits exceed insured limits. Market conditions could impact the viability of these institutions. To date, these market conditions and liquidity concerns have not impacted our results of operations. However, in the event of failure of any of the financial institutions where we maintain our cash, there can be no assurance that we would be able to access uninsured funds in a timely manner or at all. Any inability to access or delay in accessing these funds could adversely affect our business and financial position.

Recent Financing Transactions

Issuance of Convertible Notes

On April 17, 2024 we issued and sold to certain existing ProSomnus investors \$2.0 million aggregate principal amount of the Company's Senior Secured Convertible Notes due December 6, 2025 ("Bridge Notes"). In connection with this financing, we issued

\$0.7 million in aggregate principal amount of Notes to investment funds of Spring Mountain Capital (where Jason Orchard, a member of our board of directors serves as a Managing Director).

On April 29, 2024, the Company issued and sold to certain existing ProSomnus investors an additional \$2.0 million, aggregate principal amount of the Company's Bridge Notes.

DIP Credit Agreement

As approved by the Court on May 9, 2024, the Company, as borrower, and certain of the Company's direct and debtor-subidiaries, as guarantors (together with the Company, the "DIP Loan Parties"), entered into that certain senior subordinate secured debtor-in-possession term loan agreement (the "DIP Credit Agreement") with the lenders from time to time party thereto (the "DIP Lenders") and Wilmington Savings Fund Society, FSB, as administrative agent and collateral agent, on the terms and conditions set forth therein. Pursuant to the DIP Credit Agreement, the DIP Lenders have agreed, upon the terms and conditions set forth therein, including the approval of the Court, to make available to the Company a senior subordinate secured debtor-in-possession term loan credit facility in the aggregate principal amount of \$13 million, as described above. Borrowings under the DIP Credit Agreement will be used to (a) fund the Chapter 11 Cases, (b) make certain other payments as more fully provided in the Court orders relating to the approval of the DIP Credit Agreement, and (c) provide working capital for the DIP Loan Parties during the pendency of the Chapter 11 Cases, all in accordance with an approved budget (subject to the permitted variances) and as otherwise provided therein. The obligations under the DIP Credit Agreement will be secured by liens on substantially all of the real and personal property of the DIP Loan Parties (the "DIP Liens"), subject to certain exceptions. The DIP Liens will be senior to the liens securing the Subordinated Notes obligations and junior to the liens securing the Senior Notes obligations.

Borrowings under the DIP Credit Agreement will be due on November 7, 2024, or the earliest to occur of certain specified termination events. The interest rate on borrowings under the DIP Credit Agreement will be the prime rate plus 9.00%.

The DIP Credit Agreement includes customary negative covenants for debtor-in-possession loan agreements of this type, including covenants limiting the Company and its restricted subsidiaries' ability to, among other things, incur additional indebtedness, create liens on assets, make investments, loans, advances or guarantees, engage in mergers, consolidations, sales of assets and acquisitions and pay dividends and distributions, in each case subject to customary exceptions for debtor-in-possession loan agreements of this type. The DIP Credit Agreement also includes customary representations and warranties, affirmative covenants and events of default. Certain restructuring-related events are also events of default, including, but not limited to, the dismissal by the Court of any of the Chapter 11 Cases, the conversion of any of the Chapter 11 Cases to a case under chapter 7 of the Code, the appointment of a trustee pursuant to chapter 11 of the Code, and certain other events related to the impairment of the DIP Lenders' rights or liens granted under the DIP Credit Agreement.

Factors Affecting Results of Operations

The following factors have been important to our business, and we expect them to impact our results of operations and financial condition in future periods:

(a) Maintenance of the North American and International direct sales organization and international expansion

The core focus of our sales initiative is to maintain our direct sales organization in North America. With representatives located in high-value metropolitan areas, the direct sales organization will focus primarily on dentists and physicians who are practicing sleep medicine. The main purpose of this initiative is to increase case volume from these dentists and physicians by facilitating a referral relationship between dentists and physicians, helping them expand the dental sleep medicine aspect of their practices and educating them on the advantages of the ProSomnus intraoral devices. We also intend to further expand our sales to integrated health systems and hospital networks. We have initiated the marketing and sales of our ProSomnus intraoral devices in several European countries and intend to further expand our marketing efforts into additional international markets.

(b) Product line extensions and remote patient monitoring services

We intend for product line extensions to focus on enabling ProSomnus to capture a larger share of treatments for patients with OSA, snoring and other related sleep-disordered breathing conditions. We expect that each product line extension will be designed to optimize

ProSomnus products for a wider range of case types, treatment philosophies, and indications. We expect that each product line extension will utilize our unique manufacturing platform and potentially create additional opportunities for intellectual property.

We received FDA clearance for an intraoral device that enables remote patient monitoring services in November 2020. The sales of such remote patient monitoring services in connection with our intraoral devices could result in an additional recurring revenue stream that is reimbursable by insurance. Our remote patient monitoring services will be based on the incorporation of a sensor into the ProSomnus intraoral devices that provides continuous monitoring of physiological health data that physicians want and cannot typically obtain from CPAP or other intraoral appliance therapy devices. Our market research indicates that our remote patient monitoring services could be a significant driver of greater market acceptance and expansion and result in significant future revenues.

Description of Certain Components of Financial Data

Revenue

We derive primarily all of our revenue from the sale of our customized precision intraoral medical devices that clinicians use to treat patients diagnosed with Obstructive Sleep Apnea. Our revenue recognition policies are discussed in more detail in Note 2 to our condensed consolidated financial statements and notes thereto for the three and six months ended June 30, 2024 and 2023 included elsewhere in this quarterly report.

Cost of revenue

Cost of revenue consists primarily of materials and the costs related to the production of the intraoral device, including employee compensation, stock-based compensation, other employee-related expenses, inbound shipping and allocable manufacturing overhead costs. ProSomnus has a policy to classify initial recruiting and training costs of new manufacturing employees as part of research and development expenses in the Condensed Consolidated Statements of Operations.

Research and development

Research and development expenses consist of production costs for prototypes, test and pre-production units, supplies, consulting, clinical studies and personnel costs, including salaries, bonuses and benefits. Most of our research and development expenses are related to developing new products and services. Consulting expenses are related to research and development activities as well as clinical and regulatory activities and certain third-party engineering costs. Research and development expenses are expensed as incurred. We expect to continue to make investments in product development. As a result, research and development expenses are expected to increase modestly in absolute dollars as the research and development efforts increase.

Sales and marketing

Sales and marketing costs primarily consist of salaries, bonuses, benefits and travel costs for employees engaged in sales and marketing activities, as well as website, advertising, conferences and other promotions. By design, sales and marketing costs are tied to sales performance and increase as sales and corresponding revenue increase.

General and administrative

General and administrative expenses primarily consist of labor, bonuses, benefits, general insurance, office expenses and outside services. Outside services consist of audit, tax, legal and other professional fees.

Other income (expense)

Other income (expense) primarily relates to interest expense as well as the change in fair value of our convertible debt, earnout liability, warrants classified as liabilities, and other financing costs.

The components of interest expense include interest expense incurred under our Convertible Notes, subordinated notes, subordinated loan and security agreements, unsecured subordinated promissory notes, equipment financing and capital lease obligations.

Provision for income taxes

The Company accounts for income taxes under an asset and liability approach. Deferred income taxes reflect the impact of temporary differences between assets and liabilities recognized for financial reporting purposes and such amounts recognized for income tax reporting purposes as well as net operating loss carryforwards and tax credit carryforwards. The Company records a valuation allowance to reduce deferred tax assets to the amount that is believed “more-likely-than-not” to be realized. Realization of deferred tax assets is dependent upon future pretax earnings, the reversal of temporary differences between book and tax bases of assets and liabilities, and the enacted tax rates in effect in future periods. The Company recorded a full valuation allowance as of June 30, 2024 and December 31 2023. Based on available evidence, we believe that it is more likely than not that we will be unable to utilize all our deferred tax assets in the future.

The Company evaluates the tax positions taken in the course of preparing its tax returns to determine whether tax positions are more-likely-than-not of being sustained by the applicable tax authority. Tax benefits of positions not deemed to meet the more-likely-than-not threshold would be recorded as a tax expense in the current year. The amount recognized is subject to estimate and management judgment with respect to the likely outcome of each uncertain tax position. The amount that is ultimately sustained for an individual uncertain tax position or for all uncertain tax positions in the aggregate could differ from the amount that is initially recognized. Interest and penalties associated with unrecognized tax benefits, if any, are classified as income tax expense in the consolidated statements of operations.

Reorganization items

Reorganization items relates to amounts incurred after the petition date as a direct result of the bankruptcy. This includes costs associated with restructuring, including professional fees, debt valuation adjustments, and other bankruptcy-related costs.

Results of Operations

Comparison of the three months ended June 30, 2024 and 2023 (\$ in thousands):

	Three Months Ended June 30,		Change	
	2024	2023	\$	%
Revenue	\$ 9,092	\$ 6,934	\$ 2,158	31.1 %
Operating expenses:				
Cost of revenue	4,268	3,171	1,097	34.6 %
Sales and marketing	2,418	3,643	(1,225)	(33.6)%
General and administrative	3,482	4,480	(998)	(22.3)%
Research and development	1,173	1,376	(203)	(14.8)%
Total operating expenses	11,341	12,670	(1,329)	(10.5)%
Other income (expense)				
Interest expense, net	(831)	(1,240)	409	33.0 %
Change in fair value of earnout liability	130	6,700	(6,570)	n/m
Change in fair value of debt	—	(802)	802	n/m
Change in fair value of warrant liability	38	2,106	(2,068)	n/m
Other expense, net	(21)	(123)	102	n/m
Total other (expense) income, net	(684)	6,641	(7,325)	110.3 %
Reorganization items, net	(12,248)	—	(12,248)	n/m
Net (loss) income	\$ (15,181)	\$ 905	\$ (16,086)	1,777.5 %

(n/m = not meaningful)

[Table of Contents](#)

Revenue increased by \$2,158, or 31.1%, for the three months ended June 30, 2024, compared to the three months ended June 30, 2023. This increase was primarily driven by increased adoption of the use of our precision devices, increased sales and marketing investments, and mix shift to the EVO Product, all of which contributed to increased unit volumes.

Total cost of revenue increased by \$1.1 million, or 34.6%, for the three months ended June 30, 2024 compared to the three months ended June 30, 2023. The increase was primarily due to product costs associated with higher sales volume of our devices and an increase in the cost of materials and supplies.

Sales and marketing expenses decreased by \$1.2 million, or 33.6%, for the three months ended June 30, 2024, compared to the three months ended June 30, 2023. This decrease was primarily driven by a decrease of \$0.1 million in distribution and advertising expenses, a decrease of \$1.2 million in travel and in-person events expenses, and an increase of \$0.1 million in sales and marketing events expenses.

General and administrative expenses decreased by \$1.0 million, or 22.3%, for the three months ended June 30, 2024, compared to the three months ended June 30, 2023. The decrease was due to a \$0.7 million decrease in personnel costs and bonuses, \$0.3 million in professional services and \$0.4 million in other general expenses offset by increase of \$0.4 million related to legal fees and stock-based compensation.

Research and development expenses decreased by \$0.2 million, or 14.8%, for the three months ended June 30, 2024, compared to the three months ended June 30, 2023. This decrease was primarily driven by decrease in headcount-related personnel and consulting costs of \$0.1 million and \$0.1 million increase in other research and development related expenses.

Total other expense, net increased by \$7.3 million, or 110.3%, to \$0.7 million, for the three months ended June 30, 2024, compared to net total other income of \$6.6 million, for the three months ended June 30, 2023. The increase in expenses was primarily due to decrease in fair value of warrant and earnout liability of \$2.1 million, and \$6.6 million, respectively, decrease in interest expense of \$0.5 million, offset by reclassification of debt valuation as reorganization items of \$0.8 million and other expenses of \$0.1 million.

Reorganization items during the three months ended June 30, 2024 amounted to \$12.2 million, as the result of a debt valuation adjustment of \$10.1 million and professional and other bankruptcy fees of \$2.1 million, which were incurred in connection with the Chapter 11 Cases.

Comparison of the six months ended June 30, 2024 and 2023 (\$ in thousands):

	Six Months Ended June 30,		Change	
	2024	2023	\$	%
Revenue	\$ 16,550	\$ 12,742	\$ 3,808	29.9 %
Operating expenses:				
Cost of revenue	8,107	5,927	2,180	36.8 %
Sales and marketing	4,394	6,467	(2,073)	(32.1)%
General and administrative	5,968	7,833	(1,865)	(23.8)%
Research and development	2,123	2,395	(272)	(11.4)%
Total operating expenses	20,592	22,622	(2,030)	(9.0)%
Other income (expense)				
Interest expense, net	(1,977)	(2,412)	435	18.0 %
Change in fair value of earnout liability	620	8,200	(7,580)	n/m
Change in fair value of debt	5,885	(2,629)	8,514	n/m
Change in fair value of warrant liability	96	1,264	(1,168)	n/m
Other expense, net	(74)	(530)	456	n/m
Total other income, net	4,550	3,893	657	(16.9)%
Reorganization items, net	(12,248)	—	(12,248)	n/m
Net loss	\$ (11,740)	\$ (5,987)	\$ (5,753)	(96.1)%

(n/m = not meaningful)

Revenue increased by \$3.8 million, or 29.9%, for the six months ended June 30, 2024, compared to the six months ended June 30, 2023. This increase was primarily driven by increased adoption of the use of our precision devices, increased sales and marketing investments, and mix shift to the EVO Product, all of which contributed to increased unit volumes. Revenue from the Company's largest customer was 4.45% and 5.2% for the six months ended June 30, 2024 and 2023, respectively.

Total cost of revenue increased by \$2.2 million, or 36.8%, for the six months ended June 30, 2024, compared to the six months ended June 30, 2023. The increase was primarily due to product costs associated with higher sales volume of our devices and an increase in the cost of materials and supplies.

Sales and marketing expenses decreased by \$2.1 million, or 32.1%, for the six months ended June 30, 2024, compared to the six months ended June 30, 2023. This decrease was primarily driven by a decrease of \$0.5 million in distribution and advertising expenses, a decrease of \$1.8 million in travel and in-person events expenses, and an increase of \$0.2 million in sales and marketing events expenses.

General and administrative expenses decreased by \$1.9 million, or 23.8%, for the six months ended June 30, 2024, compared to the six months ended June 30, 2023. The decrease was due to a \$1.7 million decrease in personnel costs and bonuses, \$0.3 million decrease in professional services and \$0.8 million decrease in other general expenses, offset by increase of \$0.8 million related to legal fees and \$0.1 million in stock-based compensation.

Research and development expenses decreased by \$0.3 million, or 11.4%, for the six months ended June 30, 2024, compared to the six months ended June 30, 2023. This decrease was primarily driven by a decrease in headcount-related personnel and consulting costs of \$0.2 million and \$0.1 million decrease in other research and development related expenses.

Total other income, net decreased by \$0.7 million, or 16.9%, to \$4.5 million, for the six months ended June 30, 2024, compared to net total other income of \$3.9 million, for the six months ended June 30, 2023. The increase in expenses was primarily due to increase in fair value of debt of \$8.5 million, offset by decrease in fair value of warrant and earnout liability of \$1.2 million, and \$7.6 million, respectively, and decrease in other expenses of \$0.4 million.

Reorganization items during the three months ended June 30, 2024 amounted to \$12.2 million, as the result of a debt valuation adjustment of \$10.1 million and professional and other fees of \$2.1 million were incurred in connection with the Chapter 11 Cases.

LIQUIDITY AND CAPITAL RESOURCES

Going Concern and Management's Plans

Our liquidity needs are to fund our ongoing business initiatives. Historically, our sources of cash were primarily the issuance of equity securities and the incurrence of debt, and our uses of cash were to fund our operating needs and to service our indebtedness. We expect to funds received under the Chapter 11 Cases, cash flows from operations and use our existing cash to fund our operations. We have incurred recurring losses from operations and recurring negative cash flows from operating activities. We expect operating losses and negative cash flows from operations to continue for the foreseeable future.

Our ability to continue as a going concern depends principally on our ability to successfully exit from the Chapter 11 restructuring. Our plans are subject to the Bankruptcy Court's approval, implement a Chapter 11 Plan, emerge from the Chapter 11 proceedings and generate sufficient liquidity to meet our contractual obligations and operating needs. As a result of the risks and uncertainties related to, among other things, (i) our ability to obtain requisite support for a Chapter 11 Plan from various stakeholders, and (ii) the disruptive effects of the Chapter 11 proceedings on our business making it potentially more difficult to maintain business, financing and operational relationships. There can be no assurance that we will be able to successfully exit or do so on terms acceptable to the Company, on a timely basis or at all.

The following table summarizes our cash flows for the periods indicated (in thousands):

	Six Months Ended	
	June 30,	
	2024	2023
Net cash (used in) provided by:		
Operating activities	\$ (10,335)	\$ (7,789)
Investing activities	(436)	(1,212)
Financing activities	9,013	(740)
Net change in cash	<u>\$ (1,758)</u>	<u>\$ (9,741)</u>

Net cash used in operating activities

For the six months ended June 30, 2024, net cash used in operating activities of \$10.3 million was due primarily to a net loss of \$11.7 million, changes in operating assets and liabilities of \$5.6 million, and offset by non-cash adjustments of \$7.0 million. Changes in operating assets and liabilities were driven primarily by increase of \$1.7 million of accrued expenses and other current liabilities, \$0.7 million of accounts receivable, \$1.4 million of accounts payable, and \$2.2 million of prepaid expenses, offset by decrease of \$0.03 other current assets. Non-cash items primarily consisted of depreciation and amortization of \$1.5 million, noncash interest of \$1.2 million, noncash reorganization items of \$10.1 million, and stock-based compensation of \$0.9 million, partially offset by \$6.6 million of change in fair value of earn-out liability, debt and warrants.

For the six months ended June 30, 2023, net cash used in operating activities of \$7.8 million was due primarily to a net loss of \$5.9 million and changes in operating assets and liabilities of \$1.2 million, offset by non-cash adjustments of \$3 million. Changes in operating assets and liabilities were driven by \$2.1 million of accrued expenses and other current liabilities, \$0.5 million of prepaid expenses, offset by \$0.8 million of accounts receivable, and \$0.7 million of inventory. Non-cash items primarily consisted of depreciation and amortization of \$1.0 million, stock-based compensation of \$0.6 million, noncash interest of \$1.5 million and offset by \$6.9 million of change in fair value of earn-out liability, debt and warrants, \$0.1 million loss on disposal of property and equipment.

Net cash used in investing activities

For the six months ended June 30, 2024, net cash used in investing activities of \$0.4 million was related to purchases of property and equipment of property and equipment.

For the six months ended June 30, 2023, net cash used in investing activities of \$1.2 million was entirely related to purchases of property and equipment.

Net cash used in financing activities

For the six months ended June 30, 2024, net cash provided by financing activities of \$9.0 million was due to proceeds from the issuance of DIP loans and principal payments under finance lease and equipment financing obligations.

For the three months ended June 30, 2023, net cash used in financing activities of \$0.7 million was due to principal payments under deferred financing costs, finance lease and equipment financing obligations.

Contractual Obligations

Below is a summary of short-term and long-term anticipated cash requirements under contractual obligations existing as of June 30, 2024:

	2024	After 2024	Total
Recorded contractual obligations:			
DIP Facility	\$ 11,738	\$ —	\$ 11,738
Senior Convertible Notes	14,960	—	14,960
Subordinated Convertible Notes	20,700	—	20,700
Other*	1,129	10,835	11,964
Total	\$ 48,527	\$ 10,835	\$ 59,362

**(1) Represents finance and operating lease liabilities, equipment financing obligations*

As of June 30, 2024, we did not have any off-balance sheet arrangements that have, or are reasonably likely to have, a current or future material effect on our condensed consolidated financial condition, results of operations, liquidity, capital expenditures or capital resources.

Critical Accounting Policies and Significant Judgments and Estimates

Our condensed consolidated financial statements are prepared in accordance with U.S. GAAP. The preparation of our condensed consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect certain reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenue and expenses during the reporting period.

There have been no material changes to our critical accounting policies and estimates as compared to the critical accounting policies and estimates described in our Annual Report on Form 10-K for the year ended December 31, 2023. For more information, please refer to our Annual Report on Form 10-K as well as “Note 2—Basis of Accounting and Significant Accounting Policies” to the unaudited condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Emerging Growth Company and Smaller Reporting Company Status

ProSomnus is an “emerging growth company,” as defined in Section 2(a) of the Securities Act, as modified by the Jumpstart Our Business Startups Act of 2012 (the “JOBS Act”), and it may take advantage of certain exemptions from various reporting requirements that are applicable to other public companies that are not emerging growth companies including, but not limited to, not being required to comply with the independent registered public accounting firm attestation requirements of Section 404 of the Sarbanes Oxley Act, reduced disclosure obligations regarding executive compensation in its periodic reports and proxy statements, and exemptions from the requirements of holding a nonbinding advisory vote on executive compensation and stockholder approval of any golden parachute payments not previously approved.

Further, Section 102(b)(1) of the JOBS Act exempts emerging growth companies from being required to comply with new or revised financial accounting standards until private companies (that is, those that have not had a Securities Act registration statement declared effective or do not have a class of securities registered under the Exchange Act) are required to comply with the new or revised financial accounting standards.

The JOBS Act provides that a company can elect to opt out of the extended transition period and comply with the requirements that apply to non-emerging growth companies, but any such election to opt out is irrevocable. ProSomnus has elected not to opt out of such extended transition period which means that when a standard is issued or revised and it has different application dates for public or private companies, ProSomnus, as an emerging growth company, can adopt the new or revised standard at the time private companies adopt the new or revised standard. This may make comparison of ProSomnus’s financial statements with another public company which is neither an emerging growth company nor an emerging growth company which has opted out of using the extended transition period difficult or impossible because of the potential differences in accounting standards used.

Additionally, we are a “smaller reporting company” as defined in Item 10(f)(1) of Regulation S-K. Smaller reporting companies may take advantage of certain reduced disclosure obligations, including, among other things, providing only two years of audited financial statements. We will remain a smaller reporting company until the last day of the fiscal year in which (i) the market value of our ordinary shares held by non-affiliates exceeds \$250 million as of the prior June 30 or (ii) our annual revenue exceeded \$100 million during such completed fiscal year and the market value of our ordinary shares held by non-affiliates exceeds \$700 million as of the prior June 30.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

As a “smaller reporting company,” as defined by Item 10 of Regulation S-K, we are not required to provide information under Item 3.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures.

Our management, with the participation of our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), evaluated the effectiveness of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act), as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on that evaluation, our CEO and CFO concluded that, as of June 30, 2024, due to the material weakness described in our Annual Report on Form 10-K for the year ended December 31, 2023, our internal controls and procedures were not effective.

Inherent Limitations on Effectiveness of Controls

Our management, including our CEO and our CFO, do not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all errors 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. 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. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of a simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people, or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of control effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

Changes in Internal Control over Financial Reporting

There were no changes in our internal controls over financial reporting identified in management’s evaluation pursuant to Rules 13a-15(d) and 15d-15(d) of the Exchange Act that occurred during the quarter ended June 30, 2024, that materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II — OTHER INFORMATION

Item 1. Legal Proceedings

On May 7, 2024, the Company commenced voluntary cases under Chapter 11 of the Bankruptcy Code in the Bankruptcy Court. See Note 1 and Note 16 in our notes to consolidated financial statements elsewhere in this Quarterly Report on Form 10-Q for a further discussion of such cases.

From time to time, we may become involved in litigation or other legal proceedings. We are not currently a party to any other litigation or legal proceedings that are likely to have a material adverse effect on our business. Regardless of outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources and other factors.

Item 1A. Risk Factors

Except for the risk factors included below, there have been no material changes to the risk factors previously disclosed in “Part I - Item 1A. Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2023, filed with the SEC on March 27, 2024.

We are in the process of a Chapter 11 reorganization under the Bankruptcy Code, which may cause our securities to decrease in value and may render our Common Stock and other equity securities worthless.

As previously reported in our Current Report on Form 8-K filed with the SEC on May 8, 2024, on May 7, 2024, we commenced voluntary cases under Chapter 11 of the Bankruptcy Code in the Bankruptcy Court. The Chapter 11 proceedings are being jointly administered by the Bankruptcy Court under the lead case *In re ProSomnus, Inc.*, Case No. 24-10972 (JTD). Our proposed post-bankruptcy capital structure will be set pursuant to the Reorganization Plan that requires Bankruptcy Court approval. If our proposed Reorganization Plan is approved by the Bankruptcy Court, there will be no recovery for holders of our existing equity interests. Consequently, the holders of our equity securities will receive no recovery in the Chapter 11 reorganization and our equity securities, including our Common Stock and our warrants, will be worthless.

Any trading in our securities during the pendency of our Chapter 11 reorganization is highly speculative and poses substantial risks to purchasers thereof, as the price of our securities may decrease in value or become worthless. Recoveries, if any, in the Chapter 11 reorganization for holders of our securities, including our Common Stock and warrants, will depend upon, among other things, our ability to consummate the Reorganization Plan with respect to the Chapter 11 reorganization and the value of our assets. Our future results are also dependent upon our successful implementation of the Reorganization Plan.

Our being subject to a long period of operations under the Bankruptcy Court’s protection could have a material adverse effect on our business, financial condition, results of operations and liquidity. So long as the proceedings related to the Chapter 11 reorganization continue, our senior management will be required to spend a significant amount of time and effort dealing with the reorganization instead of focusing exclusively on our business operations. A prolonged period of operating under the Bankruptcy Court’s protection also may make it more difficult to retain management and other key personnel necessary to the success and growth of our business. In addition, the longer the proceedings related to the Chapter 11 reorganization continue, the more likely it is that our clients, investors, strategic partners and service providers will lose confidence in our ability to reorganize our businesses successfully and seek to establish alternative advisory and/or other commercial relationships, as applicable. Furthermore, so long as the Chapter 11 reorganization continues, we will be required to incur substantial costs for professional fees and other expenses associated with the administration of the Chapter 11 reorganization.

During the Chapter 11 reorganization, we expect our financial results to be volatile as restructuring activities and expenses, contract terminations and rejections, and claims assessments significantly impact our consolidated financial statements. As a result, our historical financial performance is likely not indicative of our financial performance after the date of the filing of the Chapter 11 reorganization.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

Item 6. Exhibits

See Exhibit Index.

EXHIBIT INDEX

Exhibit No.	Description
3.1	Amended and Restated Certificate of Incorporation of ProSomnus, Inc. (previously filed as Exhibit 3.1 of Form 8-K filed by ProSomnus with the SEC on December 13, 2022).
3.2	Amended and Restated Bylaws of ProSomnus, Inc. (previously filed as Exhibit 3.2 of Form 8-K filed by ProSomnus with the SEC on December 13, 2022).
3.3	Certificate of Designations (previously filed as Exhibit 3.1 of the Company's Current Report on Form 8-K filed with the SEC on September 21, 2023).
10.1	Form of Senior Subordinate Superiority Secured Debtor-in-Possession Credit Agreement, among ProSomnus, Inc., the Guarantors party thereto, the Lenders party thereto, and the Wilmington Savings Fund Society, FSB (previously filed as Exhibit 10.2 on Form 8-K filed with the SEC on May 8, 2024).
10.2	Restructuring Support Agreement between the Company, certain of its existing affiliates and subsidiaries of the Company, and certain sponsoring Senior Noteholders and Subordinated Noteholders, dated as of May 7, 2024.
31.1†	Certification of Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2†	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1*	Certification of Chief Executive Officer Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2*	Certification of 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.INS†	XBRL Instance Document – the instance document does not appear in the Interactive Data File because its XBRL tags are embedded within the Inline XBRL document
101.SCH†	XBRL Taxonomy Extension Schema Document
101.CAL†	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF†	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB†	XBRL Taxonomy Extension Label Linkbase Document
101.PRE†	XBRL Taxonomy Extension Presentation Linkbase Document
104†	Cover Page Interactive Data File (formatted in Inline XBRL and contained in Exhibit 101)

† Filed herewith.

* Furnished herewith

SIGNATURES

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

Date: July 31, 2024

PROSOMNUS, INC.

By: s/ Len Liptak
Name: Len Liptak
Title: Chief Executive Officer
(Principal Executive Officer)

By: /s/ Brian Dow
Name: Brian Dow
Title: Chief Financial Officer
(Principal Financial Officer)

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

I, Len Liptak, Chief Executive Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of ProSomnus, 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(s) 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(s) 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.

Dated: July 31, 2024

By: /s/ Len Liptak

Name: Len Liptak

Title: Chief Executive Officer
(Principal Executive Officer)

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

I, Brian Dow, Chief Financial Officer, certify that:

1. I have reviewed this quarterly report on Form 10-Q of ProSomnus, 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(s) 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(s) 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.

Dated: July 31, 2024

By: /s/ Brian Dow

Name: Brian Dow

Title: Chief Financial Officer

(Principal Financial Officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. § 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of ProSomnus, Inc. (the "Company") hereby certifies, to the best of my knowledge, that:

- (i) the accompanying Quarterly Report on Form 10-Q of the Company for the fiscal quarter ended June 30, 2024 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934; and
- (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: July 31, 2024

By: /s/ Len Liptak

Name: Len Liptak

Title: Chief Executive Officer
(Principal Executive Officer)

**CERTIFICATION PURSUANT TO 18 U.S.C. SECTION 350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. § 1350, as created by Section 906 of the Sarbanes-Oxley Act of 2002, the undersigned officer of ProSomnus, Inc. (the "Company") hereby certifies, to the best of my knowledge, that:

- (i) the accompanying Quarterly Report on Form 10-Q of the Company for the fiscal quarter ended June 30, 2024 (the "Report") fully complies with the requirements of Section 13(a) or Section 15(d), as applicable, of the Securities Exchange Act of 1934; and
- (ii) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: July 31, 2024

By: /s/ Brian Dow

Name: Brian Dow

Title: Chief Financial Officer

(Principal Financial and Accounting Officer)
