NUVASIVE INC
Form 10-Q
November 05, 2010

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

OR

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 000-50744

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

Delaware	**33-0768598**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

7475 Lusk Boulevard
San Diego, CA 92121
(Address of principal executive offices, including zip code)
(858) 909-1800
(Registrant s telephone number, including area code)
(Former name, former address and former fiscal year, if changed since last report)

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 þ 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files).

Yes þ 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 þ	Accelerated filer o	Non-accelerated filer o	Smaller reporting company o

(Do not check if a 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 o No þ

As of October 29, 2010, there were 39,427,829 shares of the registrant s common stock outstanding.

NUVASIVE, INC.
QUARTERLY REPORT ON FORM 10-Q
September 30, 2010
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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements

NUVASIVE, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except par value)

	September 30, 2010 (Unaudited)	December 31, 2009
ASSETS		
Current assets:		
Cash and cash equivalents	$ 70,590	$ 65,413
Short-term marketable securities	106,546	99,279
Accounts receivable, net	71,617	58,462
Inventory	98,789	90,191
Prepaid expenses and other current assets	4,520	3,757
Total current assets	352,062	317,102
Property and equipment, net	101,120	82,602
Long-term marketable securities	39,629	39,968
Intangible assets, net	101,670	103,338
Goodwill	101,938	101,938
Other assets	14,470	7,872
Total assets	$ 710,889	$ 652,820
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 43,798	$ 33,302
Accrued payroll and related expenses	13,191	19,111
Royalties payable	2,619	2,334
Total current liabilities	59,608	54,747
Convertible senior notes	230,000	230,000
Long-term acquisition related liabilities	31,264	30,694
Other long-term liabilities	29,480	27,528
Commitments and contingencies		
Noncontrolling interests	12,276	13,629
Stockholders equity:		
Common stock, $0.001 par value; 70,000 shares authorized, 39,419 and 38,774 issued and outstanding at September 30, 2010 and December 31, 2009, respectively	39	39
Additional paid-in capital	520,948	485,757
Accumulated other comprehensive income	621	126
Accumulated deficit	(173,347)	(189,700)
Total stockholders equity	348,261	296,222
Total liabilities and stockholders equity	$ 710,889	$ 652,820

See accompanying notes to unaudited condensed consolidated financial statements.

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NUVASIVE, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Revenues	$120,262	$94,916	$348,933	$263,405
Cost of goods sold, excluding amortization of purchased technology	21,580	15,874	62,037	43,108
Gross profit	98,682	79,042	286,896	220,297
Operating expenses:				
Sales, marketing and administrative	77,717	61,720	230,104	182,521
Research and development	10,085	9,874	31,989	26,638
Amortization of intangible assets	1,342	1,364	4,047	4,072
Total operating expenses	89,144	72,958	266,140	213,231
Interest income	200	203	567	1,318
Interest expense	(1,668)	(1,609)	(5,005)	(5,439)
Other income (expense), net	(6)	188	81	324
Total interest and other income (expense), net	(1,474)	(1,218)	(4,357)	(3,797)
Income before income tax (benefit) expense	8,064	4,866	16,399	3,269
Income tax (benefit) expense	(40)	430	1,399	1,053
Consolidated net income	$ 8,104	$ 4,436	$ 15,000	$ 2,216
Net loss attributable to noncontrolling interests	$ (438)	$ (628)	$ (1,353)	$ (1,311)
Net income attributable to NuVasive, Inc.	$ 8,542	$ 5,064	$ 16,353	$ 3,527
Net income per share attributable to NuVasive, Inc.:				
Basic net income per share	$ 0.22	$ 0.13	$ 0.42	$ 0.10
Diluted net income per share	$ 0.21	$ 0.13	$ 0.40	$ 0.09
Weighted average shares outstanding:				
Basic	39,394	37,733	39,180	37,008
Diluted	40,396	39,216	40,389	38,384

See accompanying notes to unaudited condensed consolidated financial statements.

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NUVASIVE, INC.
UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)

	Nine Months Ended September 30,	
	2010	**2009**
Operating activities:		
Consolidated net income	$ 15,000	$ 2,216
Adjustments to reconcile consolidated net income to net cash provided by operating activities:		
Depreciation and amortization	27,404	22,005
Stock-based compensation	21,304	18,165
Lease abandonment charge reversal		(1,997)
Allowance for excess and obsolete inventory	1,682	2,470
Allowance for doubtful accounts and sales return reserves, net of write-offs	(1,039)	1,175
Amortization of debt issuance costs	1,120	1,065
Amortization of premium/discount on marketable securities	890	62
Other non-cash adjustments	2,604	1,121
Changes in operating assets and liabilities, net of effects from acquisitions:		
Accounts receivable	(11,465)	(329)
Inventory	(10,043)	(19,027)
Prepaid expenses and other current assets	(3,878)	788
Accounts payable and accrued liabilities	6,316	7,361
Accrued payroll and related expenses	(5,973)	(2,209)
Net cash provided by operating activities	43,922	32,866
Investing activities:		
Cash paid for acquisitions and investments		(44,055)
Purchases of property and equipment	(36,622)	(21,250)
Purchases of marketable securities	(150,045)	(64,642)
Sales of marketable securities	142,313	89,336
Other assets	(659)	
Net cash used in investing activities	(45,013)	(40,611)
Financing activities:		
Issuance of common stock	12,768	9,618
Other assets	(7,722)	
Tax benefits related to stock-based compensation awards	1,118	
Net cash provided by financing activities	6,164	9,618
Effect of exchange rate changes on cash	104	85
Increase in cash and cash equivalents	5,177	1,958
Cash and cash equivalents at beginning of period	65,413	132,318
Cash and cash equivalents at end of period	$ 70,590	$134,276

See accompanying notes to unaudited condensed consolidated financial statements.

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NuVasive, Inc.
Notes to Unaudited Condensed Consolidated Financial Statements

1. Description of Business and Basis of Presentation

Description of Business

NuVasive®, Inc. (the Company or NuVasive) was incorporated in Delaware on July 21, 1997. The Company designs, develops and markets products for the surgical treatment of spine disorders. The Company began commercializing its products in 2001. Its product portfolio is focused primarily on applications for spine fusion surgery. Its principal product offering includes a minimally disruptive surgical platform called Maximum Access Surgery, or MAS®, as well as a growing set of offerings in the biologics, cervical and motion preservation areas. In the spine surgery market, the Company s currently-marketed products are primarily used to enable access to the spine and to perform restorative and fusion procedures. The Company also focuses significant research and development efforts on MAS and motion preservation products in the areas of (i) fusion procedures in the lumbar and thoracic spine; (ii) cervical fixation products; and (iii) motion preservation products such as the Company s total disc replacement products. The Company dedicates significant resources to sales and marketing efforts, including training spine surgeons on its unique technology and products.

The Company s primary business model is to loan its MAS systems to surgeons and hospitals who purchase disposables and implants for use in individual procedures. In addition, for larger customers, NeuroVision®, MaXcess® and surgical instrument sets are placed with hospitals for an extended period at no up-front cost to them. The Company also offers a range of bone allograft in patented saline packaging, disposables and spine implants, which include its branded CoRoent® products and fixation devices such as rods, plates and screws. Implants and disposables are shipped from the Company s inventories. The Company sells an immaterial quantity of MAS instrument sets, MaXcess and NeuroVision systems to hospitals.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission. Pursuant to these rules and regulations, the Company has condensed or omitted certain information and footnote disclosures it normally includes in its annual consolidated financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP). In the opinion of management, the consolidated financial statements include all adjustments necessary, which are of a normal and recurring nature, for the fair presentation of the Company s financial position and of the results of operations and cash flows for the periods presented.

The accompanying unaudited condensed consolidated financial statements as of December 31, 2009 and for the nine months ended September 30, 2010 and 2009 include the accounts of the Company and its wholly owned subsidiaries, as well as the accounts of a variable interest entity, Progentix Orthobiology, B.V. (Progentix), which is consolidated pursuant to existing guidance issued by the Financial Accounting Standards Board (FASB). All significant intercompany accounts and transactions have been eliminated in consolidation.

These financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto for the year ended December 31, 2009 included in NuVasive s Annual Report on Form 10-K, as amended, filed with the Securities and Exchange Commission. Operating results for the three or nine months ended September 30, 2010 are not necessarily indicative of the results that may be expected for any other interim period or for the full year. The balance sheet at December 31, 2009 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by GAAP for complete financial statements.

Reclassifications

Certain reclassifications have been made to the prior year consolidated balance sheet to conform to the current year presentation.

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Business Combinations

In accordance with authoritative guidance for business combinations, goodwill and other long-term liabilities on the December 31, 2009 condensed consolidated balance sheet have been retrospectively adjusted to reflect the finalization of the purchase price allocation for assets and liabilities acquired from Cervitech®, Inc. (Cervitech) in May 2009 (Note 3).

2. Significant Accounting Policies

Recently Adopted Accounting Standards

Variable Interest Entities

Effective January 1, 2010, the Company adopted a newly issued accounting standard which provides guidance for the consolidation of variable interest entities and requires an enterprise to determine whether its variable interest or interests give it a controlling financial interest in a variable interest entity. This amended consolidation guidance for variable interest entities replaces the existing quantitative approach for identifying which enterprise should consolidate a variable interest entity, which was based on which enterprise is exposed to a majority of the risks and rewards, with a qualitative approach, based on which enterprise has both (1) the power to direct the economically significant activities of the entity and (2) the obligation to absorb losses of, or the right to receive benefits from, the entity that could potentially be significant to the variable interest entity. The adoption of this standard did not have an impact on the Company s consolidated results of operations or financial position. Determination about whether an enterprise should consolidate a variable interest entity is required to be evaluated continuously as changes to existing relationships or future transactions may result in the Company consolidating or deconsolidating current or future business arrangements.

Fair Value Measurements Disclosures

Effective January 1, 2010, the Company adopted the FASB s updated guidance related to fair value measurements and disclosures, which requires a reporting entity to disclose separately the amounts of significant transfers in and out of Level 1 and Level 2 fair value measurements and to describe the reasons for the transfers. In addition, in the reconciliation for fair value measurements using significant unobservable inputs, or Level 3, a reporting entity should disclose separately information related to purchases, sales, issuances, and settlements information to be included in the rollforward of activity. The updated guidance also requires that an entity provide fair value measurement disclosures for each class of assets and liabilities and disclosures about the valuation techniques and inputs used to measure fair value for both recurring and non-recurring fair value measurements for Level 2 and Level 3 fair value measurements. The guidance is effective for interim or annual financial reporting periods beginning after December 15, 2009, except for the disclosures about purchases, sales, issuances and settlements in the rollforward activity in Level 3 fair value measurements, which are effective for fiscal years beginning after December 15, 2010 and for interim periods within those fiscal years. Therefore, the Company has not yet adopted the guidance with respect to the rollforward activity in Level 3 fair value measurements. The Company has updated its disclosures to comply with the updated guidance; however, adoption of the updated guidance did not have an impact on the Company s consolidated results of operations or financial position.

3. Cervitech® Inc. Acquisition

On May 8, 2009 (the Closing Date), the Company completed the purchase of all of the outstanding shares of Cervitech, a Delaware corporation, for an initial payment of approximately $49 million consisting of cash totaling approximately $25 million and the issuance of 638,261 shares of NuVasive common stock to certain stockholders of Cervitech. Cervitech, a New Jersey based company, is focused on the clinical approval of the PCM® cervical disc system, a motion preserving total disc replacement device in the United States. This acquisition allows NuVasive the potential to accelerate its entry into the growing mechanical cervical disc replacement market. In addition to the initial payment, the Company may be obligated to make an additional milestone payment of $33 million if the U.S. Food and Drug Administration (FDA) issues an approval order allowing the commercialization of Cervitech s PCM device in the United States with an intended use for treatment of degenerative disc disease. The milestone payment may be made in cash or a combination of cash and up to half in NuVasive common stock, at the Company s discretion. The fair value of the contingent consideration at the Closing Date was determined to be $29.7 million using a probability-weighted discounted cash flow model with the key assumptions being the interest rate, the timing of expected approval and the

probability assigned to the milestone being achieved.

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The assets and liabilities of Cervitech were recorded at their respective acquisition date estimated fair values, and identifiable intangible assets were recorded at fair value. As previously disclosed, the preliminary allocation of the estimated purchase price was based on management s preliminary valuation of the fair value of tangible assets, intangible assets and in-process research and development acquired and liabilities assumed as of the Closing Date and such estimates were subject to revision. During May 2010, the Company finalized the purchase accounting adjustments to account for facts related to deferred tax assets and liabilities acquired that existed at the Closing Date. Accordingly, the Company reduced the amount of Goodwill recorded on the acquisition of Cervitech by $0.9 million retrospectively to the Closing Date as follows *(in thousands)*:

	Initial Estimate of Fair Value	Purchase Price Adjustments	Final Fair Value
Goodwill	$55,443	$ (945)	$54,498
Deferred income tax liabilities, net	$13,560	$ 945	$12,615

The final allocation of the purchase price at December 31, 2009 is presented in the following table (*in thousands*):

	Estimated Fair Value	Estimated Useful Life
Total current assets	$ 1,233	
Property, plant and equipment	59	
Developed technology	700	14 years
Non-compete agreement	100	2 years
Trade name	700	10 years
In-process research and development	34,800	14 years
Goodwill	54,498	
Current liabilities	(483)	
Deferred income tax liabilities	(12,615)	
Total estimated purchase price allocation	$ 78,992	

Of the total $79.0 million purchase price, $34.8 million and $54.5 million was allocated to in-process research and development (IPR&D) and goodwill, respectively, based on management s valuation of the fair value of the assets acquired and liabilities assumed on the date of acquisition. The IPR&D, which has been capitalized as an indefinite-lived asset, relates to the future commercialization of Cervitech s PCM device in the United States with an intended use for treatment of degenerative disc disease. The projected cash flows utilized in management s valuation of the fair value of the IPR&D acquired were based on key assumptions such as estimates of revenues and operating profits related to the IPR&D considering its stage of development; the time and resources needed to complete the development and approval of the related product candidate; the life of the potential commercialized product and associated risks, including the inherent difficulties and uncertainties in developing a product such as obtaining marketing approval from the FDA and other regulatory agencies; and risks related to the viability of and potential alternative treatments in any future target markets. The Company submitted a premarket approval (PMA) application for FDA approval for the PCM device in the first quarter of 2010, for which an approval date is not predictable. At September 30, 2010, the remaining cost to reach FDA approval for this device is estimated at approximately $1.2 million to $1.7 million, depending on when FDA approval is received.

Goodwill totaling $54.5 million represents the excess of the purchase price over the fair value of tangible and identifiable intangible assets acquired and is due primarily to increased market penetration from future products and customers and synergies expected from combining the PCM device with the Company s existing development of motion preservation systems. This acquisition was nontaxable and, as a result, there is no tax basis in goodwill.

Accordingly, none of the goodwill associated with the Cervitech acquisition is deductible for tax purposes.

For the three and nine months ended September 30, 2009, the Company s consolidated results of operations include acquisition-related expenses incurred in connection with the Cervitech acquisition of $0 and $1.2 million, respectively, which are included in sales, marketing and administrative expenses.

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4 .Investment in Progentix Orthobiology, B.V.

In 2009, the Company completed the purchase of forty percent (40%) of the capital stock of Progentix, a company organized under the laws of the Netherlands, from existing shareholders (the Progentix Shareholders) pursuant to a Preferred Stock Purchase Agreement for $10 million in cash (the Initial Investment). Concurrent with the Initial Investment, NuVasive and Progentix also entered into a Senior Secured Facility Agreement, whereby Progentix may borrow up to $5 million from NuVasive to fund ongoing clinical and regulatory efforts (the Loan). The proceeds of the Loan are to be utilized towards achievement of all milestones, as defined in the Preferred Stock Purchase Agreement. The Loan accrues interest at a rate of six percent (6%) per year. Other than its obligations under the Loan Agreement, NuVasive is not obligated to provide additional funding to Progentix. At September 30, 2010, the Company had advanced Progentix the full $5 million in accordance with the Loan Agreement. The Company has not provided additional financing to Progentix other than this contractually required amount.

Also concurrent with the Preferred Stock Purchase Agreement, NuVasive, Progentix and the Progentix Shareholders entered into an Option Purchase Agreement dated January 13, 2009, as amended on December 30, 2009 (the Option Agreement), whereby NuVasive may be obligated (the Put Option), upon the achievement within a specified period of time of certain milestones by Progentix, to purchase the remaining sixty percent (60%) of capital stock of Progentix from its shareholders for an amount up to $45 million, payable in a combination of cash or NuVasive common stock, at NuVasive s sole discretion, subject to certain adjustments (the Remaining Shares).

NuVasive may also be obligated, in the event that Progentix achieves the milestones specified in the agreements and completes additional milestones and NuVasive achieves specified sales targets, within a specified time period, to make additional payments to the Progentix Shareholders, excluding NuVasive, of up to an aggregate total of $25 million, payable in a combination of cash and NuVasive common stock, at NuVasive s sole discretion, subject to certain adjustments. NuVasive also has the right under the Option Agreement, as amended, to purchase the Remaining Shares (the Call Option) during a stated period of time of the Option Agreement (the Option Period) for an amount up to $35 million, payable in a combination of cash and NuVasive common stock, at the Company s sole discretion, subject to certain adjustments. In the event NuVasive achieves in excess of a specified annual sales run rate on Progentix products during the Option Period, NuVasive may be required to purchase the Remaining Shares for an amount up to $35 million. NuVasive and Progentix also entered into a Distribution Agreement, as amended, whereby Progentix appointed NuVasive as its exclusive distributor for certain Progentix products. The Distribution Agreement will be in effect for a term of ten years unless terminated earlier in accordance with its terms.

In accordance with revised authoritative guidance issued by the FASB, the Company has determined that Progentix is a variable interest entity (VIE) as it does not have the ability to finance its activities without additional subordinated financial support and its equity investors will not absorb their proportionate share of expected losses and will be limited in the receipt of the potential residual returns of Progentix. Additionally, pursuant to this guidance, NuVasive is considered its primary beneficiary as NuVasive has both (1) the power to direct the economically significant activities of Progentix and (2) the obligation to absorb losses of, or the right to receive benefits from, Progentix. Accordingly, the financial position and results of operations of Progentix have been included in the consolidated financial statements from the date of the Initial Investment. The liabilities recognized as a result of consolidating Progentix do not represent additional claims on the Company s general assets. The creditors of Progentix have claims only on the assets of Progentix, which are not material, and the assets of Progentix are not available to NuVasive.

Pursuant to authoritative guidance, the equity interests in Progentix not owned by the Company, which includes shares of both common and preferred stock, are reported as noncontrolling interests on the consolidated balance sheet of the Company. The preferred stock represents 18% of the noncontrolling equity interests and provides for a cumulative 8% dividend, if and when declared by Progentix s Board of Directors. As the rights and conversion features of the preferred stock are substantially the same as those of the common stock, the preferred stock is classified as noncontrolling interest and shares in the allocation of the losses incurred by Progentix. Losses incurred by Progentix are charged to the Company and to the noncontrolling interest holders based on their ownership percentage. The Remaining Shares and the Option Agreement that was entered into between NuVasive, Progentix and the Progentix Shareholders are not considered to be freestanding financial instruments as defined by authoritative guidance. Therefore the Remaining Shares and the Option Agreement are accounted for as a combined unit on the consolidated

financial statements as a noncontrolling interest that was initially recorded at fair value and classified as mezzanine equity.

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Pursuant to authoritative guidance, when the embedded Put Option is exercisable and therefore the Remaining Shares considered currently redeemable (i.e., at the option of the holder), the instrument will be adjusted to its maximum redemption amount. If the embedded Put Option is considered not currently exercisable (e.g., because a contingency has not been met), and it is not probable that the embedded Put Option will become exercisable, an adjustment is not necessary until it is probable that the embedded Put Option will become exercisable. At September 30, 2010, the embedded Put Option was not deemed currently exercisable and therefore the Remaining Shares were not redeemable because the milestones referred to previously had not been met. Furthermore, at September 30, 2010, the Company concluded it is not probable that the milestones will be met, therefore the Remaining Shares are not expected to become redeemable. The probability of redemption is reevaluated at each reporting period. Total assets and liabilities of Progentix as of September 30, 2010 included in the accompanying consolidated balance sheet are as follows *(in thousands):*

Total current assets	$ 1,217
Identifiable intangible assets, net	15,933
Goodwill	12,654
Accounts payable & accrued expenses	505
Other long-term liabilities	253
Deferred tax liabilities	3,322
Noncontrolling interests	12,276

The following is a reconciliation of equity (net assets) attributable to the noncontrolling interests (*in thousands*):

Noncontrolling interests at December 31, 2009	$ 13,629
Net loss attributable to the noncontrolling interests	1,353
Noncontrolling interests at September 30, 2010	$ 12,276

5. Balance Sheet Reserves

The balances of the reserves for accounts receivable and inventory are as follows *(in thousands)*:

	September 30, 2010	**December 31, 2009**
Reserves for accounts receivable and sales returns	$ 2,965	$ 4,163
Reserves for excess and obsolete inventory	5,634	5,075

The Company s inventory consists primarily of finished goods, disposables and specialized implants. Inventory consists primarily of purchased finished goods, which includes specialized implants and disposables, and is stated at the lower of cost or market determined by a weighted average cost method. The Company reviews the components of its inventory on a periodic basis for excess, obsolete or impaired inventory, and records a reserve for the identified items.

6. Marketable Securities and Fair Value Measurements

Marketable securities consist of corporate debt securities, U.S. government treasury securities and government sponsored entities. The Company classifies all securities as available-for-sale, as the sale of such securities may be required prior to maturity to implement management strategies. These securities are carried at fair value, with the unrealized gains and losses reported as a component of other comprehensive income (loss) in stockholder s equity until realized. A decline in the market value of any marketable security below cost that is determined to be other-than-temporary will result in a revaluation of its carrying amount to fair value. The impairment is charged to earnings and a new cost basis for the security is established. No such impairment charges were recorded for any period presented.

Realized gains and losses from the sale of marketable securities, if any, are determined on a specific identification basis. Realized gains and losses and declines in value judged to be other-than-temporary, if any, on available-for-sale securities are included in other income or expense on the consolidated statements of operations. Realized gains and losses during the periods presented were immaterial. Premiums and discounts are amortized or accreted over the life of the related security as an adjustment to yield using the straight-line method and are included in interest income on the consolidated statements of operations. Interest and dividends on securities classified as available-for-sale are included in interest income on the consolidated statements of operations.

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The composition of marketable securities is as follows (*in thousands*):

	Contractual Maturity (in Years)	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
September 30, 2010:					
Classified as current assets:					
U.S. government treasury securities	Less than 1	$ 22,022	$ 22	$	$ 22,044
Securities of government-sponsored entities	Less than 1	76,293	47	(3)	76,337
Corporate notes	Less than 1	6,518	4		6,522
Certificates of deposit	Less than 1	1,643			1,643
Short-term marketable securities		106,476	73	(3)	106,546
Classified as non-current assets:					
Securities of government-sponsored entities	1 to 2	36,514	24	(2)	36,536
Corporate notes	1 to 2	3,092	1		3,093
Total marketable securities at September 30, 2010		$146,082	$ 98	$ (5)	$146,175

	Contractual Maturity (in Years)	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
December 31, 2009:					
Classified as current assets:					
Certificates of deposit	Less than 1	$ 1,979	$	$ (6)	$ 1,973
Corporate notes	Less than 1	4,955	4		4,959
U.S. government treasury securities	Less than 1	27,963	24	(4)	27,983
Securities of government-sponsored entities	Less than 1	64,317	67	(20)	64,364
Short-term marketable securities		99,214	95	(30)	99,279
Classified as non-current assets:					
Securities of government-sponsored entities	1 to 2	40,026	8	(66)	39,968
Total marketable securities at December 31, 2009		$139,240	$ 103	$ (96)	$139,247

As of September 30, 2010, the Company had no investments that were in a significant unrealized loss position. The Company reviews its investments to identify and evaluate investments that have an indication of possible other-than-temporary impairment. Factors considered in determining whether a loss is other-than-temporary include the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, and the Company s intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. The Company maintains an investment portfolio of various holdings, types and maturities. The Company does not hold derivative financial instruments. The Company

places its cash investments in instruments that meet high credit quality standards, as specified in its investment policy guidelines. These guidelines also limit the amount of credit exposure to any one issue, issuer or type of instrument.

The Company measures certain assets and liabilities in accordance with authoritative guidance which requires fair value measurements be classified and disclosed in one of the following three categories:

Level 1: Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities.

Level 2: Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

Level 3: Unobservable inputs are used when little or no market data is available.

Assets and liabilities are classified based on the lowest level of input that is significant to the fair value measurements. The Company reviews the fair value hierarchy classification on a quarterly basis. Changes in the ability to observe valuation inputs may result in a reclassification of levels for certain securities within the fair value hierarchy. The Company did not have any significant transfers of assets and liabilities between Level 1 and Level 2 and no transfers to or from Level 3 of the fair value measurement hierarchy during the nine months ended September 30, 2010.

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The fair values of the Company s assets and liabilities at September 30, 2010, which are measured at fair value on a recurring basis, were determined using the following inputs (*in thousands*):

	Total	Quoted Price in Active Market (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Marketable Securities:				
U.S. government treasury securities	$ 22,044	$ 22,044	$	$
Securities of government-sponsored entities	112,873	110,871	2,002	
Corporate notes	9,615	9,615		