ALIGN TECHNOLOGY INC
Form 10-Q
November 04, 2011
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2011

OR

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

For the transition period from to

Commission file number: 0-32259

ALIGN TECHNOLOGY, INC.

(Exact name of registrant as specified in its charter)

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

2560 Orchard Parkway

San Jose, California 95131

(Address of principal executive offices)

(408) 470-1000

(Registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer	x	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	Smaller reporting company	¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

The number of shares outstanding of the registrant s Common Stock, $0.0001 par value, as of October 28, 2011 was 78,544,695.

Table of Contents

ALIGN TECHNOLOGY, INC.

INDEX

PART I	FINANCIAL INFORMATION	3
ITEM 1.	FINANCIAL STATEMENTS (UNAUDITED):	3
	CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS	3
	CONDENSED CONSOLIDATED BALANCE SHEETS	4
	CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS	5
	NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS	6
ITEM 2.	MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS	20
ITEM 3.	QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK	34
ITEM 4.	CONTROLS AND PROCEDURES	34
PART II	OTHER INFORMATION	34
ITEM 1.	LEGAL PROCEEDINGS	34
ITEM 1A.	RISK FACTORS	35
ITEM 2.	UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS	47
ITEM 3.	DEFAULTS UPON SENIOR SECURITIES	47
ITEM 4.	REMOVED AND RESERVED	47
ITEM 5.	OTHER INFORMATION	47
ITEM 6.	EXHIBITS	47
SIGNATURES		48

Invisalign, Align, ClinCheck, Invisalign Assist, Invisalign Teen, Vivera, iTero and iOC amongst others, are trademarks belonging to Align Technology, Inc. or its subsidiaries and are pending or registered in the United States and other countries.

Table of Contents

PART I FINANCIAL INFORMATION

ITEM 1 FINANCIAL STATEMENTS

ALIGN TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except per share data)

(unaudited)

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Net revenues (1)	$ 125,894	$ 95,947	$ 350,836	$ 294,233
Cost of net revenues	33,524	21,014	85,103	62,572
Gross profit	92,370	74,933	265,733	231,661
Operating expenses:				
Sales and marketing	34,655	26,905	106,062	83,790
General and administrative	21,609	16,203	66,695	46,159
Research and development	8,926	6,592	27,586	19,104
Litigation settlement		3,310		3,310
Insurance settlement				(8,666)
Amortization of acquired intangible assets	868		1,460	
Total operating expenses	66,058	53,010	201,803	143,697
Profit from operations	26,312	21,923	63,930	87,964
Interest and other income (expense), net	(118)	(83)	(335)	(480)
Net profit before provision for income taxes	26,194	21,840	63,595	87,484
Provision for income taxes	6,930	5,025	17,328	23,136
Net profit	$ 19,264	$ 16,815	$ 46,267	$ 64,348
Net profit per share:				
Basic	$ 0.25	$ 0.22	$ 0.60	$ 0.85
Diluted	$ 0.24	$ 0.22	$ 0.58	$ 0.83
Shares used in computing net profit per share:				
Basic	78,455	76,081	77,735	75,653
Diluted	80,266	78,109	80,040	77,852

(1) The nine months ended September 30, 2010 includes a $14.3 million release of previously deferred revenue for Invisalign Teen replacement aligners.

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

Table of Contents

ALIGN TECHNOLOGY, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(in thousands, except per share data)

(unaudited)

	September 30, 2011	December 31, 2010
ASSETS		
Current assets:		
Cash and cash equivalents	$ 202,229	$ 294,664
Marketable securities, short-term	8,185	8,615
Accounts receivable, net of allowance for doubtful accounts of $417 and $735, respectively	86,648	65,430
Inventories	8,278	2,544
Prepaid expenses and other current assets	21,794	17,358
Total current assets	327,134	388,611
Marketable securities, long-term	677	9,089
Property, plant and equipment, net	46,388	30,684
Goodwill	135,743	478
Intangible assets, net	50,279	2,188
Deferred tax asset	22,945	42,439
Other assets	2,754	3,454
Total assets	$ 585,920	$ 476,943
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 14,138	$ 7,768
Accrued liabilities	58,281	51,358
Deferred revenues	47,768	33,848
Total current liabilities	120,187	92,974
Other long-term liabilities	8,857	6,222
Total liabilities	129,044	99,196
Commitments and contingencies (Notes 7 and 10)		
Stockholders equity:		
Preferred stock, $0.0001 par value (5,000 shares authorized; none issued)		
Common stock, $0.0001 par value (200,000 shares authorized; 78,531 and 76,390 issued and outstanding, respectively)	8	8
Additional paid-in capital	588,501	555,851
Accumulated other comprehensive income, net	346	134
Accumulated deficit	(131,979)	(178,246)
Total stockholders equity	456,876	377,747
Total liabilities and stockholders equity	$ 585,920	$ 476,943

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

4

Table of Contents

ALIGN TECHNOLOGY, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(unaudited)

	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
CASH FLOWS FROM OPERATING ACTIVITIES:		
Net profit	$ 46,267	$ 64,348
Adjustments to reconcile net profit to net cash provided by operating activities:		
Deferred taxes	13,506	17,631
Depreciation and amortization	9,099	8,694
Stock-based compensation	14,206	12,138
Amortization of intangibles	4,008	2,100
Amortization of prepaid royalties		827
Benefit from doubtful accounts	(131)	(10)
Loss (gain) on retirement and disposal of fixed assets	(25)	60
Changes in assets and liabilities, net of acquired assets and liabilities:		
Accounts receivable	(16,086)	(9,962)
Inventories	(2,975)	(343)
Prepaid expenses and other assets	522	(3,086)
Accounts payable	3,748	13
Accrued and other long-term liabilities	5,504	6,260
Deferred revenues	10,836	(1,666)
Net cash provided by operating activities	88,479	97,004
CASH FLOWS FROM INVESTING ACTIVITIES:		
Acquisition, net of cash acquired	(186,920)	
Purchase of property, plant and equipment	(21,029)	(11,932)
Puchases of marketable securities		(12,742)
Maturities of marketable securities	8,842	17,474
Other assets	(190)	(1,356)
Net cash used in investing activities	(199,297)	(8,556)
CASH FLOWS FROM FINANCING ACTIVITIES:		
Proceeds from issuance of common stock	19,882	10,907
Employees taxes paid upon the vesting of restricted stock units	(1,481)	(889)
Net cash provided by financing activities	18,401	10,018
Effect of foreign exchange rate changes on cash and cash equivalents	(18)	(29)
Net increase (decrease) in cash and cash equivalents	(92,435)	98,437
Cash and cash equivalents, beginning of period	294,664	166,487
Cash and cash equivalents, end of period	$ 202,229	$ 264,924

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

Table of Contents

ALIGN TECHNOLOGY, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(unaudited)

Note 1. Summary of Significant Accounting Policies

Basis of presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared by Align Technology, Inc. (we , our , or Align) in accordance with the rules and regulations of the Securities and Exchange Commission (SEC) and contain all adjustments, including normal recurring adjustments, necessary to present fairly our financial position as of September 30, 2011, our results of operations for the three and nine months ended September 30, 2011 and 2010, and our cash flows for the nine months ended September 30, 2011 and 2010. The Condensed Consolidated Balance Sheet as of December 31, 2010 was derived from the December 31, 2010 audited financial statements.

The results of operations for the three and nine months ended September 30, 2011 are not necessarily indicative of the results that may be expected for the year ending December 31, 2011 or any other future period, and we make no representations related thereto. The information included in this Quarterly Report on Form 10-Q should be read in conjunction with Management s Discussion and Analysis of Financial Condition and Results of Operations, Quantitative and Qualitative Disclosures About Market Risk and the Consolidated Financial Statements and notes thereto included in Items 7, 7A and 8, respectively, in our Annual Report on Form 10-K for the year ended December 31, 2010.

The preparation of financial statements in accordance with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the amounts reported in our Condensed Consolidated Financial Statements and accompanying notes. Actual results could differ materially from those estimates.

Revenue recognition

We recognize revenue when persuasive evidence of an arrangement exists, delivery has occurred, the price is fixed or determinable, and collectability is reasonably assured. Revenues are recognized from product sales, net of discounts and rebates. Service revenues related to the training of dental professionals and staff on the Invisalign treatment process is recorded when the services are completed.

Beginning January 1, 2011, we adopted revenue recognition guidance under Accounting Standards Update (ASU) 2009-13, Revenue Recognition: Multiple-Deliverable Revenue Arrangements, on a prospective basis for new or materially modified arrangements. This update amends the guidance on revenue arrangements with multiple deliverables and eliminates the use of the residual method. A deliverable constitutes a separate unit of accounting when it has stand-alone value, even if the deliverable is not sold separately.

Invisalign

We enter into arrangements (treatment plans) that involve multiple future product deliverables. For example, included in the price of Invisalign Full, Invisalign Teen and Invisalign Assist, we offer optional case refinement, which is a finishing tool used to adjust a patient s teeth to the desired final position. Case refinement may be elected by the dental professional at any time during treatment however it is generally ordered in the last stages of orthodontic treatment. Invisalign Teen also includes six optional replacement aligners in the price of the product and may be ordered at any time throughout treatment.

We use vendor specific objective evidence (VSOE) adjusted by estimated usage rates for case refinements and replacement aligners to determine the respective estimated selling price (ESP). In the absence of VSOE, we determine our best estimate of selling price, as if it is sold on a stand-alone basis, and take into consideration our pricing and discounting strategies, market conditions, as well as historical price. We regularly review our VSOE and ESP and maintain internal controls over the establishment and update of these estimates.

We determined that our treatment plans are comprised of four possible deliverables that represent separate units of accounting: single-batched aligners, multiple-batched aligners, case refinement and replacement aligners. We allocate revenue for each treatment plan based on each unit s relative selling price and recognize the revenue upon the delivery of each unit in the treatment plan.

The adoption of ASU 2009-13 did not have a material impact on our financial statements and is not expected to have a material impact in future periods. Although the financial statement impact was not material, the adoption of ASU 2009-13 did impact our accounting for Invisalign Assist with the progress tracking feature, in which aligners are shipped to the dental professional every nine stages (a batch). We determined that each batch has stand-alone value and therefore represents a separate unit of accounting. The estimated selling price for Invisalign Assist with progress tracking is allocated according to the estimated number of batches.

Table of Contents

Prior to January 1, 2011, we used VSOE as fair value to allocate revenue to the case refinement and replacement aligner deliverables. We deferred the fair value of case refinement and replacement aligner deliverables based on a breakage factor and recognized the residual revenue upon initial batch shipment. The deferred revenue was subsequently recognized as the refinement and replacement aligners were shipped. For Invisalign Assist with the progress tracking feature, we did not have independent evidence of fair value for the separate batches of aligners, so all batches of aligners were considered a single unit of accounting prior to January 1, 2011. For these treatment plans, revenue was deferred upon the first batched shipment and recognized upon the final batched shipment.

We estimate and record a provision for amounts of estimated losses on sales, if any, in the period such sales occur. We have not recorded any estimated losses for the periods presented. Provisions for discounts and rebates to customers are provided for in the same period that the related product sales are recorded based upon historical discounts and rebates.

Scanners and CAD/CAM Services

We recognize revenues from the sales of iTero and iOC scanners and CAD/CAM services. CAD/CAM services include scanning services, extended warranty for the scanners, a range of iTero restorative services and OrthoCAD services, such as OrthoCAD iCast, OrthoCAD iQ, and OrthoCAD iRecord. We sell scanners and services through both our direct sales force and distributors. The scanner sales price includes one year of warranty, and for additional fees, the customer may select an unlimited scanning service agreement over a fixed period of time or extended warranty periods. When scanners are sold with either an unlimited scanning service agreement and/or extended warranty, we allocate revenue based on each element s relative selling price. We estimate the selling price of each element, as if it is sold on a stand-alone basis, taking into consideration historical prices as well as our pricing and discounting strategies. We will continue to review our estimates as we continue to integrate Cadent into our business.

Revenues for unlimited scanning service agreements and extended warranty are recognized ratably over the service periods. If a customer selects a pay per use basis for scanning service fees, the revenue is recognized as the service is provided.

For direct sales and sales to certain distributors, scanner revenue is recognized once the scanner has been installed and on-site training is completed. For other distributors who provide training to the customer, we recognize scanner revenue when the scanner is shipped to the distributor assuming all of the other revenue recognition criteria have been met.

Revenues from iTero restorative services and OrthoCAD services are recognized as the services are provided.

Recent Accounting Pronouncements

In May 2011, the FASB issued ASU 2011-04, Fair Value Measurement (ASC 820): Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs. This new accounting standard update provides certain amendments to the fair value measurement guidance and includes some enhanced disclosure requirements. The most significant change in disclosures is an expansion of the information required for Level 3 measurements based on unobservable inputs. The standard is effective for the year beginning after December 15, 2011. We will adopt this standard in the first quarter of 2012 and are currently evaluating the impact of this new standard on our consolidated financial statements and disclosures.

In June 2011, the FASB issued ASU 2011-05, Comprehensive Income (ASC 220): Presentation of Comprehensive Income. This new accounting standard update eliminates the current option to report other comprehensive income and its components in the statement of stockholders equity. Instead, an entity will be required to present items of net income and other comprehensive income in one continuous statement or in two separate statements. The standard is effective for the year beginning after December 15, 2011. Early adoption is permitted, however, we are still determining the period of adoption.

In September 2011, FASB issued ASU 2011-08, Intangibles - Goodwill and Other (ASC 350): Testing Goodwill for Impairment. This new revised accounting standard is intended to reduce the cost and complexity of the annual goodwill impairment test by providing entities an option to perform a qualitative assessment to determine whether further impairment testing is necessary. Specifically, an entity has the option to first assess qualitative factors to determine whether it is necessary to perform the current two-step test. If an entity believes, as a result of its qualitative assessment, that it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount, the quantitative impairment test is required. Otherwise, no further testing is required. This standard is effective for annual and interim goodwill impairment tests performed for fiscal years beginning after December 15, 2011. We will adopt this standard in the first quarter of 2012 and are currently evaluating its impact on our financial statements.

Table of Contents

Note 2. Marketable Securities and Fair Value Measurements

Our short-term and long-term marketable securities as of September 30, 2011 and December 31, 2010 are as follows (in thousands):

Short-term

September 30, 2011	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds	$ 4,910	$ 1	$ (6)	$ 4,905
Foreign bonds	1,263		(10)	1,253
Agency bonds	2,023	4		2,027
Total	$ 8,196	$ 5	$ (16)	$ 8,185

Long-term

September 30, 2011	Amortized Cost	Gross Unrealized Losses	Fair Value
Corporate bonds	$ 678	$ (1)	$ 677

Short-term

December 31, 2010	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate bonds and certificate of deposit	$ 3,012	$	$ (1)	$ 3,011
Foreign bonds	705			705
Commercial paper	1,900			1,900
Discount notes	2,998	1		2,999
Total	$ 8,615	$ 1	$ (1)	$ 8,615

Long-term

December 31, 2010	Amortized Cost	Gross Unrealized Losses	Fair Value
Corporate bonds	$ 5,748	$ (11)	$ 5,737
Foreign bonds	1,307	(1)	1,306
Agency bonds	2,047	(1)	2,046
Total	$ 9,102	$ (13)	$ 9,089

For the three and nine months ended September 30, 2011 and 2010, no significant gains or losses were realized on the sale of marketable securities.

Fair Value Measurements

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

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

Our Level 1 assets consist of money market funds. We did not hold any Level 1 liabilities as of September 30, 2011.

Table of Contents

Level 2 Observable inputs other than quoted prices included in Level 1, such as quoted prices for similar assets or liabilities in active markets; quoted prices for identical or similar assets or liabilities in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability.

Our Level 2 assets consist of corporate bonds, foreign bonds and agency bonds. We did not hold any Level 2 liabilities as of September 30, 2011.

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

We did not hold any Level 3 assets or liabilities as of September 30, 2011. The following table summarizes our financial assets measured at fair value on a recurring basis as of September 30, 2011 (in thousands):

Description	Balance as of September 30, 2011	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)
Cash equivalents:			
Money market funds	$ 82,395	$ 82,395	
Short-term investments:			
Corporate bonds	4,905		4,905
Foreign bonds	1,253		1,253
Agency bonds	2,027		2,027
Long-term investments:			
Corporate bonds	677		677
	$ 91,257	$ 82,395	$ 8,862

Note 3. Balance Sheet Components

Inventories

Inventories are comprised of (in thousands):

	September 30, 2011	December 31, 2010
Raw materials	$ 4,991	$ 1,272
Work in process	1,529	1,030
Finished goods	1,758	242
	$ 8,278	$ 2,544

Work in process includes costs to produce the Invisalign and scanner products. Finished goods primarily represent our scanners and ancillary products that support the Invisalign system.

Table of Contents

Accrued liabilities

Accrued liabilities consist of the following (in thousands):

	September 30, 2011	December 31, 2010
Accrued payroll and benefits	$ 30,395	$ 26,551
Accrued litigation settlement		4,549
Accrued income taxes	310	1,936
Accrued sales rebate	6,374	3,826
Accrued sales tax and value added tax	6,624	2,940
Accrued warranty	3,273	2,607
Accrued sales and marketing expenses	2,889	2,955
Other	8,416	5,994
	$ 58,281	$ 51,358

Note 4. Business Combination

On April 29, 2011, we completed the acquisition of Cadent Holdings, Inc. (Cadent) pursuant to the Agreement and Plan of Merger (the Merger Agreement). Cadent is a provider of 3D digital scanning solutions for the orthodontic and dental industry. We expect the acquisition of Cadent to strengthen our ability to drive the adoption of Invisalign by integrating Invisalign treatment more fully with mainstream tools and procedures in doctors practices.

Pursuant to the terms and subject to the conditions set forth in the Merger Agreement, we acquired Cadent, which became a wholly owned subsidiary of Align, for an aggregate cash purchase price of approximately $187.0 million.

The following table summarizes the allocation of the preliminary purchase price as of April 29, 2011 (in thousands):

Assets	$ 16,161
Property, plant and equipment	3,645
Acquired identifiable intangible assets:	
Trademarks (one to fifteen-year useful lives)	10,300
Existing technology (thirteen year useful life)	11,900
Customer relationships (eleven year useful life)	29,900
Goodwill	135,265
Liabilities assumed	(20,171)
Total	$ 187,000

The preliminary allocation is based on estimates, assumptions, valuations and other studies which have not progressed to a stage where there is sufficient information to make a definitive allocation. Accordingly, the allocation will remain preliminary until we have all information to finalize the allocation of the purchase price. We have incurred direct transaction costs of approximately $6.4 million that include investment banking, legal and accounting fees, and other external costs directly related to the acquisition. These costs were expensed as incurred as part of our operating expenses.

Goodwill of $135.3 million represents the excess of the purchase price over the fair value of the underlying net tangible and identifiable intangible assets, and represents the expected synergistic benefits of the transaction and the knowledge and experience of the workforce in place. None of this goodwill will be deductible for tax purposes. Under the applicable accounting guidance, goodwill will not be amortized but will be tested for impairment on an annual basis or more frequently if certain indicators are present. As of September 30, 2011, we are still in the process of assessing the assignment of this goodwill to the appropriate reporting unit or units.

Table of Contents

During the period of May 2011 through September 2011, Cadent contributed revenues of approximately $18.1million and net loss of approximately $6.2 million.

The following table presents the results of Align and Cadent for three and nine months ended September 30, 2011 and 2010, on a pro forma basis, as though the companies had been combined as of the beginning of January 1, 2011 and 2010. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of January 1, 2011 and 2010 or of results that may occur in the future (in thousands):

	Proforma Net Revenues and Net Profit Three Months Ended September 30,		Proforma Net Revenues and Net Profit Nine Months Ended September 30,	
	2011	2010	2011	2010
Net revenues	$ 125,894	$ 105,596	$ 363,563	$ 322,788
Net profit	$ 19,264	$ 16,188	$ 41,967	$ 62,498

Note 5. Goodwill

The change in the carrying value of goodwill for the nine months ended September 30, 2011 is as follows (in thousands):

Balance as of December 31, 2010	$ 478
Goodwill from the Cadent acquisition	135,265
Balance as of September 30, 2011	$ 135,743

Goodwill of $135.3 million as a result of the Cadent acquisition represents the excess of the purchase price over the fair value of the underlying net tangible and identifiable intangible assets, and represents the expected synergistic benefits of the transaction and the knowledge and experience of the workforce in place. Under the applicable accounting guidance, goodwill will not be amortized but will be tested for impairment on an annual basis or more frequently if certain indicators are present.

Note 6. Intangible Assets

Acquired intangible assets

Information regarding our intangible assets as a direct result from the Cadent acquisition is being amortized as follows (in thousands):

	Gross Carrying Amount as of April 29, 2011	Accumulated Amortization	Net Carrying Value as of September 30, 2011
Trademarks	$ 10,300	$ (341)	$ 9,959
Existing technology	11,900	(449)	11,451
Customer relationships	29,900	(1,120)	28,780
	$ 52,100	$ (1,910)	$ 50,190

11

Table of Contents

Amortization of the acquired existing technology is recorded in cost of revenue, while the amortization of acquired trademarks and customer relationships are included in operating expenses. The following table summarizes the amortization expense of acquired intangible assets for the periods indicated (in thousands):

	Three Months Ended September 30, 2011	Nine Months Ended September 30, 2011
Amortization of acquired intangible assets		
In cost of revenue	$ 267	$ 450
In operating expense	868	1,460
Total	$ 1,135	$ 1,910

The total estimated annual future amortization expense for these acquired intangible assets as of September 30, 2011 is as follows (in thousands):

Fiscal Year	
2011 (remaining 3 months)	$ 1,163
2012	4,452
2013	4,352
2014	4,307
2015	4,285
2016 and thereafter	31,631
Total	$ 50,190

Non-compete Agreements

The non-compete intangible assets represent agreements received in conjunction with the October 2006 OrthoClear Agreement at gross value of $14.0 million. These assets are amortized on a straight-line basis over the expected useful life of five years. As of September 30, 2011 and December 31, 2010, the net carrying value of these non-compete agreements was $0.1 million (net of $13.9 million of accumulated amortization) and $2.2 million (net of $11.8 million of accumulated amortization), respectively.

The total estimated annual future amortization expense for these intangible assets as of September 30, 2011 is $0.1 million. These non-compete intangible assets will be fully amortized by the end of October 2011.

Impairment assessment

We perform an impairment test whenever events or changes in circumstances indicate that the carrying value of such assets may not be recoverable. Examples of such events or circumstances include significant underperformance relative to historical or projected future operating results, significant changes in the manner of use of acquired assets or the strategy for its business, significant negative industry or economic trends, and/or a significant decline in our stock price for a sustained period. Impairments are recognized based on the difference between the fair value of the asset and its carrying value, and fair value is generally measured based on discounted cash flow analyses. There were no impairments of intangible assets during the periods presented.

Note 7. Legal Proceedings

Securities Litigation

In August 2009, Plaintiff Charles Wozniak filed a lawsuit against us and our Chief Executive Officer and President, Thomas M. Prescott (Mr. Prescott   ), in District Court for the Northern District of California on behalf of a claimed class consisting of all persons or entities who purchased our common stock between January 30, 2007 and October 24, 2007. The complaint alleges that Align and Mr. Prescott violated Section 10(b) of the Securities Exchange Act of 1934 and that Mr. Prescott violated Section 20(a) of the Securities Exchange Act of 1934. Specifically, the complaint alleges that during the class period we failed to disclose that we had shifted the focus of our sales force to clearing backlog, causing a significant decrease in the number of new case starts. On November 13, 2009, the Court appointed Plumbers and Pipefitters National Pension Fund as lead plaintiff. The lead plaintiff filed an amended complaint on January 29, 2010. The amended complaint alleges that we and Mr. Prescott issued a number of purportedly false and misleading statements throughout the class period concerning the Patients First program, our production capacity, a purported backlog, and the focus of our sales force. On March 26, 2010, we and Mr. Prescott filed a motion to dismiss the amended complaint. The motion was heard by the Court on July 9, 2010 and on June 8, 2011, the Court granted our motion to dismiss with leave to amend. On July 22, 2011, the lead plaintiff filed a second amended complaint adding allegations that Align and Mr. Prescott issued a number of purportedly false and misleading statements throughout the class period concerning our ClinAdvisor product Align and Mr. Prescott moved to dismiss the amended complaint. The hearing on that motion is currently scheduled for January 13, 2012. We believe the lawsuit to be without merit and intend to vigorously defend ourselves. We believe there is no evidence to indicate that a reasonable possibility exists that a loss had been incurred as of September 30, 2011.

Table of Contents

Note 8. Legal Settlements

Ormco

On August 16, 2009 we entered into a Settlement Agreement with Ormco Corporation, an affiliate of Danaher Corporation that ended all pending litigation between the parties and included a payment of $7.0 million for prepaid royalties. We amortized $6.2 million of the prepaid royalties to cost of sales in fiscal year 2009 and the remaining $0.8 million in the first quarter of 2010.

Leiszler

On May 10, 2010, Christopher J. Leiszler filed a complaint against us in the United States District Court for the Northern District of California. The complaint alleged that we implemented unfair and fraudulent requirements for the prescription of Invisalign through the Invisalign Proficiency Requirements for minimum case submission and continuing education credits requirements. In January 2010 Dr. Leiszler s Invisalign provider status was suspended for failing to meet the Proficiency Requirements. Dr. Leiszler sued on behalf of himself and all others similarly situated. The complaint sought a refund of the price paid to us for Invisalign training. On October 19, 2010, we entered into a memorandum of understanding to resolve this litigation, and on November 30, 2010, we executed a formal Stipulation of Settlement. On December 23, 2010, the Court granted preliminary approval of the proposed settlement and on April 8, 2011, granted final approval of the settlement. The settlement took effect on May 18, 2011. Under the terms of the settlement, class members who did not elect to receive the cash remedy prior to the Court-ordered deadline will be reinstated to prescribe Invisalign treatment after the effective date under certain circumstances. In January 2011, we deposited approximately $8.0 million into an escrow account to pay eligible class members who elected the cash remedy, as well as legal fees and other costs. We recorded a total litigation settlement charge of $4.5 million during the third and fourth quarter of 2010 for this settlement. In early June 2011, payments were made from the escrow account to class members who elected the cash remedy and the remaining balance of the escrow has been refunded to Align, except for a nominal amount which has been retained for administrative purposes. As of September 30, 2011, we have no further liability related to this matter.

Note 9. Credit Facilities

On December 14, 2010, we renegotiated and amended our existing credit facility with Comerica Bank. Under this revolving line of credit, we have $30.0 million of available borrowings with a maturity date of December 31, 2012. The interest rate on borrowings will range from Libor plus 1.5% to 2.0% depending upon the amount of cash we maintain at Comerica Bank. This credit facility requires a quick ratio covenant and also requires us to maintain a minimum unrestricted cash balance of $10.0 million. Additionally, in the event our unrestricted cash deposited is less than $55.0 million, the unused facility fee will increase from 0.050% per quarter to 0.125% per quarter. As of September 30, 2011, we had no outstanding borrowings under this credit facility and are in compliance with the financial covenants.

Table of Contents

Note 10. Commitments and Contingencies

Operating Leases

As of September 30, 2011, minimum future lease payments for non-cancelable leases are as follows (in thousands):

Fiscal Year	
2011 (remaining 3 months)	$ 1,659
2012	6,193
2013	4,787
2014	3,546
2015	3,206
2016 and thereafter	5,334
Total	$ 24,725

Warranty

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

Invisalign

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

Scanners

We warrant our scanners for a period of one year, which include materials and labor. Extended warranty may be purchased for additional fees. We accrue for these warranty costs based on average historical repair costs.

The following table reflects the change in our warranty accrual during the nine months ended September 30, 2011 and 2010, respectively (in thousands):

	Nine Months Ended September 30,	
	2011	**2010**
Balance at beginning of period	$ 2,607	$ 2,376
Charged to cost of revenues	2,601	2,212
Assumed warranty from Cadent	350	
Actual warranty expenses	(2,285)	(1,930)
Balance at end of period	$ 3,273	$ 2,658

Table of Contents

Note 11. Stock-based Compensation

Summary of stock-based compensation expense

On May 19, 2011 the Shareholders approved an increase of 3,000,000 shares to the 2005 Incentive Plan (as amended) for a total reserve of 16,283,379 shares for issuance, plus up to an aggregate of 5,000,000 shares that would have been returned to our 2001 Stock Incentive Plan as a result of termination of options on or after March 28, 2005.

Stock-based compensation expense is based on the estimated fair value of awards, net of estimated forfeitures and recognized over the requisite service period on a straight line basis. Estimated forfeitures are based on historical experience at the time of grant and may be revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The stock-based compensation expense related to all of our stock-based awards and employee stock purchases for the three and nine months ended September 30, 2011 and 2010 are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Cost of revenues	$ 421	$ 399	$ 1,378	$ 1,237
Sales and marketing	1,416	1,280	3,949	3,387
General and administrative	2,372	2,141	6,813	5,960
Research and development	745	594	2,066	1,554
Total stock-based compensation expense	$ 4,954	$ 4,414	$ 14,206	$ 12,138

Options

Activity for the nine months period ended September 30, 2011 under the stock option plans are set forth below (in thousands, except years and per share amounts):

	Number of Shares Underlying Stock Options	Weighted Average Exercise Price per Share	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value
Outstanding at of December 31, 2010	7,815	$ 12.99		
Granted	421	22.07		
Exercised	(1,354)	10.90		
Cancelled or expired	(110)	15.29		
Outstanding as of September 30, 2011	6,772	$ 13.94		
Vested and expected to vest at September 30, 2011	6,626	$ 13.85	5.1	$ 19,510
Exercisable at September 30, 2011	5,099	$ 13.05	4.8	$ 17,096

Table of Contents

The fair value of stock options granted was estimated at the grant date using the Black-Scholes option pricing model with the following weighted average assumptions:

	Three Months Ended September 30, 2011 *	2010	Nine Months Ended September 30, 2011	2010
Stock Options:				
Expected term (in years)		4.4	4.4	4.4
Expected volatility		63.4%	61.0%	63.3%
Risk-free interest rate		1.5%	1.7%	1.9%
Expected dividend				
Weighted average fair value per share at grant date	$	$ 7.28	$ 10.87	$ 9.06

* There were no stock options granted during the three months ended September 30, 2011.

As of September 30, 2011, we expect to recognize $11.5 million of total unamortized compensation cost, net of estimated forfeitures, related to stock options over a weighted average period of 2.2 years.

Restricted Stock Units

A summary of the nonvested shares for the nine months ended September 30, 2011 is as follows:

	Number of Shares Underlying RSUs (in thousands)	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Nonvested as of December 31, 2010	905		
Granted	748		
Vested and released	(375)		
Forfeited	(55)		
Nonvested as of September 30, 2011	1,223	1.53	$ 18,553

As of September 30, 2011 the total unamortized compensation cost related to restricted stock units, net of estimated forfeitures, was $15.6 million, which we expect to recognize over a weighted average period of 2.6 years.

On February 18, 2011, we granted market-performance based restricted stock units (MSU) to our named executive officers. Each MSU represents the right to one share of Align s common stock and will be issued through our amended 2005 Incentive Plan. The actual number of MSUs which will be eligible to vest will be based on the performance of Align s stock price relative to the performance of the NASDAQ Composite Index over the vesting period, generally two to three years, up to 150% of the MSUs initially granted.

16

Table of Contents

The following table summarizes the MSU performance as of September 30, 2011:

	Number of Shares Underlying MSUs (in thousands)	Weighted Average Remaining Contractual Term (in years)	Aggregate Intrinsic Value (in thousands)
Nonvested as of December 31, 2010*			
Granted	138,200		
Vested and released			
Forfeited			
Nonvested as of September 30, 2011	138,200	1.9	$ 2,096

* There were no MSU grants outstanding as of December 31, 2010.

As of September 30, 2011, we expect to recognize $1.8 million of total unamortized compensation cost, net of estimated forfeitures, related to MSU over a weighted average period of 1.9 years. There were no MSUs granted during the third quarter of 2011.

Employee Stock Purchase Plan

In May 2010, our shareholders approved the 2010 Employee Stock Purchase Plan (the 2010 Purchase Plan) to replace the 2001 Purchase Plan which expired on January 31, 2011. The terms and features of the 2010 Purchase Plan are substantially the same as the 2001 Purchase Plan and will continue until terminated by either the Board or its administrator. The maximum number of shares available for issuance under the 2010 Purchase Plan is 2,400,000 shares.

The fair value of the option component of the Purchase Plan shares was estimated at the grant date using the Black-Scholes option pricing model with the following weighted average assumptions:

	Three Months Ended September 30, 2011	Three Months Ended September 30, 2010	Nine Months Ended September 30, 2011	Nine Months Ended September 30, 2010
Employee Stock Purchase Plan:				
Expected term (in years)	1.2	1.3	1.2	1.3
Expected volatility	44.9%	53.4%	43.2%	55.9%
Risk-free interest rate	0.3%	0.4%	0.4%	0.4%
Expected dividend				
Weighted average fair value per share at grant date	$ 7.46	$ 6.87	$ 7.29	$ 7.22

As of September 30, 2011, we expect to recognize $2.2 million of the total unamortized compensation cost related to employee purchases over a weighted average period of 0.5 years.

Note 12. Accounting for Income Taxes

The financial statement recognition of the benefit for an uncertain tax position is dependent upon the benefit being more-likely-than-not to be sustainable upon audit by the applicable taxing authority. If this threshold is met, the tax benefit is then measured and recognized at the largest amount that is greater than fifty percent likely of being realized upon ultimate settlement.

During the third quarter of fiscal 2011, the amount of unrecognized tax benefits was increased by approximately $1.0 million. The total amount of unrecognized tax benefits was $14.0 million as of September 30, 2011, which would impact our effective tax rate if recognized. We are subject to taxation in the U.S. and various states and foreign jurisdictions. All of our tax years will be open to examination by the U.S. federal and most state tax authorities due to our net operating loss and overall credit carryforward position. With few exceptions, we are no longer subject to examination by foreign tax authorities for years before 2006.

Table of Contents

Note 13. Net Profit Per Share

Basic net profit per share is computed using the weighted average number of shares of common stock outstanding during the period. Diluted net profit per share is computed using the weighted average number of shares of common stock, adjusted for the dilutive effect of potential common stock. Potential common stock, computed using the treasury stock method, include options, restricted stock units, and the dilutive component of Purchase Plan shares.

The following table sets forth the computation of basic and diluted net profit per share attributable to common stock (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net profit	$ 19,264	$ 16,815	$ 46,267	$ 64,348
Weighted-average common shares outstanding, basic	78,455	76,081	77,735	75,653
Effect of potential dilutive common shares	1,811	2,028	2,305	2,199
Total shares, diluted	80,266	78,109	80,040	77,852
Basic net profit per share	$ 0.25	$ 0.22	$ 0.60	$ 0.85
Diluted net profit per share	$ 0.24	$ 0.22	$ 0.58	$ 0.83

For the three and nine months ended September 30, 2011, stock options and restricted stock units totaling 1.9 million and 1.8 million, respectively, were excluded from diluted net profit per share because of their anti-dilutive effect. For the three and nine months ended September 30, 2010, stock options and restricted stock units totaling 3.3 million and 3.0 million, respectively, were excluded from diluted net profit per share because of their anti-dilutive effect.

Note 14. Comprehensive Income

Comprehensive income includes net profit, foreign currency translation adjustments and unrealized gains on available-for-sale securities. The components of comprehensive income are as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	2010	2011	2010
Net profit	$ 19,624	$ 16,815	$ 46,267	$ 64,348
Foreign currency translation adjustments	(23)	585	1	(120)
Change in unrealized gains on available-for-sale securities	(375)	(18)	211	(18)
Comprehensive income	$ 19,226	$ 17,382	$ 46,479	$ 64,210

Note 15. Segments and Geographical Information

Segment Information

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated regularly by the Chief Operating Decision Maker (CODM), or decision-making group, in deciding how to allocate resources and in assessing performance. Currently, the CODM is the Chief Executive Officer. We report segment information based on the management approach. The management approach designates the internal reporting used by management for making decisions and assessing performance as the source of our reportable segment. During all periods presented, we operated as a single business segment based on the decisions and performance assessment of Align by our CODM.

Table of Contents

Geographical Information

Net revenues and long-lived assets are presented below by geographic area (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2011	**2010**	**2011**	**2010**
Net revenues:				
North America	$ 93,925	$ 72,555	$ 263,047	$ 223,141