ENDOLOGIX INC /DE/
Form 10-Q
July 31, 2014

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 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 June 30, 2014

o 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 000-28440

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

Delaware	68-0328265
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

11 Studebaker, Irvine, California 92618
(Address of principal executive offices)
(949) 595-7200
(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 o

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 o

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	x	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 o No x

On July 28, 2014, there were 66,953,515 shares outstanding of the registrant's only class of common stock.

ENDOLOGIX, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE THREE AND SIX MONTHS ENDED JUNE 30, 2014

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Part I. Financial Information

ENDOLOGIX, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except share and par value amounts)
(Unaudited)

	June 30, 2014	December 31, 2013
ASSETS		
Current assets:		
Cash and cash equivalents	$31,843	$95,152
Marketable securities	78,941	31,313
Accounts receivable, net allowance for doubtful accounts of $187 and $399, respectively.	26,714	24,972
Other receivables	910	310
Inventories	28,484	19,558
Prepaid expenses and other current assets	3,827	2,328
Total current assets	$170,719	$173,633
Property and equipment, net	17,402	7,338
Goodwill	29,086	29,103
Intangibles, net	42,849	43,096
Deposits and other assets	3,415	3,027
Total assets	$263,471	$256,197
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$11,535	$6,265
Accrued payroll	12,697	11,476
Accrued expenses and other current liabilities	4,357	3,094
Contingently issuable common stock	—	46,500
Total current liabilities	$28,589	$67,335
Deferred income tax	1,067	1,135
Deferred rent	6,357	1,585
Contingently issuable common stock	14,500	14,400
Convertible notes	68,723	67,101
Total liabilities	$119,236	$151,556
Commitments and contingencies		
Stockholders' equity:		
Convertible preferred stock, $0.001 par value; 5,000,000 shares authorized. No shares issued and outstanding.	—	—
Common stock, $0.001 par value; 100,000,000 shares authorized. 67,006,796 and 63,866,392 shares issued, respectively. 66,909,398 and 63,866,392 shares outstanding, respectively.	67	64
Treasury stock, at cost, 97,398 and 0 shares, respectively.	(1,395)	—
Additional paid-in capital	366,418	321,756
Accumulated deficit	(219,780)	(216,082)
Accumulated other comprehensive loss	(1,075)	(1,097)
Total stockholders' equity	$144,235	$104,641
Total liabilities and stockholders' equity	$263,471	$256,197

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

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ENDOLOGIX, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME (LOSS)
(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Revenue	$38,327	$33,964	$71,591	$63,748
Cost of goods sold	9,820	8,960	18,789	16,216
Gross profit	28,507	25,004	52,802	47,532
Operating expenses:				
Research and development	4,458	3,822	8,563	7,341
Clinical and regulatory affairs	2,722	2,189	4,922	4,553
Marketing and sales	19,167	16,520	35,311	32,044
General and administrative	5,932	4,993	13,094	10,604
Total operating expenses	32,279	27,524	61,890	54,542
Loss from operations	(3,772)	(2,520)	(9,088)	(7,010)
Other income (expense):				
Interest income	67	10	126	20
Interest expense	(1,448)	(3)	(2,839)	(3)
Other income (expense), net	(148)	439	211	1,123
Change in fair value of contingent consideration related to acquisition	(3,772)	7,600	8,028	2,400
Total other income (expense)	(5,301)	8,046	5,526	3,540
Net income (loss) before income tax benefit (expense)	$(9,073)	$5,526	$(3,562)	$(3,470)
Income tax benefit (expense)	80	144	(136)	(195)
Net income (loss)	$(8,993)	$5,670	$(3,698)	$(3,665)
Other comprehensive income (loss) foreign currency translation	68	(185)	23	143
Comprehensive income (loss)	$(8,925)	$5,485	$(3,675)	$(3,522)
Basic net income (loss) per share	$(0.14)	$0.09	$(0.06)	$(0.06)
Diluted net income (loss) per share	$(0.14)	$0.09	$(0.06)	$(0.06)
Shares used in computing basic net income (loss) per share	62,699	62,330	62,403	62,260
Shares used in computing diluted net income (loss) per share	62,699	65,496	62,403	62,260

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

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ENDOLOGIX, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Six Months Ended June 30,	
	2014	2013
Cash flows from operating activities:		
Net loss	$(3,698)	$(3,665)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,213	1,235
Stock-based compensation	3,753	4,327
Change in fair value of contingent consideration related to acquisition	(8,028)	(2,400)
Accretion of interest on convertible note	1,622	—
Amortization of deferred financing costs	198	—
Non-cash foreign exchange gain	(212)	—
Changes in operating assets and liabilities:		
Accounts receivable and other receivables	(2,108)	(5,717)
Inventories	(8,793)	647
Prepaid expenses and other current assets	(1,283)	(454)
Accounts payable	3,855	336
Accrued payroll	1,224	683
Accrued expenses and other liabilities	2,097	3,319
Net cash used in operating activities	$(10,160)	$(1,689)
Cash flows from investing activities:		
Purchases of marketable securities	(74,114)	—
Maturities of marketable securities	25,585	—
Purchases of property and equipment	(5,743)	(1,373)
Net cash used in investing activities	$(54,272)	$(1,373)
Cash flows from financing activities:		
Proceeds from sale of common stock under employee stock purchase plan	1,446	1,646
Proceeds from exercise of stock options	1,094	1,328
Funding of restricted cash account	—	(5,395)
Minimum tax withholding paid on behalf of employees for restricted stock units	(1,395)	—
Net cash provided by (used in) financing activities	$1,145	$(2,421)
Effect of exchange rate changes on cash and cash equivalents	(22)	172
Net decrease in cash and cash equivalents	$(63,309)	$(5,311)
Cash and cash equivalents, beginning of period	95,152	45,118
Cash and cash equivalents, end of period	$31,843	$39,807
Supplemental disclosure of cash flow information:		
Cash paid for interest	$1,045	$—
Cash paid for income taxes	207	—
Non-cash investing and financing activities:		
Landlord funded leasehold improvements	3,870	—
Fair value of OUS Milestone Shares (note 9)	38,372	—
Acquisition of property and equipment included in accounts payable	$1,403	$—

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

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ENDOLOGIX, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(all tabular amounts presented in thousands, except per share, per unit, and number of years)
(Unaudited)

1. Description of Business, Basis of Presentation, and Operating Segment

(a) Description of Business

Endologix, Inc. (the "Company","we","our" or "us") is a Delaware corporation with corporate headquarters and production facilities located in Irvine, California. The Company develops, manufactures, markets, and sells innovative medical devices for the treatment of aortic disorders. The Company's products are intended for the treatment of abdominal aortic aneurysms ("AAA"). The Company's AAA products are built on one of two platforms: (1) traditional minimally-invasive endovascular repair ("EVAR") or (2) endovascular sealing (“EVAS”), the Company's innovative solution for sealing the aneurysm sac while maintaining blood flow through two blood flow lumens. The Company's current EVAR products include the Endologix AFX Endovascular AAA System (“AFX”) and the Endologix Intuitrak Endovascular AAA System (“Intuitrak”). The Company's current EVAS product is the Nellix Endovascular Aneurysm Sealing System (“Nellix EVAS System”). Sales of the Company's EVAR and EVAS platforms (including extensions and accessories) to hospitals in the U.S. and Europe, and to third-party international distributors, provide the sole source of the Company's reported revenue.

The Company's EVAR products consist of (i) a cobalt chromium alloy stent covered by polytetrafluoroethylene (commonly referred to as "ePTFE") graft material (“Stent Graft”) and (ii) an accompanying delivery system. Once fixed in its proper position within the abdominal aorta, the Company's EVAR device provides a conduit for blood flow, thereby relieving pressure within the weakened or “aneurysmal” section of the vessel wall, which greatly reduces the potential for the AAA to rupture.

The Company's EVAS product consists of (i) bilateral covered stents with endobags, (ii) a biocompatible polymer injected into the endobags to seal the aneurysm and (iii) a delivery system and polymer dispenser. The Company's EVAS product seals the entire aneurysm sac effectively, excluding the aneurysm sac and reducing the likelihood of future aneurysm rupture. Additionally, it has the potential to reduce post procedural re-interventions.

(b) Basis of Presentation

The accompanying Condensed Consolidated Financial Statements in this Quarterly Report on Form 10-Q have been prepared in accordance with generally accepted accounting principles in the United States of America ("GAAP") and the rules and regulations of the U.S. Securities and Exchange Commission ("SEC"). These financial statements include the financial position, results of operations, and cash flows of the Company, including its subsidiaries, all of which are wholly-owned. All inter-company accounts and transactions have been eliminated in consolidation. For the three and six months ended June 30, 2014 and 2013, there were no related party transactions.

The interim financial data as of June 30, 2014 is unaudited and is not necessarily indicative of the results for a full year. In the opinion of the Company's management, the interim data includes normal and recurring adjustments necessary for a fair presentation of the Company's financial results for the three and six months ended June 30, 2014. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been condensed or omitted pursuant to SEC rules and regulations relating to interim financial statements.

The accompanying Condensed Consolidated Financial Statements should be read in conjunction with the Company's audited Consolidated Financial Statements and Notes thereto included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2013, filed with the SEC on March 3, 2014.

On May 28, 2014, the Financial Accounting Standards Board issued Auditing Standards Update ("ASU ") No. 2014-09, "Revenue from Contracts with Customers", which requires an entity to recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to customers. The ASU will replace most existing revenue recognition guidance in U.S. GAAP when it becomes effective. The new standard is effective for the Company on January 1, 2017. Early application is not permitted. The standard permits the use of either the retrospective or cumulative effect transition method. The Company is evaluating the effect that ASU 2014-09 will have on its consolidated financial statements and related disclosures. The Company has not yet selected a transition method nor has it determined the effect of the standard on its ongoing financial reporting.

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(all tabular amounts presented in thousands, except per share, per unit, and number of years)
(Unaudited)

(c) Operating Segment

The Company has one operating and reporting segment that is focused exclusively on the development, manufacture, marketing, and sale of EVAR and EVAS product for the treatment of aortic disorders. For the three and six months ended June 30, 2014, all of the Company's revenue and related expenses were solely attributable to these activities. Substantially all of the Company's long-lived assets are located in the U.S.

2. Use of Estimates and Summary of Significant Accounting Policies

The preparation of financial statements in conformity with GAAP requires the Company's management to make estimates and assumptions that affect the reported amounts of assets and liabilities, revenue and expenses, and related disclosure of contingent liabilities. On an on-going basis, the Company's management evaluates its estimates, including those related to (i) collectibility of customer accounts; (ii) whether the cost of inventories can be recovered; (iii) the value of goodwill and intangible assets; (iv) realization of tax assets and estimates of tax liabilities; (v) likelihood of payment and value of contingent liabilities; and (vi) potential outcome of litigation. Such estimates are based on management's judgment which takes into account historical experience and various assumptions. Nonetheless, actual results may differ from management's estimates.
For a complete summary of our significant accounting policies, please refer to Note 1, "Summary of Significant Accounting Policies", in Part II, Item 8 of our 2013 Annual Report on Form 10-K for the year ended December 31, 2013, filed March 3, 2014. There have been no material changes to our significant accounting policies during the three and six months ended June 30, 2014.

3. Balance Sheet Account Detail

(a) Property and Equipment

Property and equipment consisted of the following:

	June 30, 2014	December 31, 2013
Production equipment, molds, and office furniture	$8,577	$8,033
Computer hardware and software	3,725	3,290
Leasehold improvements	3,055	3,058
Construction in progress (software and related implementation, production equipment, and leasehold improvements)	12,651	2,594
Property and equipment, at cost	$28,008	$16,975
Accumulated depreciation	(10,606)	(9,637)
Property and equipment, net	$17,402	$7,338

Depreciation expense for property and equipment for the three months ended June 30, 2014, and 2013 was $0.5 million, and $0.7 million respectively. For the six months ended June 30, 2014, and 2013 depreciation expense for property and equipment was $1.0 million, and $1.1 million respectively.

(b) Inventories

Inventories consisted of the following:

	June 30, 2014	December 31, 2013
Raw materials	$5,081	$3,793
Work-in-process	7,848	4,539
Finished goods	15,555	11,226
Inventories	$28,484	$19,558

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(all tabular amounts presented in thousands, except per share, per unit, and number of years)
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(c) Goodwill and Intangible Assets

The following table presents goodwill, indefinite lived intangible assets, finite lived intangible assets, and related accumulated amortization:

	June 30, 2014	December 31, 2013
Goodwill (1)	$29,086	$29,103
Intangible assets:		
Indefinite lived intangibles		
Trademarks and trade names	$2,708	$2,708
Finite lived intangibles		
Developed technology (2)	$40,100	$40,100
Accumulated amortization	(182)	(48)
Developed technology, net	$39,918	$40,052
Patent	$100	$100
Accumulated amortization	(100)	(95)
Patent, net	$—	$5
License	$100	$100
Accumulated amortization	(57)	(41)
License, net	$43	$59
Customer relationships	$539	$544
Accumulated amortization	(359)	(272)
Customer relationships, net	$180	$272
Intangible assets (excluding goodwill), net	$42,849	$43,096

(1) Difference in goodwill value between these dates is solely due to a foreign currency translation adjustment.
(2) Was reclassified in the first quarter of 2013 from in-process research and development to finite lived intangibles, which coincided with the European commercial launch of the product (Nellix EVAS System) associated with this intangible asset. A significant portion of this intangible asset will not begin amortization until the U.S. launch of this product, currently scheduled for 2016.

Amortization expense for intangible assets for the three months ended June 30, 2014, and 2013 was $0.1 million, and $0.1 million respectively. For the six months ended June 30, 2014, and 2013 amortization expense for intangible assets was $0.2 million, and $0.1 million respectively.

Estimated amortization expense for the five succeeding years and thereafter (which includes amortization of intangible assets which commenced in February 2013 with the commercial launch of the Nellix System in Europe) is as follows:

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
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	Amortization Expense
Remainder of 2014	$238
2015	655
2016	980
2017	2,315
2018	3,976
2019	4,650
2020 & Thereafter	27,327
Total	$40,141

(d) Marketable securities

Investments in held-to-maturity marketable securities consist of the following at June 30, 2014:

	June 30, 2014			
	Amortized Cost	Gross Unrealized Gain	Gross Unrealized Loss	Fair Value
Corporate and other debt securities	$79,764	$13	$(5)	$79,772

At June 30, 2014, the Company's investments included 12 held-to-maturity debt securities in unrealized loss positions with a total unrealized loss of approximately $5 thousand and a total fair market value of approximately $79.8 million. All investments with gross unrealized losses have been in unrealized loss positions for less than 6 months. The unrealized losses were caused by interest rate fluctuations. There was no change in the credit risk of the securities. The Company does not intend to sell the securities and it is not likely that the Company will be required to sell the securities before the expected recovery of their amortized cost bases. There were no realized gains or losses on the investments for the three and six months ended June 30, 2014.

(e) Fair Value Measurements

The following fair value hierarchy table presents information about each major category of the Company's assets and liabilities measured at fair value on a recurring basis as of June 30, 2014:

	Quoted prices in active markets for identical assets (Level 1)	Significant other observable inputs (Level 2)	Significant unobservable inputs (Level 3)	Total
At December 31, 2013				
Cash and cash equivalents	$95,152	$—	$—	$95,152
Contingently issuable common stock	$—	$—	$60,900	$60,900
At June 30, 2014				
Cash and cash equivalents	$31,843	$—	$—	$31,843
Contingently issuable common stock	$—	$—	$14,500	$14,500

There were no re-measurements to fair value during the six months ended June 30, 2014 of financial assets and liabilities that are not measured at fair value on a recurring basis. There were no transfers between Level 1, Level 2, or Level 3 securities during the six months ended June 30, 2014.

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(all tabular amounts presented in thousands, except per share, per unit, and number of years)
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(f) Instruments Not Recorded at Fair Value on a Recurring Basis

We measure the fair value of our Senior Notes carried at amortized cost quarterly for disclosure purposes. The estimated fair value of the Senior Notes is determined by Level 2 inputs and is based primarily on quoted market prices for the same or similar issues. Based on the market prices, the fair value of our long-term debt was $87.2 million as of June 30, 2014 and $84.9 million as of December 31, 2013.

We measure the fair value of our held-to-maturity marketable securities carried at amortized cost quarterly for disclosure purposes. The fair value of certain marketable securities is determined by Level 2 inputs and is based primarily on quoted market prices for the same or similar instruments.

4. Stock-Based Compensation

The Company classifies stock-based compensation expense in the accompanying Condensed Consolidated Statements of Operations and Comprehensive Income (Loss), based on the department to which the recipient belongs. Stock-based compensation expense included in cost of goods sold and operating expenses during the three and six months ended June 30, 2014 and 2013, was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Cost of goods sold	$197	$227	$404	$377
Operating expenses:				
Research and development	185	191	335	396
Clinical and regulatory affairs	365	35	262	438
Marketing and sales	645	1,087	1,194	1,665
General and administrative	748	557	1,558	1,451
Total operating expenses	$1,943	$1,870	$3,349	$3,950
Total	$2,140	$2,097	$3,753	$4,327

5. Net Income (Loss) Per Share

Basic net income (loss) per share was calculated by dividing net income (loss) by the weighted average number of common shares outstanding for the three and six months ended June 30, 2014 and 2013. Diluted net income per share for the three months ended June 30, 2013, was calculated by adjusting outstanding shares for the dilutive effects of outstanding, but unexercised, stock options and unvested restricted stock, as calculated under the treasury stock method.

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Net income (loss)	$(8,993)	$5,670	$(3,698)	$(3,665)
Weighted average shares- basic	62,699	62,330	62,403	62,260
Weighted average shares- diluted	62,699	65,496	62,403	62,260

Net income (loss) per share- basic	$(0.14)	$0.09	$(0.06)	$(0.06)
Net income (loss) per share- diluted	$(0.14)	$0.09	$(0.06)	$(0.06)

The following outstanding Company securities were included in the above calculations of net income per share because their impact was dilutive:

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(all tabular amounts presented in thousands, except per share, per unit, and number of years)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Common stock options	—	2,580	—	—
Restricted stock awards	—	393	—	—
Restricted stock units	—	193	—	—
Total	—	3,166	—	—

The following outstanding Company securities were excluded from the above calculations of net income (loss) per share because their impact would have been anti-dilutive:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Common stock options	1,813	387	1,917	2,727
Restricted stock awards	420	—	422	397
Restricted stock units	143	5	202	189
Total	2,376	392	2,541	3,313

As discussed in Note 6, in December 2013, the Company issued $86.3 million aggregate principal amount of 2.25% convertible senior notes due 2018 (the “Notes”) in an underwritten public offering. Upon any conversion the Notes may be settled, at the Company’s election, in cash, shares of the Company’s common stock or a combination of cash and shares of the Company’s common stock. For purposes of calculating the maximum dilutive impact, it is presumed that the Notes will be settled in common stock with the resulting potential common shares included in diluted earnings per share if the effect is more dilutive. The effect of the conversion of the Notes is excluded from the calculation of dilutive earnings per share because the impact of these securities would be anti-dilutive. The potential dilutive effect of these securities is shown in the chart below:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Conversion of the Notes	3,588	—	3,588	—

The effect of the contingently issuable common stock is excluded from the calculation of basic net income (loss) per share until all necessary conditions for issuance have been satisfied. Refer to Note 9 of the Notes to the Condensed Consolidated Financial Statements for further discussion.

6. Credit Facilities

2.25% Convertible Senior Notes

On December 10, 2013, the Company issued $86.3 million aggregate principal amount 2.25% Convertible Senior Notes (the “Notes”). The Notes mature on December 15, 2018 unless earlier repurchased by the Company or converted. The Company received net proceeds from the sale of the Notes of approximately $82.6 million, after deducting underwriting discounts and commissions and offering expenses payable by the Company. Interest is payable on the Notes on June 15 and December 15 of each year, beginning June 15, 2014.

The Notes are governed by the terms of a base indenture (the “Base Indenture”), as supplemented by the first supplemental indenture relating to the Notes (the “First Supplemental Indenture,” and together with the Base Indenture, the “Indenture”), between the Company and Wells Fargo Bank, National Association (the “Trustee”), each of which were entered into on December 10, 2013.

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(all tabular amounts presented in thousands, except per share, per unit, and number of years)
(Unaudited)

The Notes are senior unsecured obligations and are: (1) senior in right of payment to the Company's future indebtedness that is expressly subordinated in right of payment to the Notes; (2) equal in right of payment to the Company's existing and future unsecured indebtedness that is not so subordinated; (3) effectively junior to any of the Company's secured indebtedness to the extent of the value of the assets securing such indebtedness; and (4) structurally junior to all existing and future indebtedness (including trade payables) incurred by the Company's subsidiaries.

The Company may not redeem the Notes prior to December 15, 2016. On or after December 15, 2016, the Company may redeem for cash all or any portion of the Notes, at its option, but only if the closing sale price of the Company's common stock for at least 20 trading days (whether or not consecutive) during any 30 consecutive trading day period ending on, and including, the second trading day immediately preceding the date on which the Company provides notice of redemption, exceeds 130% of the conversion price on each applicable trading day. The redemption price will equal 100% of the principal amount of the Notes to be redeemed, plus accrued and unpaid interest to, but excluding, the redemption date. No sinking fund is provided for the Notes.

Holders may convert their Notes at any time prior to the close of business on the business day immediately preceding September 15, 2018 only under the following circumstances: (1) during any calendar quarter commencing after the calendar quarter ending on June 30, 2014, if the closing sale price of the Company's common stock, for at least 20 trading days (whether or not consecutive) in the period of 30 consecutive trading days ending on the last trading day of the calendar quarter immediately preceding the calendar quarter in which the conversion occurs, is more than 130% of the conversion price of the Notes in effect on each applicable trading day; (2) during the five consecutive business-day period following any five consecutive trading-day period in which the trading price for the Notes for each such trading day was less than 98% of the closing sale price of the Company's common stock on such date multiplied by the then-current conversion rate; (3) if the Company calls all or any portion of the notes for redemption, at any time prior to the close of business on the second scheduled trading day prior to the redemption date; or (4) upon the occurrence of specified corporate events. On or after September 15, 2018 until the close of business on the second scheduled trading day immediately preceding the stated maturity date, holders may surrender their Notes for conversion at any time, regardless of the foregoing circumstances.

Upon conversion, the Company will at its election pay or deliver, as the case may be, cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock.

The initial conversion rate will be 41.6051 shares of the Company's common stock for each $1,000 principal amount of Notes, which represents an initial conversion price of approximately $24.04 per share. Following certain corporate transactions that occur on or prior to the stated maturity date or the Company's delivery of a notice of redemption, the Company will increase the conversion rate for a holder that elects to convert its Notes in connection with such a corporate transaction.

If a fundamental change (as defined in the Indenture) occurs prior to the stated maturity date, holders may require the Company to purchase for cash all or any portion of their Notes at a fundamental change purchase price equal to 100% of the principal amount of the Notes to be purchased, plus accrued and unpaid interest to, but excluding, the fundamental change purchase date.

The Indenture contains customary terms and covenants and events of default with respect to the Notes. If an event of default (as defined in the Indenture) occurs and is continuing, either the Trustee or the holders of at least 25% in aggregate principal amount of the outstanding Notes may declare the principal amount of the Notes to be due and payable immediately by notice to the Company (with a copy to the Trustee). If an event of default arising out of certain events of bankruptcy, insolvency or reorganization involving the Company or a significant subsidiary (as set forth in the Indenture) occurs with respect to us, the principal amount of the Notes and accrued and unpaid interest, if any, will automatically become immediately due and payable.

The Company was not required to separate the conversion option in the Notes under ASC 815, "Derivatives and Hedging", and has the ability to settle the Notes in cash, common stock or a combination of cash and common stock, at its option. In accordance with cash conversion guidance contained in ASC 470-20, "Debt with Conversion and Other Options", the Company accounted for the Notes by allocating the issuance proceeds between the liability and the equity component. The equity component is classified in stockholders’ equity and the resulting discount on the liability component is accreted such that interest expense equals the Company’s nonconvertible debt borrowing rate. The separation was performed by first determining the fair value of a similar debt that does not have an associated equity component. That amount was then deducted from the initial proceeds of the Notes as a whole to arrive at a residual amount, which was allocated to the conversion feature that is classified as equity. The initial fair value of the indebtedness was $66.9 million resulting in a $19.3 million allocation to the embedded

conversion option. The embedded conversion option was recorded in stockholders' equity and as debt discount, to be subsequently accreted to interest expense over the term of the Notes. Underwriting discounts and commissions and offering expenses totaled $3.7 million and were allocated between the liability and the equity component in proportion to the allocation of proceeds and accounted for as debt issuance costs and equity issuance costs, respectively. As a result, $2.9 million attributable to the indebtedness was recorded as deferred financing costs in other assets, to be subsequently amortized as interest expense over the term of the Notes, and $0.8 million attributable to the equity component was recorded a a reduction to additional paid-in-capital in stockholders' equity.

As of June 30, 2014, the Company had outstanding borrowings of $68.7 million, and deferred financing costs of $2.6 million, related to the Notes. There are no principal payments due during the term. Annual interest expense on these notes will range from $5.7 million to $6.9 million through maturity.

Capped Call Transactions

On December 10, 2013, in connection with the pricing of the Notes and the exercise in full of their overallotment option by the underwriters, the Company entered into privately-negotiated capped call transactions (the "Capped Call Transactions") with Bank of America, N.A., an affiliate of Merrill Lynch, Pierce, Fenner & Smith Incorporated. The Capped Call Transactions initial conversion rate and number of options substantially corresponds to each $1,000 principal amount of Notes. The Company used approximately $7.4 million of the net proceeds from the Notes offering to pay for the cost of the Capped Call Transactions.

The Capped Call Transactions are separate transactions entered into by the Company with Bank of America, N.A., are not part of the terms of the Notes and will not change the holders' rights under the Notes. The Capped Call Transactions have anti-dilution adjustments substantially similar to those applicable to the Notes. The Capped Call Transactions are derivative instruments that qualify for classification within stockholders' equity because they meet an exemption from mark-to-market derivative accounting.

The Capped Call Transactions are expected generally to reduce the potential dilution and/or offset potential cash payments that the Company is required to make in excess of the principal amount upon conversion of the Notes in the event that the market price per share of the Company's common stock, as measured under the terms of the Capped Call Transactions, is greater than the strike price of the Capped Call Transactions, which initially corresponds to the $24.04 conversion price of the Notes. If, however, the market price per share of the Company's common stock, as measured under the terms of the Capped Call Transactions, exceeds the initial cap price of $29.02, there would nevertheless be dilution and/or there would not be an offset of such potential cash payments, in each case, to the extent that such market price exceeds the cap price of the Capped Call Transactions.

The Company will not be required to make any cash payments to Bank of America, N.A. or any of its affiliates upon the exercise of the options that are a part of the Capped Call Transactions, but will be entitled to receive from Bank of America, N.A. (or an affiliate thereof) a number of shares of the Company's common stock and/or an amount of cash generally based on the amount by which the market price per share of the Company's common stock, as measured under the terms of the Capped Call Transactions, is greater than the strike price of the Capped Call Transactions during the relevant valuation period under the Capped Call Transactions. However, if the market price of the Company's common stock, as measured under the terms of the Capped Call Transactions, exceeds the cap price of

the Capped Call Transactions during such valuation period under the Capped Call Transactions, the number of shares of common stock and/or the amount of cash the Company expects to receive upon exercise of the Capped Call Transactions will be capped based on the amount by which the cap price exceeds the strike price of the Capped Call Transactions.

For any conversions of Notes prior to the close of business on the 55th scheduled trading day immediately preceding the stated maturity date of the Notes, including without limitation upon an acquisition of the Company or similar business combination, a corresponding portion of the Capped Call Transactions will be terminated. Upon such termination, the portion of the Capped Call Transactions being terminated will be settled at fair value (subject to certain limitations), as determined by Bank of America, N.A., in its capacity as calculation agent under the Capped Call Transactions, which the Company expects to receive from Bank of America, N.A., and no payments will be due Bank of America, N.A. The capped call expires on December 13, 2018.

Wells Fargo line of credit

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In October 2009, the Company entered into a revolving credit facility with Wells Fargo Bank (“Wells”), which was last amended on March 31, 2014, whereby the Company may borrow up to $20.0 million, subject to the calculation and limitation of a borrowing base (the “Wells Credit Facility”). All amounts owing under the Wells Credit Facility will become due and payable upon its expiration on November 15, 2014. A sub-feature in the line of credit allows for the issuance of up to $7.5 million in letters of credit. As of June 30, 2014, the Company issued a total of $6.4 million in letters of credit under the Wells Credit Facility. Any outstanding amounts under the Wells Credit Facility bear interest at a variable rate equal to the Wells prime rate, plus 1.0%, which is payable on a monthly basis. The Wells Credit Facility is collateralized by all of the Company's assets, except its intellectual property.

The Wells Credit Facility contains financial covenants requiring the Company to (i) maintain a minimum current ratio of 2.0, equal to the quotient of modified current assets to current liabilities, as defined in the Wells Credit Facility (the "Modified Quick Ratio Covenant"), and (ii) not to exceed pre-tax net loss (excluding non-cash contingent consideration associated with the acquisition of Nellix) of $11.0 million for the three months ended March 31, 2014; $18.0 million for the six months ended June 30, 2014; $22.0 million for the nine months ended September 30, 2014; and $26.0 million for the year ended December 31, 2014 (the "Net Loss Covenant"). The Wells Credit Facility also included a negative covenant limiting 2013 capital expenditures to an aggregate of $6.0 million and 2014 capital expenditures to an aggregate of $13.0 million. The Company was in compliance with the financial covenants as of and for the three and six months ended June 30, 2014.

The Wells Credit Facility also contains a “material adverse change” clause (“MAC”). If the Company encounters difficulties that would qualify as a MAC in its (i) operations, (ii) condition (financial or otherwise), or (iii) ability to repay amounts outstanding under the Wells Credit Facility, it could be canceled at Wells' sole discretion. Wells could then elect to declare the indebtedness, together with accrued interest and other fees, to be immediately due and payable and proceed against any collateral securing such indebtedness. No borrowings were outstanding at June 30, 2014.

7. Revenue by Geographic Region

The Company's revenue by geographic region, was as follows:

	Three Months Ended June 30,				Six Months Ended June 30,				
	2014		2013		2014		2013		
United States	$27,992	73.0%	$26,342	77.6%	$51,980	72.6%	$51,069	80.1	%
Europe	$7,816	20.4%	$4,126	12.1%	$14,401	20.1%	$7,472	11.7	%
Rest of World ("ROW"):									
Latin America	$1,309	3.4%	$1,680	4.9%	$2,226	3.1%	$2,253	3.6	%
Asia/Pacific	1,210	3.2%	1,816	5.4%	2,984	4.2%	2,954	4.6	%
Total ROW	$2,519	6.6%	$3,496	10.3%	$5,210	7.3%	$5,207	8.2	%
Revenue	$38,327	100.0%	$33,964	100.0%	$71,591	100.0%	$63,748	100.0%	

8. Commitments and Contingencies

(a) Leases

The Company leases its administrative, research, and manufacturing facilities located in Irvine, California and an administrative office located in Den Bosch, The Netherlands. These facility lease agreements require the Company to pay operating costs, including property taxes, insurance, and maintenance. In addition, the Company has certain equipment under long-term agreements that are accounted for as operating leases.

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Future minimum payments by year under non-cancelable leases with initial terms in excess of one year were as follows as of June 30, 2014:

Remainder of 2014	$673
2015	2,066
2016	2,108
2017	2,165
2018	2,229
2019	2,296
2020 and thereafter	25,273
Total	$36,810

Facilities rent expense for the three months ended June 30, 2014 and 2013 were $0.7 million and $0.2 million, respectively. For the six months ended June 30, 2014 and 2013 facilities rent expense were $1.3 million and $0.3 million, respectively.

On June 12, 2013, the Company entered into a lease agreement for two adjacent office, research and development, and manufacturing facilities in Irvine, California. The premises consist of approximately 129,000 combined square feet. The lease has a 15-year term beginning January 1, 2014 and provides for one optional five year extension. The initial base rent under the lease is $1.9 million per year, payable in monthly installments, and escalates by 3% per year for years 2015 through 2019, and 4% per year for years 2020 and beyond. The Company is entitled to rent abatement for the first nine months of the lease. These premises will replace the Company's existing Irvine facilities.

The terms of this lease agreement provide for $6.8 million of landlord-funded improvements (and certain other allowances) to this facility, in order to best suit the Company's requirements. In June 2013, the Company had Wells Fargo issue the landlord two letters of credit in the aggregate amount of $6.4 million under its Wells Credit Facility, representing financial collateral while these facility improvements are completed. The Company placed the same amount in a restricted cash account with Wells Fargo, in order to fully support these issued, but undrawn, letters of credit. In July 2013, this restricted cash account was fully released under the July 26, 2013 amendment to the Wells Fargo Credit Facility.

(b) Employment Agreements and Retention Plan

The Company has entered into employment agreements with its executive officers under which payment and benefits would become payable in the event of termination by the Company for any reason other than cause, death or disability or termination by the employee for good reason (collectively, an “Involuntary Termination”) prior to, upon or following a change in control of the Company. The severance payment will generally be in a range of six to eighteen months of the employee’s then current salary for an Involuntary Termination prior to a change in control of the Company, and will generally be in a range of eighteen to twenty-four months of the employee’s then current salary for an Involuntary Termination upon or following a change in control of the Company.

(c) Legal Matters

We are from time to time involved in various claims and legal proceedings of a nature we believe are normal and incidental to a medical device business. These matters may include product liability, intellectual property, employment, and other general claims. Such cases and claims may raise complex factual and legal issues and are subject to many uncertainties, including, but not limited to, the facts and circumstances of each particular case or claim, the jurisdiction in which each suit is brought, and differences in applicable law. We accrue for contingent

liabilities when it is probable that a liability has been incurred and the amount can be reasonably estimated. The accruals are adjusted periodically as assessments change or as additional information becomes available.

LifePort Sciences LLC v. Endologix, Inc.

On December 28, 2012, LifePort Sciences, LLC ("LifePort") filed a complaint against us in the U.S. District Court, District of Delaware, alleging that certain of our products infringe U.S. Patent Nos. 5,489,295, 6,117,167, 6,302,906, 5,993,481 and 5,676,696, which are alleged to be owned by LifePort. LifePort is seeking an unspecified amount of monetary damages for sale of our products and injunctive relief. We do not believe that we infringe on any of these patents and we intend to vigorously

defend against this matter. The case is currently scheduled for trial in April 2016. We do believe, however, that the outcome will not have a material adverse effect on our financial position, results of operations, or cash flow. However, in order to avoid further legal costs and diversion of management resources, it is reasonably possible that we may reach a settlement with LifePort, which could result in a liability. However, we cannot presently estimate the amount, or range, of reasonably possible losses due to the nature of this potential litigation settlement.

9. Contingently Issuable Common Stock

On October 27, 2010, Endologix, Inc. (the "Company"), entered into an Agreement and Plan of Merger and Reorganization (the "Merger Agreement") with Nepal Acquisition Corporation, a wholly-owned subsidiary of the Company ("Merger Sub"), Nellix, Inc., certain of Nellix's stockholders named therein and Essex Woodlands Health Ventures, Inc., as representative of the former Nellix stockholders. On December 10, 2010 (the "Nellix Closing Date"), the Company completed the merger (the "Merger") of Merger Sub with and into Nellix Inc., a pre-revenue, AAA medical device company pursuant to the terms of the Merger Agreement. The purchase price consisted of 3.2 million shares of the Company's common stock, issuable to the former Nellix stockholders as of the Nellix Closing Date, then representing a value of $19.4 million. Additional payments, solely in the form of shares of the Company's common stock (the "Contingent Payment"), will be made upon the achievement of a revenue milestone and a regulatory approval milestone (collectively, the "Nellix Milestones").

The ultimate value of the Contingent Payment will be determined on the date that each Nellix Milestone is achieved. The number of issuable shares will be established using an applicable per share price, which is subject to a ceiling and/or floor, resulting at the closing of the merger in a potential maximum of 10.2 million shares issuable upon the achievement of the Nellix Milestones. As of the Closing Date, the fair value of the Contingent Payment was estimated to be $28.2 million.

The Merger Agreement provides that, in addition to the shares of common stock of the Company (the "Common Stock") issued to the former Nellix stockholders at the closing of the Merger, the former Nellix stockholders are entitled to receive shares of the Common Stock if the Company's sales of one of Nellix's products (the "Nellix Product") outside of the United States exceed $10.0 million within a certain time period following the Company's receipt of CE mark approval for the Nellix Product (the "OUS Milestone"). The aggregate dollar value of the shares of the Common Stock to be issued upon achievement of the OUS Milestone ranged from a high of $24.0 million to a low of $10.0 million. The price per share of the Common Stock to be issued upon achievement of the OUS Milestone was subject to a floor of $3.50 per share and a ceiling of $7.50 per share.

On June 17, 2014, the Company announced its achievement of the OUS Milestone and the issuance of an aggregate of 2.7 million unregistered shares of the Common Stock (the "OUS Milestone Shares"), plus an amount of cash in lieu of fractional shares, to the former Nellix stockholders. The Company offered and sold the OUS Milestone Shares in reliance upon exemptions from registration pursuant to Section 4(2) under the Securities Act of 1933, as amended (the "Securities Act"). The former Nellix stockholders previously gave representations to the Company regarding their investment intent, experience, financial sophistication, access to information regarding the Company and certain other matters to support the Company's reasonable belief that it could rely upon the foregoing exemptions from registration pursuant to Section 4(2) of the Securities Act. No underwriting discounts or commissions were or will be paid in conjunction with the issuance of the OUS Milestone Shares. The Company previously filed a Registration Statement on Form S-3 (Registration No. 333-171639) (the "Form S-3") for the purpose of registering for resale shares of the Common Stock issued or issuable pursuant to the Merger Agreement, including the OUS Milestone Shares. The Securities and Exchange Commission declared the Form S-3 effective on January 18, 2011.

If the Company receives approval from the FDA to sell the Nellix Product in the United States (the “PMA Milestone”), the Company will issue additional shares of the Common Stock to the former stockholders of Nellix. The dollar value of the shares of the Common Stock to be issued upon achievement of the PMA Milestone will be equal to $15.0 million (less the dollar value of certain cash payments and other deductions). The price per share of the shares of the Common Stock to be issued upon achievement of the PMA Milestone is subject to a stock price floor of $4.50 per share, but not subject to a stock price ceiling.

As of June 30, 2014 the Company's stock price last closed at $15.21 per share. Thus, had the PMA Milestone been achieved on June 30, 2014, the Contingent Payment would have comprised 1.1 million shares, representing a value of $16.7 million.

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The value of the Contingent Payment is derived using a discounted income approach model, with a range of probabilities and assumptions related to the timing and likelihood of achievement of the PMA Milestone (which include Level 3 inputs - see Note 3(e) and the Company's stock price (Level 1 input) as of the balance sheet date). These varying probabilities and assumptions and changes in the Company's stock price have required fair value adjustments of the Contingent Payment in periods subsequent to the Nellix Closing Date.

The Contingent Payment fair value will continue to be evaluated on a quarterly basis until milestone achievement occurs, or until the expiration of the "earn-out period," as defined within the Nellix purchase agreement. Adjustments to the fair value of the Contingent Payment are recognized within other income (expense) in the Condensed Consolidated Statements of Operations and Comprehensive Income (Loss).

	Fair Value of Contingently Issuable Common Stock
December 31, 2013	$60,900
Fair Value Adjustment of Contingent Payment for the six months ended June 30, 2014	(8,028)
Fair Value of OUS Milestone Shares	(38,372)
June 30, 2014	$14,500

10. Income Tax Expense

The Company applied an estimated annual effective tax rate (“ETR”) approach for calculating a tax provision for interim periods. The Company recorded a benefit (provision) for income taxes of $0.1 million and $(0.1) million for the three and six months ended June 30, 2014. The Company's ETR was 0.9% and (3.8)% for the three and six months ended June 30, 2014. The Company's ETR for the three and six months ended June 30, 2014 differs from the U.S. federal statutory tax rate of 34% primarily as a result of nondeductible expenses (including the Nellix Contingent Payment), state income taxes, foreign income taxes, and the impact of a full valuation allowance on its deferred tax assets.

The Company has evaluated the available evidence supporting the realization of its deferred tax assets, including the amount and timing of future taxable income, and has determined that it is more likely than not that its net deferred tax assets will not be realized in the U.S. and certain foreign jurisdictions. Due to uncertainties surrounding the realization of the deferred tax assets, the Company maintains a full valuation allowance against substantially all deferred tax assets. If/when the Company determines that it will be able to realize some portion or all of its deferred tax assets, an adjustment to its valuation allowance on its deferred tax assets would have the effect of increasing net income in the period(s) such determination is made.

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

Cautionary Note Concerning Forward-Looking Statements

In addition to historical information, this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the "Securities Act"), and Section 21E of the Securities Exchange Act of 1934, as amended (the "Exchange Act"). These forward looking statements are intended to qualify for the safe harbor from liability established by the Private Securities Litigation Reform Act of 1995. You can identify forward-looking statements by the use of forward-looking terminology such as "anticipates," "believes," "can," "continue," "could," "estimates," "expects," "intends," "may," "plans," "potential," "predicts," "should" or "will" or the negati terms or other comparable terminology, or by discussions of strategies, opportunities, plans or intentions. In addition, any statements that refer to projections of our future financial performance, trends in our businesses, or other characterizations of future events or circumstances are forward-looking statements. We have based these forward-looking statements largely on our current expectations based on information currently available to us and projections about future events and trends affecting the financial condition of our business. Although we do not make forward-looking statements unless we believe we have a reasonable basis for doing so, we cannot guarantee their accuracy. These forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially from future results expressed or implied by such forward-looking statements. Actual results could differ materially from those projected in forward-looking statements as a result of the following factors, among others:

- continued market acceptance of our products;
- continued growth in the number of patients qualifying for treatment of abdominal aortic aneurysms through our products;
- our ability to effectively compete with the products offered by our competitors;
- the level and availability of third party payor reimbursement for our products;
- our ability to successfully commercialize products which incorporate the technology obtained in our acquisition of Nellix, Inc. ("Nellix");
- our ability to effectively develop new or complementary technologies;
- our ability to manufacture our endovascular systems to meet demand;
- changes to our international operations;
- our ability to effectively manage our business and keep pace with our anticipated growth;
- our ability to develop and retain a direct sales force in the United States and select European and other foreign countries;
- the nature of and any changes to legislative, regulatory and other legal requirements that apply to us, our products, our suppliers and our competitors;
- the timing of and our ability to obtain and maintain any required regulatory clearances and approvals;
- our ability to protect our intellectual property rights and proprietary technologies;
- our ability to operate our business without infringing the intellectual property rights and proprietary technology of third parties;
- product liability claims and litigation expenses; reputational damage to our products caused by mis-use or off-label use or government or voluntary product recalls;
- our utilization of a single source supplier for specialized components of our product lines;
- our ability to attract, retain, and motivate qualified personnel;
- our ability to make future acquisitions and successfully integrate any such future-acquired businesses;
- our ability to maintain adequate liquidity to fund our operational needs and research and developments expenses; and
- general macroeconomic and world-wide business conditions.

Our actual results, performance or achievements may differ materially from any future results, performance or achievements expressed or implied from such forward-looking statements. Important factors that could cause our actual results, performance or achievements to differ materially from our expectations are disclosed in our Annual Report on Form 10-K for the year ended December 31, 2013, filed with the SEC on March 3, 2014, including but not limited to those factors discussed in “Management's Discussion and Analysis of Financial Condition and Results of Operations,” “Risk Factors,” “Consolidated Financial Statements” and “Notes to Consolidated Financial Statements.” All subsequent written and oral forward-looking statements attributable to us or by persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. We expressly disclaim any intent or obligation to update information contained in any forward-looking statement after the date thereof to conform such information to actual results or to changes in our opinions or expectations.

Our forward-looking statements speak only as of the date each such statement is made. We expressly disclaim any intent or obligation to update any forward-looking statements after the date hereof to conform such statements to actual results or to changes

in our opinions or expectations, except as required by applicable law or the rules and regulations of the SEC and The NASDAQ Stock Market, LLC.

Overview

Our Business

Our corporate headquarters and manufacturing facility is located in Irvine, California. We develop, manufacture, market, and sell innovative medical devices for the treatment of aortic disorders. Our principal products are intended for the treatment of abdominal aortic aneurysms ("AAA"). Our AAA products are built on one of two platforms: (1) traditional minimally-invasive endovascular repair ("EVAR") or (2) endovascular sealing (“EVAS”), our innovative solution for sealing the aneurysm sac while maintaining blood flow through two blood flow lumens.

We sell our products through (i) our direct U.S. and European sales forces and (ii) third-party international distributors and agents in other parts of the world.

See Item 1. of our Annual Report on Form 10-K for the year ended December 31, 2013, entitled "Business," for a discussion of:

- Market Overview and Opportunity
- Our Products
- Manufacturing and Supply
- Marketing and Sales
- Competition
- Clinical Trials and Product Developments

Endologix®, AFX® and Nellix® are registered trademarks of Endologix, Inc., and Ventana™, VELA™ and the respective product logos are trademarks of Endologix, Inc.

Recent Highlights of Our Product Development Initiatives and Regulatory Approvals

Nellix

In February 2013, our EVAS device, the Nellix EVAS System, commenced limited market introduction in Europe and a limited commercial release is currently underway. In December 2013, we received Investigational Device Exemption approval in the United States to begin a clinical trial which commenced in January 2014.

AFX

In February 2014, we launched a new proximal extension in the US, VELA, designed specifically for the treatment of proximal aortic neck anatomies. VELA features a circumferential graft line marker and controlled delivery system that enable predictable deployment and final positional adjustments. The VELA launch is expected in Europe in the second half of 2014.

Characteristics of Our Revenue and Expenses

Revenue

Revenue is derived from sales of our EVAR and EVAS products (including extensions and accessories) to hospitals upon completion of AAA repair procedure, or from sales to distributors upon title transfer (which is typically at shipment), provided our other revenue recognition criteria have been met.

Cost of Goods Sold

Cost of goods sold includes compensation (including stock-based compensation) and benefits of production personnel and production support personnel. Cost of goods sold also includes depreciation expense for production equipment, production materials and supplies expense, allocated facilities-related expenses, and certain direct costs such as shipping.

Research and Development

Research and development expenses consist of compensation (including stock-based compensation) and benefits for research and development personnel, materials and supplies, research and development consultants, outsourced and licensed research and development costs, and allocated facilities-related costs. Our research and development activities primarily relate to the development and testing of new devices and methods to treat aortic disorders.

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Clinical and Regulatory

Clinical and regulatory expenses consist of compensation (including stock-based compensation) and benefits for clinical and regulatory personnel, regulatory and clinical payments related to studies, regulatory costs related to registration and approval activities, and allocated facilities-related costs. Our clinical and regulatory activities primarily relate to gaining regulatory approval for the commercialization of our devices.

Marketing and Sales

Marketing and Sales expenses primarily consist of compensation (including stock-based compensation) and benefits for our sales force, clinical specialist, internal sales support functions, and marketing personnel. It also includes costs attributable to marketing our products to our customers and prospective customers.

General and Administrative

General and administrative expenses primarily include compensation (including stock-based compensation) and benefits for personnel that support our general operations such as information technology, executive management, financial accounting, and human resources. General and administrative expenses also include bad debt expense, patent and legal fees, financial audit fees, insurance, recruiting fees, other professional services, the federal Medical Device Excise Tax, and allocated facilities-related expenses.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets, liabilities, and the disclosure of contingent assets and liabilities as of the date of the financial statements and the reported amounts of revenue and expenses during the periods presented. While management believes these estimates are reasonable and consistent, they are by their very nature, estimates of amounts that will depend on future events. Accordingly, actual results could differ from these estimates. Our Audit Committee periodically reviews our significant accounting policies.

For a description of our critical accounting policies and estimates, please refer to the “Critical Accounting Policies and Estimates” section in Part II, Item 7, “Management’s Discussion and Analysis of Financial Condition and Results of Operations”, in our Annual Report on Form 10-K for the year ended December 31, 2013. There have been no material changes in any of our critical accounting policies and estimates during the three and six months ended June 30, 2014.

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Results of Operations

Operations Overview - Three and Six Months Ended June 30, 2014 versus 2013

The following table presents our results of continuing operations and the related percentage of the period's revenue (in thousands):

	Three Months Ended June 30,				Six Months Ended June 30,			
	2014		2013		2014		2013	
Revenue	$38,327	100.0%	$33,964	100.0%	$71,591	100.0%	$63,748	100.0%
Cost of goods sold	9,820	25.6%	8,960	26.4%	18,789	26.2%	16,216	25.4%
Gross profit	28,507	74.4%	25,004	73.6%	52,802	73.8%	47,532	74.6%
Operating expenses:								
Research and development	4,458	11.6%	3,822	11.3%	8,563	12.0%	7,341	11.5%
Clinical and regulatory affairs	2,722	7.1%	2,189	6.4%	4,922	6.9%	4,553	7.1%
Marketing and sales	19,167	50.0%	16,520	48.6%	35,311	49.3%	32,044	50.3%
General and administrative	5,932	15.5%	4,993	14.7%	13,094	18.3%	10,604	16.6%
Total operating expenses	32,279	84.2%	27,524	81.0%	61,890	86.4%	54,542	85.5%
Loss from operations	(3,772)	(9.8)%	(2,520)	(7.4)%	(9,088)	(12.7)%	(7,010)	(10.9)%
Total other income (expense)	(5,301)	(13.8)%	8,046	23.7%	5,526	7.7%	3,540	5.6%
Net income (loss) before income tax expense	(9,073)	(23.6)%	5,526	16.3%	(3,562)	(5.0)%	(3,470)	(5.3)%
Income tax benefit (expense)	80	0.2%	144	0.4%	(136)	(0.2)%	(195)	(0.3)%
Net income (loss)	$(8,993)	(23.4)%	$5,670	16.7%	$(3,698)	(5.2)%	$(3,665)	(5.6)%

Comparison of the Three Months Ended June 30, 2014 versus 2013

Revenue

	Three Months Ended June 30,			
	2014	2013	Variance	Percent Change
	(in thousands)			
Revenue	$38,327	$33,964	$4,363	12.8%

Our 12.8% revenue increase of $4.4 million over the prior year period primarily resulted from:

(i) a $3.7 million increase in European sales volume due to strong direct sales growth related to both Nellix and AFX;

(ii) a $1.7 million increase in U.S. sales procedures due to continued physician adoption of AFX;

(iii) a decrease in sales volume to Latin America and our Asia Pacific markets.

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Cost of Goods Sold, Gross Profit, and Gross Margin

	Three Months Ended June 30,			
	2014	2013	Variance	Percent Change
	(in thousands)			
Cost of goods sold	$9,820	$8,960	$860	9.6 %
Gross profit	28,507	25,004	3,503	14.0 %
Gross margin percentage (gross profit as a percent of revenue)	74.4 %	73.6 %		

The $0.9 million increase in cost of goods sold was primarily driven by our revenue increase of $4.4 million.

Gross margin for the three months ended June 30, 2014 increased to 74.4% from 73.6% for the three months ended June 30, 2013. The increase in gross margin is primarily due to a $1.2 million decrease in charges to adjust our inventory to its net realizable value. This was partially offset by product and geography mix with a greater proportion of sales from international markets, which have lower average selling prices; in addition, Nellix has a higher cost to produce compared to AFX.

Operating Expenses

	Three Months Ended June 30,			
	2014	2013	Variance	Percent Change
	(in thousands)			
Research and development	$4,458	$3,822	$636	16.6%
Clinical and regulatory affairs	2,722	2,189	533	24.3%
Marketing and sales	19,167	16,520	2,647	16.0%
General and administrative	5,932	4,993	939	18.8%

Research and Development. The $0.6 million increase in research and development expenses was primarily attributable to continued product development investments related to Nellix and AFX.

Clinical and Regulatory Affairs. The $0.5 million increase in clinical expenses is due to continued patient and outside services costs to support ongoing clinical trials.

Marketing and Sales. The $2.6 million increase in marketing and sales expenses for the three months ended June 30, 2014, as compared to the prior year period, was primarily related to increased investments in our European sales force and marketing activities.

General and Administrative. The $0.9 million increase in general and administrative expenses is primarily attributable to professional fees, audit fees and expense to support the continued growth in Europe.

Other income (expense), net

	Three Months Ended June 30,			
	2014	2013	Variance	Percent Change
	(in thousands)			
Other income (expense), net	$(5,301)	$8,046	(13,347)	>100%

Other Income (Expense), Net. Other expense for the three months ended June 30, 2014 includes a non-cash expense of $3.8 million which reflects an increase in the fair value of the Nellix Contingent consideration, which was almost entirely related to the increase in Endologix's stock price during the quarter (see Note 9) along with interest expense associated with our convertible notes. Other income for the three months ended June 30, 2013 includes non-cash income of $7.6 million, which reflects a decrease in the fair value of the Nellix Contingent consideration.

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Provision for Income Taxes

	Three Months Ended June 30,			
	2014	2013	Variance	Percent Change
	(in thousands)			
Income tax benefit	$80	$144	$(64)	(44.4)%

Our income tax benefit was $0.1 million and our effective tax rate was 0.9% for the three months ended June 30, 2014 due to our tax positions in various jurisdictions. During the three months ended June 30, 2014 and 2013, we had operating legal entities in the U.S., Italy, New Zealand, Switzerland and the Netherlands (including registered sales branches in certain countries in Europe).

Comparison of the Six Months Ended June 30, 2014 versus 2013

Revenue

	Six Months Ended June 30,			
	2014	2013	Variance	Percent Change
	(in thousands)			
Revenue	$71,591	$63,748	$7,843	12.3%

Our 12.3% revenue increase of $7.8 million over the prior year period primarily resulted from:

(i) a $6.9 million increase in European sales volume due to strong direct sales growth related to both Nellix and AFX;

(ii) a $0.9 million increase in U.S. sales procedures due to continued physician adoption of AFX.

(iii) sales volume to Latin America and our Asia Pacific markets remained flat.

Cost of Goods Sold, Gross Profit, and Gross Margin

	Six Months Ended June 30,			
	2014	2013	Variance	Percent Change
	(in thousands)			
Cost of goods sold	$18,789	$16,216	$2,573	15.9 %
Gross profit	52,802	47,532	5,270	11.1 %
Gross margin percentage (gross profit as a percent of revenue)	73.8 %	74.6 %		

The $2.6 million increase in cost of goods sold was driven by our revenue increase of $7.8 million.

Gross margin for the six months ended June 30, 2014 decreased to 73.8% from 74.6% for the six months ended June 30, 2013. The increase in cost of goods sold, and corresponding decrease to gross margin is due to geography and product mix with a greater proportion of sales from international markets, which have lower average selling prices; in addition, Nellix has a higher cost to produce compared to AFX. This increase in cost was partially offset by a decrease in charges to adjust our inventory to its net realizable value.

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Operating Expenses

	Six Months Ended June 30,			
	2014	2013	Variance	Percent Change
	(in thousands)			
Research and development	$8,563	$7,341	$1,222	16.6%
Clinical and regulatory affairs	4,922	4,553	369	8.1%
Marketing and sales	35,311	32,044	3,267	10.2%
General and administrative	13,094	10,604	2,490	23.5%

Research and Development. The $1.2 million increase in research and development expenses was primarily attributable to continued product development investments related to Nellix and AFX.

Clinical and Regulatory Affairs. The $0.4 million increase in clinical expenses is due to continued patient and outside services costs to support ongoing clinical trials.

Marketing and Sales. The $3.3 million increase in marketing and sales expenses for the six months ended June 30, 2014, as compared to the prior year period, was primarily related to increased investments in our European sales force and marketing activities.

General and Administrative. The $2.5 million increase in general and administrative expenses is primarily attributable to professional fees, audit fees and expense to support the continued growth in Europe.

Other income (expense), net

	Six Months Ended June 30,			
	2014	2013	Variance	Percent Change
	(in thousands)			
Other income, net	$5,526	$3,540	1,986	56.1%

Other Income (Expense), Net. Other Income for the six months ended June 30, 2014 includes a non-cash benefit of $8.0 million, which reflects a decrease in the fair value of the Nellix contingent consideration, which was related to the decrease in Endologix's stock price during the six months ended June 30, 2014 (see Note 9). Partially offsetting this fair value adjustment is interest expense associated with our convertible notes.

Provision for Income Taxes

	Six Months Ended June 30,			
	2014	2013	Variance	Percent Change
	(in thousands)			
Income tax expense	$(136)	$(195)	$59	(30.3)%

Our income tax expense was $0.1 million and our effective tax rate was (3.8)% for the six months ended June 30, 2014. During the six months ended June 30, 2014 and 2013, we had operating legal entities in the U.S., Italy, New Zealand, Switzerland and the Netherlands (including registered sales branches in certain countries in Europe). We have certain minimum tax liabilities attributable to our operations in these countries and in the U.S (see Note 10).

Liquidity and Capital Resources

The chart provided below summarizes selected liquidity data and metrics as of June 30, 2014, December 31, 2013, and June 30, 2013:

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	June 30, 2014	December 31, 2013	June 30, 2013
	(in thousands, except financial metrics data)		
Cash and cash equivalents	$31,843	$95,152	$39,807
Marketable securities	78,941	31,313	—
Accounts receivable, net	26,714	24,972	28,245
Total current assets	170,719	173,633	93,138
Total current liabilities	28,589	67,335	21,353
Working capital surplus (a)	142,130	106,298	71,785
Current ratio (b)	6.0	2.6	4.4
Days sales outstanding ("DSO") (c)	63	65	76
Inventory turnover (d)	1.5	1.7	2.0

(a) total current assets minus total current liabilities as of the corresponding balance sheet date.
(b) total current assets divided by total current liabilities as of the corresponding balance sheet date.
(c) net accounts receivable at period end divided by revenue for the current period multiplied by the number of days in the period.
(d) cost of goods sold divided by the average inventory balance for the corresponding period.

Operating Activities

Cash used in operating activities was $10.2 million for the six months ended June 30, 2014 as compared to cash used in operating activities of $1.7 million in the prior year period. The cash used in operating activities primarily consisted of (i) a change in the fair value of the Nellix contingent consideration of $8.0 million; (ii) inventory purchases of $8.8 million; offset by an increase in accounts payable of $3.9 million and accretion of interest on convertible note by $1.6 million.

During the six months ended June 30, 2014, and 2013 our cash collections from customers totaled $71.0 million and $60.1 million, respectively, representing 99% and 94.0% of reported revenue for the same periods.

Investing Activities

Cash used in investing activities for the six months ended June 30, 2014 was $54.3 million, as compared to cash used in investing activities of $1.4 million in the prior year period. The cash used in investing activities primarily consisted of $5.7 million used for machinery and equipment purchases and $74.1 million used to purchase marketable debt securities; offset by $25.6 million in maturities of marketable securities.

Financing Activities

Cash provided by financing activities was $1.1 million for the six months ended June 30, 2014, as compared to cash used in financing activities of $2.4 million in the prior year period. Cash used in financing activities consisted of $1.4 million used in minimum tax withholding paid on behalf of employees for restricted stock units; offset by proceeds of $1.1 million from the exercise of stock options and proceeds from employee stock purchase plan of $1.4 million.

Credit Arrangements

See Note 6 of the Notes to the Condensed Consolidated Financial Statements. We were in compliance with all debt covenants as of June 30, 2014.

Credit Risk

The majority of our accounts receivable arise from product sales in the U.S. However, we also have significant receivable balances from customers within the European Union, Japan, Brazil, Argentina, and Mexico. Our accounts receivable in the U.S. are primarily due from public and private hospitals. Our accounts receivable outside of the U.S. are primarily due from public and private hospitals and independent distributors. Our historical write-offs of accounts receivable have not been significant.

We monitor the financial performance and credit worthiness of our customers so that we can properly assess

and respond to changes in their credit profile. Since our customers operate in certain countries such as Greece and Italy, where adverse economic conditions persist, it increases the risk of our inability to collect amounts due to us from them. To determine our allowance for doubtful accounts we consider these factors and other relevant considerations. Our allowance for doubtful accounts of $0.2 million as of June 30, 2014, represents our best estimate of the amount of probable credit losses in our existing accounts receivable.

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Future Capital Requirements

We believe that the future growth of our business will depend upon our ability to successfully develop new technologies for the treatment of aortic disorders and successfully bring these technologies to market. We expect to incur significant expenditures in completing product development and clinical trials for Ventana and the Nellix System.

The timing and amount of our future capital requirements will depend on many factors, including:

- the need for working capital to support our sales growth;
- the need for additional capital to fund future development programs;
- the need for additional capital to fund our sales force expansion;
- the need for additional capital to fund strategic acquisitions;
- our requirements for additional facility space or manufacturing capacity;
- our requirements for additional information technology infrastructure and systems; and
- adverse outcomes from potential litigation and the cost to defend such litigation.

We believe that our world-wide cash resources are adequate to operate our business. We presently have several operating subsidiaries and branches outside of the U.S. As of June 30, 2014, these subsidiaries and branches hold an aggregate $6.5 million in foreign bank accounts to fund their local operations. A portion of these balances related to undistributed earnings, and are deemed by management to be permanently reinvested in the corresponding country in which our subsidiary operates. Management has no present or planned intention to repatriate foreign earnings into the U.S. However, in the event that we required additional funds in the U.S. and had to repatriate any foreign earnings to meet those needs, we would then need to accrue, and ultimately pay, incremental income tax expenses on such "deemed dividend," unless we then had sufficient net operating losses to offset this potential tax liability.

In the event we require additional financing in the future, it may not be available on commercially reasonable terms, if at all. Even if we are able to obtain financing, it may cause substantial dilution (in the case of an equity financing), or may contain burdensome restrictions on the operation of our business (in the case of debt financing). If we are not able to obtain required financing, we may need to curtail our operations and/or our planned product development.

Contractual Obligations

Contractual obligation payments by year with initial terms in excess of one year were as follows as of June 30, 2014 (in thousands):

	Payments due by period							
Contractual Obligations	Total	Remainder of 2014	2015	2016	2017	2018	2019	2020 and thereafter
Long-term debt obligations	$86,250	$—	$—	$—	$—	$86,250	$—	$—
Interest on debt obligations	8,734	970	1,941	1,941	1,941	1,941	—	—
Operating lease obligations	36,810	673	2,066	2,108	2,165	2,229	2,296	25,273
Total	$131,794	$1,643	$4,007	$4,049	$4,106	$90,420	$2,296	$25,273

Refer to Note 6 of the Notes to the Condensed Consolidated Financial Statements for a discussion of long-term debt obligations and Note 8 of the Notes to the Condensed Consolidated Financial Statements for a discussion of operating lease obligations.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements (except for operating leases) that provide financing, liquidity, market or credit risk support, or involve derivatives. In addition, we have no arrangements that may expose us to liability that are not expressly reflected in the accompanying Consolidated Financial Statements.

As of June 30, 2014, we did not have any relationships with unconsolidated entities or financial partnerships, often referred to as "structured finance" or "special purpose entities," established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, we are not subject to any material financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

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Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK.

We do not believe that we currently have material exposure to interest rate, foreign currency exchange rate or other relevant market risks.

Interest Rate and Market Risk. We have investments in U.S. Government and agency securities, corporate bonds and other debt securities. As a result, we are exposed to potential loss from market risks that may occur as a result of changes in interest rates, changes in credit quality of the issuer or otherwise.

We generally place our marketable security investments in high quality credit instruments, as specified in our investment policy guidelines. A hypothetical 100 basis point decrease in interest rates would result in an approximate $82,910 increase in the fair value of our investments as of June 30, 2014. We believe, however, that the conservative nature of our investments mitigates our interest rate exposure, and our investment policy limits the amount of our credit exposure to any one issue, issuer (with the exception of U.S. agency obligations) and type of instrument. We do not expect any material loss from our marketable security investments and therefore believe that our potential interest rate exposure is limited. We intend to hold the majority of our investments to maturity, in accordance with our business plans.

We do not use derivative financial instruments in our investment portfolio. We are averse to principal loss and try to ensure the safety and preservation of our invested funds by limiting default risk, market risk, and reinvestment risk. We attempt to mitigate default risk by investing in only high credit quality securities and by positioning our portfolio to appropriately respond to a significant reduction in the credit rating of any investment issuer or guarantor.

We are also exposed to market risk for changes in interest rates on the Wells Credit Facility. All outstanding amounts under the Wells Credit Facility bear interest at a variable rate equal to the Wells prime rate, plus 1.00%, which is payable on a monthly basis. As of June 30, 2014, we had no amounts outstanding under the Wells Credit Facility. However, if we draw down the Wells Credit Facility, we may be exposed to market risk due to changes in the rate at which interest accrues.

Our Senior Notes bear fixed interest rates, and therefore, would not be subject to interest rate risk. The capped call transactions are derivative instruments that qualify for classification within stockholders' equity because they meet an exemption from mark-to-market derivative accounting. The settlement amounts for the capped call transactions are each determined based upon the difference between a strike price and a traded price of the Company's common stock.

Foreign Currency Transaction Risk. While a majority of our business is denominated in the U.S. dollar, a portion of our revenue and expenses are denominated in foreign currencies. Fluctuations in the rate of exchange between the U.S. dollar and the Euro or the British Pound Sterling may affect our results of operations and the period-to-period comparisons of our operating results. Foreign currency transaction realized and unrealized gains and losses resulted in approximately $0.2 million of losses and $0.2 million of gain during the three and six months ended June 30, 2014, respectively. During the three and six months ended June 30, 2014, our primary exposure to foreign currency rates related to our Europe operations.

Item 4. CONTROLS AND PROCEDURES.

We carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)). Based on that evaluation, our chief executive officer and chief financial officer have concluded that our disclosure controls and

procedures, as of the end of the period covered by this report, were effective to ensure that information we are required to disclose in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in SEC rules and to ensure that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is accumulated and communicated to our management, including our chief executive officer and chief financial officer, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure.

There has been no change in our internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) during the second quarter of 2014 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

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Part II. Other Information

Item 1. LEGAL PROCEEDINGS.

Refer to Note 8 of the Notes to the Condensed Consolidated Financial Statements for discussion of legal proceedings.

Item 6. EXHIBIT INDEX.

The following exhibits are filed or furnished herewith:

Exhibit 3.1		Amended and Restated Certificate of Incorporation, as amended.
Exhibit 31.1		Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934.
Exhibit 31.2		Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934.
Exhibit 32.1	(1)	Certification of Chief Executive Officer Pursuant to Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
Exhibit 32.2	(1)	Certification of Chief Financial Officer Pursuant to Rule 13a-14(b)/15d-14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
Exhibit 101.INS		XBRL Instance Document
Exhibit 101.SCH		XBRL Taxonomy Extension Schema Document
Exhibit 101.CAL		XBRL Taxonomy Extension Calculation Lin Base Document
Exhibit 101.DEF		XBRL Taxonomy Extension Definition Link Base Document
Exhibit 101.LAB		XBRL Taxonomy Extension Label Link Base Document
Exhibit 101.PRE		XBRL Taxonomy Extension Presentation Link Base Document

(1) Furnished herewith and not “filed” for purposes of Section 18 of the Securities Exchange Act of 1934, as amended.

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SIGNATURES

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

ENDOLOGIX, INC.

July 31, 2014	/s/ John McDermott Chief Executive Officer and Chairman of the Board (Principal Executive Officer)
July 31, 2014	/s/ Shelley B. Thunen Chief Financial Officer (Principal Financial and Accounting Officer)