DEXCOM INC
Form 10-Q
May 08, 2008
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10 - Q

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**
For the quarterly period ended March 31, 2008

¨ **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	**33-0857544**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
6340 Sequence Drive	
San Diego, California	**92121**
(Address of Principal Executive offices)	**(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 x 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 definitions of accelerated filer, large accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act (Check one):

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

Indicate by check mark whether the Registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act).

Yes ¨ No x

As of April 25, 2008, 29,475,505 shares of the Registrant s common stock were outstanding.

DexCom, Inc.

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DexCom, Inc.

Balance Sheets

(In thousands except share and per share data)

(Unaudited)

	March 31, 2008	December 31, 2007
Assets		
Current assets:		
Cash and cash equivalents	$ 23,952	$ 23,115
Short-term marketable securities, available-for-sale	26,632	41,208
Accounts receivable, net	321	215
Inventory	1,824	1,139
Prepaid and other current assets	1,118	1,614
Total current assets	53,847	67,291
Property and equipment, net	6,854	6,649
Restricted cash	5,977	914
Other assets	2,284	2,405
Total assets	$ 68,962	$ 77,259
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 3,245	$ 4,535
Accrued payroll and related expenses	2,410	2,537
Current portion of long-term debt	2,275	1,375
Current portion of deferred revenue	167	
Total current liabilities	8,097	8,447
Long-term portion of deferred revenue	296	
Other liabilities	673	666
Long-term debt, net of current portion	62,788	61,031
Total liabilities	71,854	70,144
Commitments and contingencies (Note 4)		
Stockholders (deficit) equity:		
Preferred stock, $0.001 par value, 5,000 shares authorized; no shares issued and outstanding at March 31, 2008 and December 31, 2007, respectively		
Common stock, $0.001 par value, 100,000 authorized; 29,753 and 29,479 issued and outstanding at March 31, 2008; 28,778 and 28,624 shares issued and outstanding at December 31, 2007	30	29
Additional paid-in capital	186,249	183,325
Accumulated other comprehensive income	53	13
Accumulated deficit	(189,224)	(176,252)
Total stockholders (deficit) equity	(2,892)	7,115
Total liabilities and stockholders equity	$ 68,962	$ 77,259

See accompanying notes

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DexCom Inc.

Statements of Operations

(In thousands except per share data)

(Unaudited)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Product revenues	$ 1,824	$ 1,012
Development grant revenue	38	
Total revenues	1,862	1,012
Product cost of sales	3,112	3,062
Development cost of sales	130	
Total cost of sales	3,242	3,062
Gross margin	(1,380)	(2,050)
Operating expenses		
Research and development	4,843	4,035
Selling, general and administrative	6,421	5,371
Total operating expenses	11,264	9,406
Operating loss	(12,644)	(11,456)
Interest income	565	792
Interest expense	(893)	(265)
Net loss	$ (12,972)	$ (10,929)
Basic and diluted net loss per share	$ (0.44)	$ (0.39)
Shares used to compute basic and diluted net loss per share	29,228	28,223

See accompanying notes

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DexCom, Inc.

Statements of Cash Flows

(In thousands)

(Unaudited)

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Operating activities		
Net loss	$ (12,972)	$ (10,929)
Adjustments to reconcile net loss to cash used in operating activities:		
Depreciation and amortization	855	626
Share-based compensation	1,948	1,096
Accretion and amortization related to investments, net	(37)	(50)
Amortization of debt issuance costs	139	
Changes in operating assets and liabilities:		
Accounts receivable	(106)	(78)
Inventory	(685)	(44)
Prepaid and other assets	422	246
Restricted cash	(5,063)	(199)
Accounts payable and accrued liabilities	(1,303)	254
Accrued payroll and related expenses	(127)	633
Deferred revenue	463	
Deferred rent and other liabilities	7	35
Net cash used in operating activities	(16,459)	(8,410)
Investing activities		
Purchase of available-for-sale marketable securities	(17,564)	(19,646)
Proceeds from the maturity of available-for-sale marketable securities	32,210	18,503
Purchase of property and equipment	(1,060)	(327)
Net cash provided/(used) in investing activities	13,586	(1,470)
Financing activities		
Proceeds from issuance of senior convertible notes		60,000
Payment of senior convertible notes issuance costs		(2,282)
Purchase of senior convertible notes call spread options		(10,950)
Net proceeds from issuance of common stock	1,053	361
Proceeds from equipment loan	3,000	412
Repayment of equipment loan	(343)	
Net cash provided by financing activities	3,710	47,541
Increase in cash and cash equivalents	837	37,661
Cash and cash equivalents, beginning of period	23,115	18,167
Cash and cash equivalents, ending of period	$ 23,952	$ 55,828
Non-cash investing and financing transactions:		
Common shares received as settlement for a call spread option	$ 869	$

See accompanying notes

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DexCom, Inc.

Notes to Financial Statements

(Unaudited)

1. Organization and Summary of Significant Accounting Policies

Organization and Business

DexCom, Inc. (the Company) is a medical device company focused on the design, development and commercialization of continuous glucose monitoring systems for people with diabetes. On March 24, 2006, the Company received approval from the FDA for its first product, the STS, designed for up to three days of continuous use. On May 31, 2007, the Company received approval from the FDA for its second generation continuous glucose monitoring system, the SEVEN, designed for up to seven days of continuous use, and the Company began commercializing this product in the third quarter of 2007.

Basis of Presentation

The Company has prepared the accompanying unaudited financial statements in accordance with accounting principles generally accepted in the United States of America 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. generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, which (except for the changes in estimates described below) include only normal recurring adjustments considered necessary for a fair presentation, have been included. Operating results for the three months ended March 31, 2008 are not necessarily indicative of the results that may be expected for the year ending December 31, 2008. These unaudited financial statements should be read in conjunction with the audited financial statements and related notes thereto for the year ended December 31, 2007 included in the Annual Report on Form 10-K filed by the Company with the Securities and Exchange Commission on March 11, 2008.

Use of Estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from these estimates. Significant estimates include estimated excess or obsolete inventories, warranty accruals, employee bonus, clinical study expenses, trade show expenses, allowances for returned product, allowance for bad debt, and share-based compensation expense. Excess and obsolete inventories are estimated by identifying the amount of on hand and on order materials and comparing those to expected future sales, taking into account clinical trial and development usage along with new product introductions. The 2008 bonus plan authorized target bonus amounts of up to 50%, 35% and 25% of base salary for the Company s Chief Executive Officer, its Senior Vice Presidents, and the remainder of its non-sales management employees, respectively, to be awarded from the bonus pool based on the weighted average achievement of certain objectives. The amount of any bonus under the 2008 plan will be predicated on achieving targeted revenue goals and performance milestones. Generally speaking, 70% of any bonus paid under the 2008 Plan is based on achieving certain annual revenue goals and 30% is based on achieving certain performance milestones. The Company also approved a bonus plan for its Vice President of Sales, pursuant to which the Vice President of Sales is eligible to receive a bonus of up to 50% of his base salary upon achievement of specified minimum quarterly revenue targets. Clinical trial expenses are accrued based on estimates of progress under related contracts and include initial set up costs as well as ongoing monitoring over multiple sites in the U.S. and abroad. An allowance for refunds is determined by analyzing the timing and amounts of past refund activity.

Share-Based Compensation

The Company recorded $1.9 million and $1.1 million in share-based compensation expense during the three months ended March 31, 2008 and 2007, respectively. At March 31, 2008, unrecognized estimated compensation costs related to non-vested stock options totaled $19.2 million and is expected to be recognized through 2012. The Company utilizes the Black-Scholes option-pricing model as the method of valuation for share-based awards granted.

Revenue Recognition

The Company sells its durable systems and disposable units through a direct sales force in the United States. Components are individually priced and can be purchased separately or together. The SEVEN durable system includes a reusable transmitter, a receiver, a power cord, a finger-stick meter interface cable, data management software and a USB cable. Disposable sensors for use with the SEVEN durable system are sold separately in packages of four. The initial SEVEN durable system price is not dependent upon the purchase of any amount of disposable SEVEN sensors. The Company discontinued sales of its STS 3-day durable system in the second quarter of 2007. The Company continues to sell three day disposable sensors to customers who previously purchased the STS 3-day durable system, but it expects to discontinue sales of the three day sensor in the second quarter of 2008. Disposable sensors for use with the STS 3-day durable system are sold separately in packages of five.

Revenue on product sales is 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. The Company s products are generally paid for at the time of shipment using a customer s credit card and do not include customer acceptance provisions. After approval of the Company s second generation continuous glucose monitoring system, the SEVEN, on May 31, 2007, the Company started taking orders for an Upgrade Kit to upgrade existing customers for $150. For systems sold that included an upgrade right, a portion of the sales price is allocated to the undelivered upgrade and deferred based on the fair value of the upgrade kit. This deferred revenue is recognized when the upgrade has been delivered to the customer. In August 2007, the Company adopted a 30-day money back guarantee program whereby customers who purchase the SEVEN durable system and a package of four disposable sensors may return the SEVEN durable system

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for any reason within thirty days of purchase and receive a full refund of their purchase price. The Company accrues for estimated returns and/or refunds by reducing revenues and establishing a liability account at the time of shipment based on historical experience.

Revenue from development grants is recognized ratably over the life of the development agreements when all conditions for revenue recognition have been met as outlined in Staff Accounting Bulletin 104 and Emerging Issues Task Force (EITF) 00-21 Revenue with Multiple Element Arrangements.

Warranty Accrual

Estimated warranty costs are recorded at the time of shipment. The Company estimates warranty accruals by analyzing the timing, cost and amount of returned product. Assumptions and historical warranty experience are evaluated on at least a quarterly basis to determine the continued appropriateness of such assumptions.

Comprehensive Loss

SFAS No. 130, *Reporting Comprehensive Income*, requires that all components of comprehensive income, including net income, be reported in the financial statements in the period in which they are recognized. Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. Net income (loss) and other comprehensive income (loss), including foreign currency translation adjustments, and unrealized gains and losses on investments, shall be reported, net of their related tax effect, to arrive at comprehensive income (loss). The Company s comprehensive loss is as follows (in thousands):

	For the Three Months Ended March 31,	
	2008	**2007**
Net loss	$ (12,972)	$ (10,929)
Unrealized gain (loss) on short-term available-for-sale marketable securities	40	(4)
Comprehensive loss	$ (12,932)	$ (10,933)

Inventory

Inventory is valued at the lower of cost or market value. The Company makes 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. The Company utilizes a standard cost system to track inventories on a part-by-part basis that approximates first in, first out. If necessary, adjustments are made to the standard materials, standard labor and standard overhead costs to approximate actual labor and actual overhead costs. The labor and overhead elements of the standard costs are based on full utilization of the Company s manufacturing capacity.

Income Taxes

At December 31, 2007, the Company has federal and state tax net operating loss carryforwards of approximately $159.0 million and $119.8 million, respectively. The federal and state tax loss carryforwards will begin to expire in 2019 and 2012, respectively, unless previously utilized. The Company also has federal and state research and development tax credit carryforwards of approximately $3.2 million and $3.3 million, respectively. The federal research and development tax credit will begin to expire in 2019, unless previously utilized.

Utilization of net operating losses and credit carryforwards are subject to an annual limitation due to ownership change limitations provided by Section 382 and 383 of the Internal Revenue Code of 1986, as amended, and similar state provisions. However, these limitations were not material during the quarter ended March 31, 2008. The tax benefits related to future utilization of federal and state net operating losses and tax credit carryforwards may be limited or lost if cumulative changes in ownership exceed 50% within any three-year period.

Recent Accounting Guidance

In September 2006, the Financial Accounting Standards Board (FASB) issued SFAS No. 157, *Fair Value Measurements*, which defines fair value, establishes a framework for measuring fair value in GAAP, and expands disclosures about fair value measurements. SFAS 157 does not require any new fair value measurements, but provides guidance on how to measure fair value by providing a fair value hierarchy used to classify the source of the information. In February 2008, the FASB deferred the effective date of SFAS 157 by one year for certain non-financial assets and non-financial liabilities, except those that are recognized or disclosed at fair value in the financial statements on a recurring basis (at least annually). On January 1, 2008, the Company adopted the provisions of SFAS 157, except as it applies to those nonfinancial assets and nonfinancial liabilities for which the effective date has been delayed by one year.

The fair value hierarchy described by the standard 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.

In accordance with SFAS 157, the following table represents the Company s fair value hierarchy for its financial assets (cash equivalents and investments) measured at fair value on a recurring basis as of March 31, 2008 (in thousands):

	Fair Value Measurements Using			
	Level 1	**Level 2**	**Level 3**	**Total**
Cash and cash equivalents	$ 23,952			$ 23,952
Marketable securities, available for sale	$ 26,632			$ 26,632
Restricted cash	$ 5,977			$ 5,977

The adoption of SFAS 157 did not have a material effect on the Company s financial position or results of operations. The book values of cash and 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.

Effective January 1, 2008 the Company adopted Statement of Financial Accounting Standard No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, Including an Amendment of FASB Statement No. 115*. This Standard permits the Company to choose to measure many financial instruments and certain other items at fair value and established presentation and disclosure requirements. In adopting this Standard, the Company did not elect to measure any new assets or liabilities at their respective fair values.

In December 2007, the FASB ratified the consensus reached by the Emerging Issues Task Force Issue 07-1, *Accounting for Collaborative Arrangements*. EITF 07-1 requires collaborators to present the results of activities for which they act as the principal on a gross basis and report any payments received from (made to) other collaborators based on other applicable GAAP or, in the absence of other applicable GAAP, based on analogy to authoritative accounting literature or a reasonable, rational, and consistently applied accounting policy election. Further, EITF 07-1 clarified that the determination of whether transactions within a collaborative arrangement are part of a vendor-customer (or analogous) relationship subject to EITF 01-9, *Accounting for Consideration Given by a Vendor to a Customer (Including a Reseller of the Vendor s Products)*. EITF 07-1 will be effective for the Company beginning on January 1, 2009. The adoption of EITF 07-1 is not expected to have a material effect on the Company s financial statements.

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, warrants, and the conversion of convertible senior notes 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 thousands):

	March 31,	
	2008	2007
Options to purchase common stock	5,491	4,329
Restricted stock	124	50