DEXCOM INC
Form 10-Q
May 01, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2014

.. 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 000-51222
DEXCOM, INC.
(Exact name of Registrant as specified in its charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	33-0857544 (I.R.S. Employer Identification No.)
6340 Sequence Drive San Diego, California (Address of Principal Executive Offices)	92121 (Zip Code)

Registrant's Telephone Number, including area code: (858) 200-0200
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 ý No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act (Check one):

Large Accelerated Filer	ý	Accelerated Filer	o
Non-Accelerated Filer	o (Do not check if a smaller reporting company)	Smaller Reporting Company	o

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
As of April 28, 2014, 74,917,857 shares of the Registrant's common stock were outstanding.

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DexCom, Inc.
Consolidated Balance Sheets
(In millions—except par value data)

	March 31, 2014 (Unaudited)	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$45.7	$43.2
Short-term marketable securities, available-for-sale	11.7	11.4
Accounts receivable, net	23.8	26.1
Inventory	8.9	9.0
Prepaid and other current assets	3.5	3.4
Total current assets	93.6	93.1
Property and equipment, net	22.9	20.7
Restricted cash	1.0	1.0
Intangible assets, net	3.4	3.6
Goodwill	3.2	3.2
Other assets	0.8	0.9
Total assets	$124.9	$122.5
Liabilities and stockholders' equity		
Current liabilities:		
Accounts payable and accrued liabilities	$15.9	$14.1
Accrued payroll and related expenses	11.0	15.1
Current portion of long-term debt	2.2	2.2
Current portion of deferred revenue	0.6	0.7
Total current liabilities	29.7	32.1
Other liabilities	1.1	1.7
Long-term debt, net of current portion	4.1	4.6
Total liabilities	34.9	38.4
Commitments and contingencies (Note 4)		
Stockholders' equity:		
Preferred stock, $0.001 par value, 5.0 shares authorized; no shares issued and outstanding at March 31, 2014 and December 31, 2013, respectively	—	—
Common stock, $0.001 par value, 100.0 authorized; 75.1 and 74.8 issued and outstanding, respectively, at March 31, 2014; and 72.8 and 72.5 shares issued and outstanding, respectively, at December 31, 2013	0.1	0.1
Additional paid-in capital	577.9	559.5
Accumulated other comprehensive loss	(0.1)	(0.1)
Accumulated deficit	(487.9)	(475.4)
Total stockholders' equity	90.0	84.1
Total liabilities and stockholders' equity	$124.9	$122.5

See accompanying notes

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DexCom, Inc.
Consolidated Statements of Operations
(In millions—except per share data)
(Unaudited)

	Three Months Ended March 31,	
	2014	2013
Product revenue	$46.7	$27.8
Development grant and other revenue	0.4	1.8
Total revenue	47.1	29.6
Product cost of sales	16.9	12.4
Development and other cost of sales	0.4	0.7
Total cost of sales	17.3	13.1
Gross profit	29.8	16.5
Operating expenses		
Research and development	14.5	9.3
Selling, general and administrative	27.6	18.1
Total operating expenses	42.1	27.4
Operating loss	(12.3)	(10.9)
Interest expense	(0.2)	(0.2)
Net loss	$(12.5)	$(11.1)
Basic and diluted net loss per share	$(0.17)	$(0.16)
Shares used to compute basic and diluted net loss per share	73.3	69.8

See accompanying notes

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DexCom, Inc.
Consolidated Statements of Comprehensive Loss
(In millions)
(Unaudited)

	Three Months Ended March 31,	
	2014	2013
Net loss	$(12.5)	$(11.1)
Unrealized gain (loss) on short-term available-for-sale marketable securities	—	—
Foreign currency translation gain (loss)	—	—
Comprehensive loss	$(12.5)	$(11.1)

See accompanying notes

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DexCom, Inc.
Consolidated Statements of Cash Flows
(In millions)
(Unaudited)

	Three Months Ended March 31,	
	2014	2013
Operating activities		
Net loss	$(12.5)	$(11.1)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	1.9	1.8
Share-based compensation	8.7	5.0
Accretion and amortization related to marketable securities, net	—	0.1
Amortization of debt issuance costs	0.1	—
Change in fair value of contingent consideration	1.2	0.3
Other non-cash expenses	0.1	—
Changes in operating assets and liabilities:		
Accounts receivable	2.2	3.2
Inventory	0.2	(0.1)
Prepaid and other assets	—	(0.1)
Accounts payable and accrued liabilities	(0.1)	(0.5)
Accrued payroll and related expenses	(4.0)	(2.0)
Deferred revenue	(0.1)	(1.1)
Deferred rent and other liabilities	(0.1)	—
Net cash used in operating activities	(2.4)	(4.5)
Investing activities		
Purchase of available-for-sale marketable securities	(3.0)	(4.9)
Proceeds from the maturity of available-for-sale marketable securities	2.6	18.9
Purchase of property and equipment	(3.9)	(1.4)
Net cash provided by (used in) investing activities	(4.3)	12.6
Financing activities		
Net proceeds from issuance of common stock	9.7	2.7
Repayment of long-term debt	(0.5)	—
Net cash provided by financing activities	9.2	2.7
Increase in cash and cash equivalents	2.5	10.8
Cash and cash equivalents, beginning of period	43.2	8.1
Cash and cash equivalents, ending of period	$45.7	$18.9

See accompanying notes

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DexCom, Inc.
Notes to Consolidated Financial Statements
(Unaudited)

1. Organization and Summary of Significant Accounting Policies

Organization and Business

DexCom, Inc. is a medical device company focused on the design, development and commercialization of continuous glucose monitoring ("CGM") systems for ambulatory use by people with diabetes and by healthcare providers in the hospital for the treatment of people with and without diabetes. Unless the context requires otherwise, the terms "we," "us," "our," the "company," or "DexCom" refer to DexCom, Inc. and its subsidiaries.

Basis of Presentation

We have incurred operating losses since our inception and have an accumulated deficit of $487.9 million at March 31, 2014. As of March 31, 2014, we had available cash, cash equivalents and short-term marketable securities totaling $57.4 million, excluding $1.0 million of restricted cash, and working capital of $63.9 million. Our ability to transition to attaining profitable operations is dependent upon achieving a level of revenues adequate to support our cost structure. If events or circumstances occur such that we do not meet our operating plan as expected, we may be required to reduce planned increases in compensation related expenses or other operating expenses which could have an adverse impact on our ability to achieve our intended business objectives. We believe our working capital resources will be sufficient to fund our operations through at least March 31, 2015.

We have prepared the accompanying unaudited consolidated financial statements in accordance with accounting principles generally accepted in the United States of America ("U.S. GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and disclosures required by U.S. GAAP for complete financial statements. In the opinion of management, all adjustments, which include only normal recurring adjustments considered necessary for a fair presentation (except for the changes in estimates described below), have been included. Operating results for the three months ended March 31, 2014 are not necessarily indicative of the results that may be expected for the year ending December 31, 2014. These unaudited consolidated financial statements should be read in conjunction with the audited financial statements and related notes thereto for the year ended December 31, 2013 included in the Annual Report on Form 10-K filed by us with the Securities and Exchange Commission on February 20, 2014.

Principles of Consolidation

The consolidated financial statements include the accounts of DexCom and our wholly owned subsidiaries, DexCom AB and SweetSpot Diabetes Care, Inc. ("SweetSpot"). All significant intercompany balances and transactions have been eliminated in consolidation.

Segment Reporting

An operating segment is identified as a component of a business that has discrete financial information available, and one for which the chief operating decision maker must decide the level of resource allocation. In addition, the guidance for segment reporting indicates certain quantitative thresholds. The operations of SweetSpot, our subsidiary, does not meet the definition of an operating segment and are currently not material, but may become material in the future. We currently consider our operations to be, and manage our business as, one operating segment.

Use of Estimates

The preparation of consolidated financial statements in conformity with U.S. GAAP requires us to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ from these estimates. Significant estimates include excess or obsolete inventories, valuation of inventory, warranty accruals, employee bonus, clinical trial expenses, allowance for bad debt, accounting for the SweetSpot acquisition including contingent consideration, and share-based compensation expense.

Share-Based Compensation

We recorded $8.7 million in share-based compensation expense during the three months ended March 31, 2014, compared to $5.0 million during the three months ended March 31, 2013. At March 31, 2014, unrecognized estimated compensation costs related to unvested stock options and restricted stock units totaled $140.0 million and are expected to be recognized through

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2018. We issued performance restricted stock units (the “Performance Awards”) in connection with our acquisition of SweetSpot in March 2012. The performance targets for these Performance Awards are tied to earnings before interest, taxes, depreciation and amortization (“EBITDA”) for fiscal years 2013 and 2014. We recognize expense for the Performance Awards when it is probable that the EBITDA targets will be met. The performance target for fiscal 2013 EBITDA was not achieved. At March 31, 2014, we had $2.2 million of unrecognized share-based compensation expense related to the Performance Awards for the fiscal 2014 performance target. We use the grant date fair value of our common stock for valuing restricted stock unit awards. Our determination of the fair value of share-based payment awards on the date of grant is affected by our stock price. Compensation costs will be adjusted for future changes in estimated forfeitures.

Revenue Recognition

We sell our durable systems and disposable units through a direct sales force in the United States and through distribution arrangements in the United States, Canada, Australia, New Zealand, and in portions of Europe, the Middle East and Latin America. Components are individually priced and can be purchased separately or together. We receive payment directly from customers who use our products, as well as from distributors, organizations and third-party payors. Our durable system includes a reusable transmitter, a receiver, a power cord, data management software and a USB cable. Disposable sensors for use with the durable system are sold separately in packages of four. The initial durable system price is not dependent upon the purchase of any amount of disposable sensors.

Revenue is recognized when persuasive evidence of an arrangement exists, delivery has occurred or services have been rendered, the price is fixed or determinable, and collectability is reasonably assured. Revenue on product sales is generally recognized upon shipment, which is when title and the risk of loss have been transferred to the customer and there are no other post shipment obligations. With respect to customers who directly pay for products, the products are generally paid for at the time of shipment using a customer’s credit card and do not include customer acceptance provisions. We recognize revenue from contracted insurance payors based on the contracted rate. For non-contracted insurance payors, we obtain prior authorization from the payor and recognize revenue based on the estimated collectible amount and historical experience. We also receive a prescription or statement of medical necessity and, for insurance reimbursement customers, an assignment of benefits prior to shipment.

We provide a “30-day money back guarantee” program whereby customers who purchase a durable system and a package of four disposable sensors may return the durable system for any reason within thirty days of purchase and receive a full refund of the purchase price of the durable system. We accrue for estimated returns, refunds and rebates by reducing revenues and establishing a liability account at the time of shipment based on historical experience.

We have entered into distribution agreements with Byram Healthcare and their subsidiaries ("Byram"), RGH Enterprises, Inc. (“Edgepark”) and other distributors that allow the distributors to sell our durable systems and disposable units. Revenue on product sales to distributors is generally recognized at the time of shipment, which is when title and risk of loss have been transferred to the distributor and there are no other post-shipment obligations. Revenue is recognized based on contracted prices and invoices are either paid by check following the issuance of a purchase order or letter of credit, or they are paid by wire at the time of placing the order. Terms of distributor orders are generally Freight on Board (“FOB”) shipping point (Free Carrier (“FCA”) shipping point for international orders). Distributors do not have rights of return per their distribution agreement outside of our standard warranty. The distributors typically have a limited time frame to notify us of any missing, damaged, defective or non-conforming products. For any such products, we shall either, at our option, replace the portion of defective or non-conforming product at no additional cost to the distributor or cancel the order and refund any portion of the price paid to us at that time for the sale in question.

We shipped product directly to certain distributors’ customers and recognized $6.1 million in revenue, which represents 13% of our total revenues for the three months ended March 31, 2014, compared to $4.9 million in revenue, which represents 17% of our total revenues for the same period in 2013. With respect to other distributors that stock inventory of our product and fulfill orders from their inventory, we shipped product to these distributors and recognized $26.0 million in revenue from these arrangements, which represents 55% of our total revenues for the three months ended March 31, 2014, compared to $11.9 million in revenue from these arrangements, which represents 40% of our total revenues for the same period in 2013. We monitor shipments to, and on-hand inventory levels of,

these distributors, and at March 31, 2014, these distributors had limited amounts of our product in their inventory. We have collaborative license and development arrangements with strategic partners for the development and commercialization of products utilizing our technologies. The terms of these agreements typically include multiple deliverables by us (for example, license rights, provision of research and development services and manufacture of clinical materials) in exchange for consideration to us of some combination of non-refundable license fees, funding of research and development activities, payments based upon achievement of clinical development milestones and royalties in the form of a designated

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percentage of product sales or profits. With the exception of royalties, these types of consideration are classified as development grant and other revenue in our consolidated statements of operations and are generally recognized over the service period except for substantive milestone payments, which are generally recognized when the milestone is achieved. In determining whether each milestone is substantive, we considered whether the consideration earned by achieving the milestone should (i) be commensurate with either (a) our performance to achieve the milestone or (b) the enhancement of value of the item delivered as a result of a specific outcome resulting from our performance to achieve the milestone, (ii) relate solely to past performance and (iii) be reasonable relative to all deliverables and payment terms in the arrangement. We recognize royalties in the period in which we obtain the royalty report, which is necessary to determine the amount of royalties we are entitled to receive.

Non-refundable license fees are recognized as revenue when we have a contractual right to receive such payment, the contract price is fixed or determinable, the collection of the resulting receivable is reasonably assured and we have no further performance obligations under the license agreement. Multiple element arrangements, such as license, development and other multiple element service arrangements, are analyzed to determine how the arrangement consideration should be allocated among the separate units of accounting, or whether they must be accounted for as a single unit of accounting.

For transactions containing multiple element arrangements, we consider deliverables as separate units of accounting and recognize deliverables as revenue upon delivery only if (i) the deliverable has standalone value and (ii) if the arrangement includes a general right of return relative to the delivered item(s), delivery or performance of the undelivered item(s) is probable and substantially controlled by us. We allocate consideration to the separate units of accounting using the relative selling price method, in which allocation of consideration is based on vendor-specific objective evidence (“VSOE”) if available, third-party evidence (“TPE”), or if VSOE and TPE are not available, management’s best estimate of a standalone selling price for elements.

We use judgment in estimating the value allocable to the deliverables in an agreement based on our estimate of the fair value or relative selling price attributable to the related deliverables and the consideration from such an agreement is typically recognized as product revenue or development grant and other revenue. For arrangements that are accounted for as a single unit of accounting, total payments under the arrangement are recognized as revenue on a straight-line basis over the period we expect to complete our performance obligations. We review the estimated period of our performance obligations on a periodic basis and update the recognition period as appropriate. The cumulative amount of revenue earned is limited to the cumulative amount of payments we are entitled to as of the period ending date.

If we cannot reasonably estimate when our performance obligation either ceases or becomes inconsequential, then revenue is deferred until we can reasonably estimate when the performance obligation ceases or becomes inconsequential. Revenue is then recognized over the remaining estimated period of performance. Deferred revenue amounts are classified as current liabilities to the extent that revenue is expected to be recognized within one year. Significant management judgment is required in determining the level of effort required under an arrangement and the period over which we are expected to complete our performance obligations under an arrangement.

Warranty Accrual

Estimated warranty costs are recorded at the time of shipment. We estimate future warranty costs by analyzing historical warranty experience for the timing and amount of returned product, and these estimates are evaluated on at least a quarterly basis to determine the continued appropriateness of such assumptions.

Foreign Currency

The financial statements of our non-U.S. subsidiary, whose functional currency is the Swedish Krona, are translated into U.S. dollars for financial reporting purposes. Assets and liabilities are translated at period-end exchange rates, and revenue and expense transactions are translated at average exchange rates for the period. Cumulative translation adjustments are recognized as part of comprehensive income and are included in accumulated other comprehensive income in the consolidated balance sheet. Gains and losses on transactions denominated in other than the functional currency are reflected in operations. To date the results of operations of this subsidiary and related translation adjustments have not been material in our consolidated results.

Comprehensive Loss

We report all components of comprehensive loss, including net loss, in the consolidated financial statements in the period in which they are recognized. Comprehensive loss is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. Net loss and other comprehensive loss, including unrealized gains and

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losses on marketable securities and foreign currency translation adjustments, are reported, net of their related tax effect, to arrive at comprehensive loss.

Inventory

Inventory is valued at the lower of cost or market value on a part-by-part basis that approximates first in, first out. We make adjustments to reduce the cost of inventory to its net realizable value, if required, for estimated excess, obsolete and potential scrapped inventories. Factors influencing these adjustments include inventories on hand and on order compared to estimated future usage and sales for existing and new products, as well as judgments regarding quality control testing data, and assumptions about the likelihood of scrap and obsolescence. Once written down the adjustments are considered permanent and are not reversed until the related inventory is sold or disposed.

Short-Term Marketable Securities

We have classified our short-term marketable securities as “available-for-sale” and carry them at fair value with unrealized gains and losses, if any, reported as a separate component of stockholders' equity and included in comprehensive loss. Realized gains and losses are calculated using the specific identification method and recorded as interest income.

Fair Value Measurements

The fair value hierarchy described by the authoritative guidance for fair value measurements is based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value and include the following:

Level 1—Quoted prices in active markets for identical assets or liabilities.

Level 2—Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

We base the fair value of our Level 1 financial instruments that are in active markets using quoted market prices for identical instruments. Our Level 1 financial instruments include certificates of deposit.

We obtain the fair value of our Level 2 financial instruments, which are not in active markets, from a primary professional pricing source using quoted market prices for identical or comparable instruments, rather than direct observations of quoted prices in active markets. Fair value obtained from this professional pricing source can also be based on pricing models whereby all significant observable inputs, including maturity dates, issue dates, settlement date, benchmark yields, reported trades, broker-dealer quotes, issue spreads, benchmark securities, bids, offers or other market related data, are observable or can be derived from, or corroborated by, observable market data for substantially the full term of the asset.

We validate the quoted market prices provided by our primary pricing service by comparing the fair values of our Level 2 marketable securities portfolio balance provided by our primary pricing service against the fair values of our Level 2 marketable securities portfolio balance provided by our investment managers.

Certain contingent consideration liabilities are classified within Level 3 of the fair value hierarchy because they use unobservable inputs. For those liabilities, fair value is determined using a probability-weighted discounted cash flow model, the significant inputs, which include the probability and expected timing of achievement and the discount rate, are not observable in the market.

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The following table represents our fair value hierarchy for our financial assets (cash equivalents, marketable securities and restricted cash) and liabilities measured at fair value on a recurring basis as of March 31, 2014 (in millions):

	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total
Cash equivalents	$—	$24.4	$—	$24.4
Marketable securities, available for sale				
U.S. government agencies	—	8.7	—	8.7
Corporate debt	—	2.1	—	2.1
Commercial paper	—	0.9	—	0.9
Total marketable securities, available for sale	$—	$11.7	$—	$11.7
Restricted cash	$1.0	$—	$—	$1.0
Contingent consideration	$—	$—	$5.4	$5.4

The following table represents our fair value hierarchy for our financial assets (cash equivalents, marketable securities and restricted cash) and liabilities measured at fair value on a recurring basis as of December 31, 2013 (in millions):

	Fair Value Measurements Using			
	Level 1	Level 2	Level 3	Total
Cash equivalents	$—	$28.7	$—	$28.7
Marketable securities, available for sale				
U.S. government agencies	—	8.9	—	8.9
Corporate debt	—	2.5	—	2.5
Total marketable securities, available for sale	$—	$11.4	$—	$11.4
Restricted cash	$1.0	$—	$—	$1.0
Contingent consideration	$—	$—	$4.2	$4.2

The book values of cash equivalents, short-term marketable securities, accounts receivable and accounts payable approximate their respective fair values due to the short-term nature of these instruments. The book value of long-term debt approximates fair value due to the recent issuance.

Contingent Consideration Liability

In connection with the acquisition of SweetSpot in March 2012, at the closing of the acquisition, we agreed to issue up to an additional 357,176 shares of our common stock upon the achievement of certain specified milestones, which is classified as contingent consideration. The fair value of the contingent consideration at the closing of $2.2 million was determined using a probability-weighted discounted cash flow model, the significant inputs of which are not observable in the market. The key assumptions in applying this approach are the interest rate and the estimated probabilities and timing assigned to the milestones being achieved. During 2012, approximately $1.1 million related to the contingent consideration was earned and paid through the issuance of 89,296 shares of our common stock, with up to 267,880 shares of our common stock that may still be issued upon the achievement of remaining performance milestones. We did not issue any shares of common stock for milestone payments in 2013. Changes in fair value are recorded in the consolidated statements of operations as research and development expense since the milestones are related to development activities.

The following table sets forth the change in the estimated fair value for our liabilities measured on a recurring basis using significant unobservable inputs (Level 3) (in millions):

	Three Months Ended March 31,	
	2014	2013
Fair value measurement at the beginning of period	$4.2	$1.7
Changes in fair value measurement included in operating expenses	1.2	0.3
Fair value measurement at end of period	$5.4	$2.0

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Impairment of Goodwill and Intangible Assets

We test goodwill and intangible assets with indefinite lives for impairment on an annual basis. Also, between annual tests we test for impairment if events and circumstances indicate it is more likely than not that the fair value is less than the carrying value. Events that would indicate impairment and trigger an interim impairment assessment include, but are not limited to, current economic and market conditions, including a decline in market capitalization, a significant adverse change in legal factors, business climate or operational performance of the business and an adverse action or assessment by a regulator.

Property and Equipment

Property and equipment is stated at cost and depreciated over the estimated useful lives of the assets, generally three years for computer equipment, four years for machinery and equipment, and five years for furniture and fixtures, using the straight-line method. Leasehold improvements are stated at cost and amortized over the shorter of the estimated useful lives of the assets or the lease term.

Recent Accounting Guidance

In July 2013, the FASB issued authoritative guidance for Presentation of an Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists, which provides explicit guidance on the financial statement presentation of an unrecognized tax benefit when a net operating loss carryforward, a similar tax loss, or a tax credit carryforward exists. The guidance is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013, with early adoption permitted. We adopted this guidance on January 1, 2014, and the adoption of this guidance did not have a material impact on our consolidated financial statements or related financial statement disclosures.

2. Net Loss Per Common Share

Basic net loss per share attributable to common stockholders is calculated by dividing the net loss attributable to common stockholders by the weighted-average number of common shares outstanding for the period, without consideration for common stock equivalents. Diluted net loss per share attributable to common stockholders is computed by dividing the net loss attributable to common stockholders by the weighted-average number of common share equivalents outstanding for the period determined using the treasury-stock method. For purposes of this calculation, options and unvested restricted stock units are considered to be common stock equivalents and are only included in the calculation of diluted net loss per share when their effect is dilutive.

Historical outstanding anti-dilutive securities not included in diluted net loss per share attributable to common stockholders calculation (in millions):

	Three Months Ended March 31,	
	2014	2013
Options outstanding to purchase common stock	4.8	7.0
Unvested restricted stock units	4.7	4.0
Total	9.5	11.0

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3. Financial Statement Details (in millions)

Short Term Marketable Securities, Available for Sale

Short term marketable securities, consisting solely of debt securities with contractual maturities of less than one year were as follows:

	March 31, 2014			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
U.S. government agencies	$8.7	$—	$—	$8.7
Corporate debt	2.1	—	—	2.1
Commercial paper	0.9	—	—	0.9
Total	$11.7	$—	$—	$11.7

	December 31, 2013			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Market Value
U.S. government agencies	$8.9	$—	$—	$8.9
Corporate debt	2.5	—	—	2.5
Total	$11.4	$—	$—	$11.4

Inventory

	March 31, 2014	December 31, 2013
Raw materials	$4.5	$4.8
Work-in-process	0.9	0.3
Finished goods	3.5	3.9
Total	$8.9	$9.0

Accounts Payable and Accrued Liabilities

	March 31, 2014	December 31, 2013
Accounts payable trade	$4.8	$4.2
Accrued tax, audit, and legal fees	1.1	1.2
Clinical trials	0.2	0.3
Accrued other including warranty	4.4	4.8
Acquisition-related liabilities	5.4	3.6
Total	$15.9	$14.1

Accrued Warranty

	Three Months Ended March 31,	
	2014	2013
Beginning balance	$0.9	$0.3
Charges to costs and expenses	1.0	0.5
Costs incurred	(1.1)	(0.6)
Ending balance	$0.8	$0.2

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4. Commitments and Contingencies

Long-Term Debt

In November 2012, we entered into a loan and security agreement (the “Loan Agreement”) that provides for (i) a $15.0 million revolving line of credit and (ii) a total term loan of up to $20.0 million (the "Term Loan"), in both cases, to be used for general corporate purposes. The borrowings under the Loan Agreement are collateralized by a first priority security interest in substantially all of our assets with a negative pledge on our intellectual property.

The revolving line of credit is an interest-only financing that bears an interest rate equal to the prime rate plus 0.5% and requires repayment of principal at the maturity date of November 2015. Available funds, which were $15.0 million as of March 31, 2014, up to the borrowing base of 80% of eligible accounts receivables, under the revolving line of credit can be drawn at any time, and repaid funds can be redrawn. No amounts have been drawn against the revolving line of credit.

Per the Loan Agreement, $7.0 million was advanced under the Term Loan at the funding date in November 2012 and up to $13.0 million in additional funds was available upon our request from June 1, 2013 to September 30, 2013 (the "Draw Period"). In August 2013, the Loan Agreement was amended to change the Draw Period for the additional funds under the Term Loan to January 1, 2014 through March 31, 2014, at which time the Draw Period expired. The Term Loan bears a fixed interest rate equal to the three-year treasury rate at the time of advance plus 6.94% and requires payment of interest only for the first year and amortized payments of interest and principal thereafter through the maturity date of November 2016.

The aggregate debt issuance costs and fees incurred with respect to the issuance of the Loan Agreement were $1.1 million. These costs have been capitalized as debt issuance costs on our consolidated balance sheet as other assets. Fees related to the revolving line of credit are being amortized through the maturity date of November 2015. Issuance costs and fees related to the term loan are being amortized through the maturity date of November 2016 using the effective interest method. As of March 31, 2014, the remaining unamortized issuance costs and fees totaled $0.5 million. Principal repayment obligations under the Loan Agreement as of March 31, 2014 were as follows (in millions):

Fiscal Year Ending	
Remainder of 2014	$1.7
2015	2.3
2016	2.3
Total	$6.3

Leases

In April 2006, we entered into an office lease agreement for facilities located in San Diego, California. In August 2010, we entered into a First Amendment to Office Lease (the “Lease Amendment”) with respect to facilities in the buildings at 6340 Sequence Drive and 6310 Sequence Drive, each in San Diego, California (the “Buildings”). Under the Lease Amendment, we leased additional space in the Buildings. The lease term for the Buildings extends through November 2016 and we have an option to renew the lease upon the expiration of the initial term for an additional five years. These facility leases have annual rental increases ranging from approximately 2.5% to 4.0%. The difference between the straight-line expense over the term of the lease and actual amounts paid are recorded as deferred rent. In September 2008, our subsidiary in Sweden entered into a three-year lease for a small shared office space, which was renewed for a three-year term and has a quarterly adjustment clause for rent to increase or decrease in proportion to changes in consumer prices. In July 2012, our subsidiary SweetSpot entered into a five-year lease for a small office space in a multi-tenant commercial building in Portland, Oregon. Rental obligations, excluding real estate taxes, operating costs, and tenant improvement allowances, under all lease agreements as of March 31, 2014 were as follows (in millions):

Fiscal Year Ending	
Remainder of 2014	$2.1
2015	2.9

2016	2.6
Total	$7.6

Total rent expense for the three months ended March 31, 2014 was $0.7 million, compared to $0.8 million for the same period of 2013.

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Litigation

On August 11, 2005, Abbott Diabetes Care, Inc. (“Abbott”) filed a patent infringement lawsuit against us in the United States District Court for the District of Delaware, seeking a declaratory judgment that our continuous glucose monitor infringes certain patents held by Abbott. In August 2005, we moved to dismiss these claims and filed requests for reexamination of the Abbott patents with the United States Patent and Trademark Office (the “Patent Office”) and by March 2006, the Patent Office ordered reexamination of each of the four patents originally asserted against us in the litigation. On June 27, 2006, Abbott amended its complaint to include three additional patents owned or licensed by Abbott which are allegedly infringed by our continuous glucose monitor. On August 18, 2006, the court granted our motion to stay the lawsuit pending reexamination by the Patent Office of each of the four patents originally asserted by Abbott, and the court dismissed one significant infringement claim. In approving the stay, the court also granted our motion to strike, or disallow, Abbott's amended complaint in which Abbott had sought to add three additional patents to the litigation. Subsequent to the court's August 18, 2006 order striking Abbott's amended complaint, Abbott filed a separate action in the U.S. District Court for the District of Delaware alleging patent infringement of the three additional patents it had sought to include in the litigation discussed above. On September 7, 2006, we filed a motion to strike Abbott's new complaint on the grounds that it is redundant of claims Abbott already improperly attempted to inject into the original case, and because the original case is now stayed, Abbott must wait until the court lifts that stay before it can properly ask the court to consider these claims. Alternatively, we asked the court to consolidate the new case with the original case and thereby stay the entirety of the case pending conclusion of the reexamination proceedings in the Patent Office. In February 2007, the Patent Office ordered reexamination of each of the three patents cited in this new lawsuit. On September 30, 2007, the court granted our motion to consolidate the cases and stay the entirety of the case pending conclusion of the reexamination proceedings in the Patent Office relating to all seven patents asserted against us.

On December 31, 2013, Abbott filed a motion with the district court seeking to lift the stay of the two consolidated cases. We filed an opposition to the motion on January 17, 2014, and Abbott filed a reply brief in support of its motion on January 29, 2014. The court has taken the motion under submission, although it is not clear when it will issue a ruling. On December 31, 2013, Abbott filed a new complaint for patent infringement. In that complaint, Abbott alleges that our products, including our SEVEN PLUS and G4 PLATINUM continuous glucose monitoring systems, infringe claims of United States Patent No. 8,175,673. We filed an answer to the complaint on January 23, 2014. On January 28, 2014, we also filed a motion to consolidate the newest case (case no. 1-13-cv-02105-GMS) with the first two cases (case nos.1:05-cv-00509-GMS and 1:06-cv-00514-GMS), and to stay the three cases pending conclusion of all pending reexamination proceedings in the Patent Office.

In connection with this litigation, two of the seven patents that are the subject of the litigation have reexamination requests on appeal at the Patent Office. Certificates of Reexamination were issued for five of the seven patents. In many of these reexamination proceedings, Abbott filed responses with the Patent Office seeking claim construction to differentiate certain claims from the prior art we presented, seeking to amend certain claims to overcome the prior art we presented, canceling claims and/or seeking to add new claims.

In addition, since 2008, Abbott has copied claims from certain of our applications, and stated that it may seek to provoke an interference with certain of our pending applications in the Patent Office. If interference is declared and Abbott prevails in the interference, we would lose certain patent rights to the subject matter defined in the interference. Also since 2008, Abbott has filed 38 reexamination requests seeking to invalidate 31 of our patents. Three of the 38 reexamination requests are in various stages at the Patent Office, and 34 have been issued a Certificate of Reexamination (one Reexamination Request was denied). We have filed responses with the Patent Office seeking claim construction to differentiate certain claims from the prior art presented in the reexaminations, seeking to amend certain claims to overcome the prior art presented in the reexaminations, canceling claims and/or seeking to add new claims. It is possible that the Patent Office may determine that some or all of the claims of our patents subject to the reexamination are invalid. Additionally, Abbott has filed an Opposition to six of our European patents, one of which was not defended and one of which was revoked.

Although it is our position that Abbott's assertions of infringement have no merit, and that the potential interference and reexamination requests by Abbott have no merit, neither the outcome of the litigation nor the amount and range of potential fees associated with the litigation, potential interference or reexamination requests can be assessed, and as of March 31, 2014, no amounts have been accrued.

From time to time, we are subject to various claims and suits arising out of the ordinary course of business, including commercial and employment related matters. We do not expect that the resolution of these matters would have a material adverse effect on our consolidated financial position.

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Purchase Commitments

We are party to various purchase arrangements related to our manufacturing and development activities including materials used in our glucose monitoring systems. As of March 31, 2014, we had purchase commitments with vendors totaling $21.5 million due within one year. There are no material purchase commitments due beyond one year.

5. Development and Other Agreements

Edwards Lifesciences LLC

On November 10, 2008, and as amended on May 5, 2009, we entered into a Collaboration Agreement (the "Collaboration Agreement") with Edwards Lifesciences LLC ("Edwards"). Pursuant to the Collaboration Agreement, we and Edwards agreed to develop jointly and to market an in-hospital automatic blood glucose monitoring system. Under the terms of the Collaboration Agreement, as amended, we will receive a royalty of up to 6% of commercial sales of the product. The Collaboration Agreement provides Edwards with an exclusive license under our intellectual property to the critical care sector in the hospital market. Our development obligations under the Collaboration Agreement were completed in the fourth quarter of 2012.

Each of the milestones related to the Collaboration Agreement is considered to be substantive under the terms of the Collaboration Agreement and, at the outset of the agreement, we were entitled to receive up to $12.0 million in milestones related to regulatory approvals and manufacturing readiness, subject to reductions based on the timing of the receipt of approvals. However, we do not expect to receive all or any of such milestones due to regulatory and joint development delays. We did not recognize any consideration for milestones related to the Collaboration Agreement for the three months ended March 31, 2014 and 2013.

Roche Diagnostics Operations, Inc.

On November 1, 2011, we entered into a non-exclusive Research and Development Agreement (the "Roche Agreement") with Roche Diagnostics Operations, Inc. ("Roche") to integrate a future generation of our continuous glucose monitoring technology with Roche's next generation Accu-Chek insulin delivery system in the United States. On February 20, 2013, Roche provided us with notice that Roche was terminating the Roche Agreement in accordance with its terms. We did not record any development grant and other revenue related to consideration previously received for development efforts for the three months ended March 31, 2014, compared to $0.8 million for the three months ended March 31, 2013. As a result of the termination of the Roche Agreement, we are no longer entitled to receive any further consideration for milestones or development activities pursuant to the Roche Agreement.

Tandem Diabetes Care, Inc.

On February 1, 2012, we entered into a non-exclusive Development and Commercialization Agreement (the "Tandem Agreement") with Tandem Diabetes Care, Inc. ("Tandem") to integrate a future generation of our continuous glucose monitoring technology with Tandem's t:slim™ insulin delivery system in the United States. On January 4, 2013, the Tandem Agreement was amended to allow for the integration of our G4 PLATINUM system with Tandem's t:slim insulin delivery system in the United States. Under the terms of the Tandem Agreement, we are entitled to receive up to $1.0 million to offset certain development, clinical and regulatory expenses. We received an initial payment of $1.0 million as a result of the execution of the Tandem Agreement. We are also entitled to receive up to an additional $2.0 million upon the achievement of certain milestones related to regulatory submissions and approvals as set forth in the Tandem Agreement. Each of the milestones related to the Tandem Agreement is considered to be substantive. We did not recognize any consideration for milestones for the three months ended March 31, 2014 and 2013. We recorded $0.1 million in development grant and other revenue related to consideration previously received for development efforts for the three months ended March 31, 2014, compared to $0.1 million for the same period in 2013.

The Leona M. and Harry B Helmsley Charitable Trust

In July 2013, we were awarded a $4.0 million grant (the "Helmsley Grant") from the Leona M. and Harry B. Helmsley Charitable Trust (the "Helmsley Trust") to accelerate the development of the sixth generation of our advanced glucose-sensing technologies (the "Gen 6 Sensor"). The funding is milestone-based and is contingent upon our meeting specific development milestones related to the Gen 6 Sensor over the next several years. Upon successful commercialization of our Gen 6 Sensor, we are obligated to either (1) make royalty payments based on a percentage of product sales of up to $2.0 million per year for four years, or (2) at our sole election, make a one-time $6.0 million

royalty payment. The Helmsley Grant funds will offset research and development expense as incurred and earned. During 2013, $0.5 million of the Helmsley Grant was received and $0.5 million was earned. During the three months ended March 31, 2014, $0.5 million of the Helmsley Grant was received and $0.5 million was earned.

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

CAUTIONARY NOTE REGARDING FORWARD-LOOKING STATEMENTS

This document, including the following Management's Discussion and Analysis of Financial Condition and Results of Operations, contains forward-looking statements that are based upon current expectations. These forward-looking statements fall within the meaning of the federal securities laws that relate to future events or our future financial performance. In some cases, you can identify forward-looking statements by terminology such as "may," "wil