ALIGN TECHNOLOGY INC
Form 10-Q
May 03, 2013

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

FORM 10-Q

(Mark One)

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934

For the quarterly period ended March 31, 2013

OR

¨ 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: 0-32259

ALIGN TECHNOLOGY, INC.
(Exact name of registrant as specified in its charter)

Delaware	94-3267295
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

2560 Orchard Parkway
San Jose, California 95131
(Address of principal executive offices)
(408) 470-1000
(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 "large accelerated filer," "accelerated filer," and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	o (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

The number of shares outstanding of the registrant's Common Stock, $0.0001 par value, as of April 26, 2013 was 81,557,143

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Invisalign, Align, ClinCheck, Invisalign Assist, Invisalign Teen Vivera, SmartForce, SmartTrack, Power Ridges, iTero, Orthocad iCast and Orthocad iRecord amongst others, are trademarks belonging to Align Technology, Inc., and/or its subsidiaries and are pending or registered in the United States and other countries.

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PART I—FINANCIAL INFORMATION
ITEM 1 FINANCIAL STATEMENTS
ALIGN TECHNOLOGY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Three Months Ended March 31,	
	2013	2012
Net revenues	$153,580	$135,079
Cost of net revenues	40,731	34,319
Gross profit	112,849	100,760
Operating expenses:		
Sales and marketing	42,281	38,717
General and administrative	30,348	23,511
Research and development	11,282	10,526
Impairment of goodwill	40,693	—
Impairment of long-lived assets	26,320	—
Total operating expenses	150,924	72,754
Income (loss) from operations	(38,075)	28,006
Other expenses, net	(988)	(812)
Net income (loss) before provision for income taxes	(39,063)	27,194
Provision for income taxes	2,920	6,210
Net income (loss)	$(41,983)	$20,984
Net income (loss) per share:		
Basic	$(0.52)	$0.26
Diluted	$(0.52)	$0.26
Shares used in computing net income (loss) per share:		
Basic	81,248	79,235
Diluted	81,248	81,856

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

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ALIGN TECHNOLOGY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in thousands)
(unaudited)

	Three Months Ended March 31,	
	2013	2012
Net income (loss)	$(41,983)	$20,984
Net change in cumulative translation adjustment	(55)	159
Change in unrealized gains (losses) on available-for-sale securities, net of tax	3	(12)
Other comprehensive income (loss)	(52)	147
Comprehensive income (loss)	$(42,035)	$21,131

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

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ALIGN TECHNOLOGY, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except per share data)
(unaudited)

	March 31, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$328,745	$306,386
Restricted cash	508	1,575
Marketable securities, short-term	37,975	28,485
Accounts receivable, net of allowance for doubtful accounts and returns of $1,247 and $2,484, respectively	108,672	98,992
Inventories	15,442	15,122
Prepaid expenses and other current assets	35,989	35,233
Total current assets	527,331	485,793
Marketable securities, long-term	10,680	21,252
Property, plant and equipment, net	72,672	79,191
Goodwill	58,543	99,236
Intangible assets, net	25,429	45,777
Deferred tax assets	28,417	21,609
Other assets	3,173	3,454
Total assets	$726,245	$756,312
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$19,748	$19,549
Accrued liabilities	64,635	74,247
Deferred revenues	59,472	61,975
Total current liabilities	143,855	155,771
Other long-term liabilities	21,272	19,224
Total liabilities	165,127	174,995
Commitments and contingencies (Note 7)		
Stockholders' equity:		
Preferred stock, $0.0001 par value (5,000 shares authorized; none issued)	—	—
Common stock, $0.0001 par value (200,000 shares authorized; 81,725 and 80,611 issued and outstanding in 2013 and 2012, respectively)	8	8
Additional paid-in capital	694,334	670,732
Accumulated other comprehensive income, net	151	203
Accumulated deficit	(133,375)	(89,626)
Total stockholders' equity	561,118	581,317
Total liabilities and stockholders' equity	$726,245	$756,312

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

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ALIGN TECHNOLOGY, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Three Months Ended March 31, 2013	2012 Revised*
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net income (loss)	$(41,983)	$20,984
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Deferred taxes	931	4,726
Depreciation and amortization	3,855	2,753
Amortization of intangibles	1,089	1,146
Stock-based compensation	6,410	4,863
Excess tax benefit from share-based payment arrangements	(7,739)	(8,043)
Impairment of goodwill	40,693	—
Impairment of long-lived assets	26,320	—
Recovery of doubtful accounts and returns	(1,196)	(119)
Other	(10)	52
Changes in assets and liabilities:		
Accounts receivable	(9,240)	(2,398)
Inventories	(320)	(4,030)
Prepaid expenses and other assets	(586)	(1,530)
Accounts payable	1,611	(3,641)
Accrued and other long-term liabilities	(7,941)	(9,191)
Deferred revenues	(1,476)	1,809
Net cash provided by operating activities	10,418	7,381
CASH FLOWS FROM INVESTING ACTIVITIES:		
Release of restricted cash	1,053	3
Purchase of property, plant and equipment	(5,608)	(12,559)
Purchase of marketable securities	(3,282)	(28,190)
Maturities of marketable securities	4,366	2,751
Other assets	26	—
Net cash used in investing activities	(3,445)	(37,995)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	13,268	10,180
Common stock repurchase	(2,438)	(2,524)
Excess tax benefit from share-based payment arrangements	7,739	8,043
Employees' taxes paid upon the vesting of restricted stock units	(3,141)	(1,408)
Other	(5)	—
Net cash provided by financing activities	15,423	14,291
Effect of foreign exchange rate changes on cash and cash equivalents	(37)	9
Net increase (decrease) in cash and cash equivalents	22,359	(16,314)
Cash and cash equivalents, beginning of the period	306,386	240,675
Cash and cash equivalents, end of the period	$328,745	$224,361

The accompanying notes are an integral part of these unaudited condensed consolidated financial statements.
*See Note 1 of Condensed Consolidated Financial Statements.

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ALIGN TECHNOLOGY, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)
Note 1. Summary of Significant Accounting Policies

Basis of presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared by Align Technology, Inc. (“we”, “our”, or “Align”) in accordance with the rules and regulations of the Securities and Exchange Commission (SEC) and contain all adjustments, including normal recurring adjustments, necessary to present fairly our results of operations for the three months ended March 31, 2013 and 2012, our comprehensive income (loss) for the three months ended March 31, 2013 and 2012, our financial position as of March 31, 2013 and our cash flows for the three months ended March 31, 2013 and 2012. The Condensed Consolidated Balance Sheet as of December 31, 2012 was derived from the December 31, 2012 audited financial statements.

The results of operations for the three months ended March 31, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013 or any other future period, and we make no representations related thereto. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with “Management’s Discussion and Analysis of Financial Condition and Results of Operations,” “Quantitative and Qualitative Disclosures About Market Risk” and the Consolidated Financial Statements and notes thereto included in Items 7, 7A and 8, respectively, in our Annual Report on Form 10-K for the year ended December 31, 2012.

Use of estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the United States of America (“U.S.”) requires our management to make estimates and assumptions that affect the amounts reported in the consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates. On an ongoing basis, we evaluate our estimates, including those related to the fair values of financial instruments, long-lived assets and goodwill, useful lives of intangible assets and property and equipment, stock-based compensation, income taxes, and contingent liabilities, among others. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities.

Revision of Prior Period Financial Statements
In connection with the preparation of our consolidated financial statements for the third quarter of 2012, we determined that we had not correctly recognized the excess tax benefits related to stock-based awards in the first quarter of 2012.
In accordance with Staff Accounting Bulletin (SAB) No. 99, “Materiality”, and SAB No. 108, “Considering the Effects of Prior Year Misstatements when Quantifying Misstatements in Current Year Financial Statements”, we evaluated the materiality of the errors from qualitative and quantitative perspectives, and evaluated the quantified errors under both the iron curtain and the roll-over methods. We concluded that the errors were not material to the financial statements for the first quarter of 2012 and revised the presentation of the statement of cash flows for the first quarter of 2012.
The following tables summarize the effects of the revision on our Condensed Consolidated Statement of Cash Flows.
The revision did not impact our Condensed Consolidated Statement of Operations for the first quarter of 2012.

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Cash flows

	Three Months Ended March 31, 2012 (in thousands)		
	Previously Reported	Adjustment	As Revised
Statement of Cash Flows			
Net cash provided by operating activities	$15,424	$(8,043)	$7,381
Net cash provided by financing activities	6,248	8,043	14,291
Net decrease in cash and cash equivalents	(16,314)	—	(16,314)

Recent Accounting Pronouncements

In February 2013, the FASB issued ASU 2013-02, "Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income ("AOCI")" . This standard requires reporting, in one place, information about reclassifications out of AOCI by component. An entity is required to present, either on the face of the financial statements or in the notes, significant amounts reclassified out of AOCI by the respective line items of net income, but only if the amount is reclassified in its entirety in the same reporting period. For amounts that are not required to be reclassified to net income in their entirety, an entity is required to cross-reference to other currently required disclosures that provide additional detail about those amounts. The information required by this standard must be presented in one place, either parenthetically on the face of the financial statements by income statement line item or in a note. The adoption of this guidance during the period ended March 31, 2013 did not have a material affect to our condensed consolidated financial statements.

Note 2. Marketable Securities and Fair Value Measurements

Our short-term and long-term marketable securities as of March 31, 2013 and December 31, 2012 are as follows (in thousands):

Short-term

March 31, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds	27,145	21	(2)	27,164
U.S. dollar dominated foreign corporate bonds	8,052	10	—	8,062
Commercial paper	2,749	—	—	2,749
Total	$37,946	$31	$(2)	$37,975

Long-term

March 31, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds	$7,592	$2	$(4)	$7,590
U.S. government agency bonds	2,066	2	—	2,068
U.S. dollar dominated foreign corporate bonds	1,023	—	(1)	1,022
Total	$10,681	$4	$(5)	$10,680

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Short-term

December 31, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds	$18,767	$7	$(4)	$18,770
Commercial paper	4,646	1	—	4,647
U.S. dollar dominated foreign corporate bonds	5,060	9	(1)	5,068
Total	$28,473	$17	$(5)	$28,485

Long-term

December 31, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds	16,132	16	(7)	16,141
U.S. government agency bonds	$2,069	$1	$—	$2,070
U.S. dollar dominated foreign corporate bonds	3,038	4	(1)	3,041
Total	$21,239	$21	$(8)	$21,252

For the three months ended March 31, 2013 and 2012, realized losses were immaterial. Unrealized gains and losses for our available for sale securities as of March 31, 2013 and December 31, 2012 were also immaterial. Cash and cash equivalents were not included in the table above as the gross unrealized gains and losses were not material. We have no material short-term or long-term investments that have been in a continuous unrealized loss position for greater than twelve months as of March 31, 2013 and December 31, 2012. Amounts reclassified to earnings from accumulated other comprehensive income related to unrealized gain or losses were immaterial for the three months ended March 31, 2013 and 2012.

Our fixed-income securities investment portfolio consists of corporate bonds, U.S. government agency bonds, U.S. dollar dominated foreign corporate bonds and commercial paper that have a maximum maturity of two years. The corporate debt and government and agency securities that we invest in are generally deemed to be low risk based on their credit ratings from the major rating agencies. The longer the duration of these securities, the more susceptible they are to changes in market interest rates and bond yields. As interest rates increase, those securities purchased at a lower yield show a mark-to-market unrealized loss. The unrealized losses are due primarily to changes in credit spreads and interest rates. We expect to realize the full value of all these investments upon maturity or sale. As of March 31, 2013 and December 31, 2012, these securities had a weighted average remaining duration of approximately 6 months and 10 months, respectively.

	March 31, 2013 (in thousands)	December 31, 2012 (in thousands)
One year or less	$37,975	$28,485
One year through two years	10,680	21,252
Total available for sale securities	$48,655	$49,737

Fair Value Measurements

We measure the fair value of our cash equivalents and marketable securities as the price that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We use the GAAP fair value hierarchy that prioritizes the inputs to valuation techniques used to measure fair value. This hierarchy requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of inputs that may be used to measure fair value:

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

Our Level 1 assets consist of money market funds. We did not hold any Level 1 liabilities as of March 31, 2013.

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Level 2—Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities 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 asset or liability.

Our Level 2 assets consist of commercial paper, corporate bonds, foreign bonds, agency bonds, and our Israeli severance funds that are mainly invested in insurance policies. We obtain these fair values for level 2 investments from our asset manager for each of our portfolios. Our custody bank and asset managers independently use professional pricing services to gather pricing data which may include quoted market prices for identical or comparable financial instruments, or inputs other than quoted prices that are observable either directly or indirectly, and we are ultimately responsible for these underlying estimates.

We did not hold any Level 2 liabilities as of March 31, 2013.

Level 3—Unobservable inputs to the valuation methodology that are supported by little or no market activity and that are significant to the measurement of the fair value of the assets or liabilities. Level 3 assets and liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques, as well as significant management judgment or estimation.

We did not hold any Level 3 assets or liabilities as of March 31, 2013.
Non-Recurring Fair Value Measurements

During the first quarter 2013, we recorded an impairment charge to our long-lived assets and goodwill for $26.3 million and $40.7 million, respectively, related to our SCCS reporting unit as an event occurred or circumstances changed that led us to perform an impairment analysis between the annual test which required us to determine the fair value of the SCCS reporting unit (Refer to Note 4). These fair value measurements were calculated using unobservable inputs, using the income approach which is classified as Level 3 within the fair value hierarchy. Inputs for the income approach includes the amount and timing of future cash flows based on our most recent operational budgets, strategic plans, terminal growth rates assumptions and other estimates.

The following table summarizes our financial assets measured at fair value on a recurring basis as of March 31, 2013 (in thousands):

Description	Balance as of March 31, 2013	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Cash equivalents:			
Money market funds	$258,819	$258,819	$—
Commercial paper	500	—	500
Short-term investments:			
Commercial paper	2,749	—	2,749
Corporate bonds	27,164	—	27,164
U.S. dollar dominated foreign corporate bonds	8,062	—	8,062
Long-term investments:			
Corporate bonds	7,590	—	7,590
U.S. government agency bonds	2,068	—	2,068
U.S. dollar dominated foreign corporate bonds	1,022	—	1,022

Other assets:			
Israeli severance funds	2,265	—	2,265
	$310,239	$258,819	$51,420

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The following table summarizes our financial assets measured at fair value on a recurring basis as of December 31, 2012 (in thousands):

Description	Balance as of December 31, 2012	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Cash equivalents:			
Money market funds	$ 86,166	$86,166	$—
Commercial paper	950	—	950
Short-term investments:			
Commercial paper	4,647	—	4,647
Corporate bonds	18,770	—	18,770
U.S. government agency bonds	5,068	—	5,068
Long-term investments:			
U.S. government agency bonds	2,070	—	2,070
Corporate bonds	16,141	—	16,141
U.S. dollar denominated foreign corporate bonds	3,041	—	3,041
Other assets:			
Israeli severance funds	2,218	—	2,218
	$ 139,071	$86,166	$52,905

Note 3. Balance Sheet Components

Inventories

Inventories are comprised of (in thousands):

	March 31, 2013	December 31, 2012
Raw materials	$7,381	$7,629
Work in process	3,196	3,889
Finished goods	4,865	3,604
	$15,442	$15,122

Work in process includes costs to produce our clear aligner and intra-oral scanner products. Finished goods primarily represent our intra-oral scanners and ancillary products that support our clear aligner products.

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Accrued liabilities

Accrued liabilities consist of the following (in thousands):

	March 31, 2013	December 31, 2012
Accrued payroll and benefits	$31,246	$39,621
Accrued sales rebate	8,996	8,333
Accrued sales tax and value added tax	4,890	5,253
Accrued sales and marketing expenses	3,695	4,088
Accrued warranty	4,129	4,050
Accrued accounts payable	2,230	2,866
Accrued distributor expenses	2,300	1,800
Accrued professional fees	1,207	2,349
Unclaimed merger consideration	508	1,575
Accrued income taxes	595	572
Other	4,839	3,740
Total	$64,635	$74,247

Warranty

We regularly review the accrued balances and update these balances based on historical warranty trends. Actual warranty costs incurred have not materially differed from those accrued. However, future actual warranty costs could differ from the estimated amounts.

Clear Aligner

We warrant our Invisalign products against material defects until the Invisalign case is complete. We accrue for warranty costs in cost of net revenues upon shipment of products. The amount of accrued estimated warranty costs is primarily based on historical experience as to product failures as well as current information on replacement costs.

Scanners

We warrant our scanners for a period of one year from the date of training and installation. We accrue for these warranty costs which includes materials and labor based on estimated historical repair costs. Extended service packages may be purchased for additional fees.

The following table reflects the change in our warranty accrual during the three months ended March 31, 2013 and 2012, respectively (in thousands):

	Three Months Ended March 31, 2013