Inogen Inc
Form 10-Q
November 10, 2015

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, 2015

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: 001-36309

INOGEN, INC.

(Exact name of registrant as specified in its charter)

Delaware	33-0989359
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
326 Bollay Drive	
Goleta, California	93117
(Address of principal executive offices)	(Zip Code)

(805) 562-0500

(Registrant’s telephone number, including area code)

None

(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 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.

Large accelerated filer ¨	Accelerated filer ¨	Non-accelerated filer x (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 o No x

As of October 31, 2015, the registrant had 19,652,273 shares of common stock, par value $0.001, outstanding.

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INOGEN, INC.

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Inogen, Inc.

Balance Sheets

(unaudited)

(amounts in thousands)

	September 30, 2015	December 31, 2014
Assets		
Current assets		
Cash and cash equivalents	$ 55,090	$ 56,836
Short-term investments	19,028	—
Accounts receivable, net of allowances of $7,129 and $3,745 as of September 30, 2015 and December 31, 2014, respectively	20,890	19,349
Inventories, net of allowances of $128 and $141 as of September 30, 2015 and December 31, 2014, respectively	9,357	7,616
Deferred cost of revenue	474	515
Income tax receivable	2,161	2,129
Deferred tax asset - current	5,540	4,976
Prepaid expenses and other current assets	1,896	1,122
Total current assets	114,436	92,543
Property and equipment		
Rental equipment, net of allowances of $897 and $832 as of September 30, 2015 and December 31, 2014, respectively	54,369	48,359
Manufacturing equipment and tooling	4,391	3,985
Computer equipment and software	4,349	3,699
Furniture and equipment	795	649
Leasehold improvements	961	756
Land and building	126	126
Construction in process	593	193
Total property and equipment	65,584	57,767

Less accumulated depreciation	(33,875)	(25,840)
Property and equipment, net	31,709	31,927
Intangible assets, net	227	270
Deferred tax asset - noncurrent	11,002	15,248
Other assets	97	97
Total assets	$ 157,471	$ 140,085

See accompanying condensed notes to the financial statements.

Inogen, Inc.

Balance Sheets (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

	September 30, 2015	December 31, 2014
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable and accrued expenses	$ 14,303	$ 11,273
Accrued payroll	4,639	4,066
Current portion of long-term debt	311	299
Warranty reserve - current	1,172	781
Deferred revenue - current	2,412	2,316
Total current liabilities	22,837	18,735
Long-term liabilities		
Warranty reserve - noncurrent	616	334
Deferred revenue - noncurrent	3,695	2,176
Long-term debt - noncurrent	80	315
Other noncurrent liabilities	321	375
Total liabilities	27,549	21,935
Commitments and contingencies (Note 5)		
Stockholders' equity		
Common stock, $0.001 par value per share; 200,000,000 authorized; 19,586,673 and 19,059,364 shares issued and outstanding as of September 30, 2015 and December 31, 2014, respectively	19	19
Additional paid-in capital	178,869	174,824
Accumulated deficit	(48,966)	(56,693)
Total stockholders' equity	129,922	118,150
Total liabilities and stockholders' equity	$ 157,471	$ 140,085

See accompanying condensed notes to the financial statements.

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Inogen, Inc.

Statements of Operations

(unaudited)

(amounts in thousands, except share and per share amounts)

	Three months ended September 30, 2015	Three months ended September 30, 2014	Nine months ended September 30, 2015	Nine months ended September 30, 2014
Revenue				
Sales revenue	$29,248	$19,425	$84,682	$54,746
Rental revenue	11,530	9,968	33,877	28,673
Total revenue	40,778	29,393	118,559	83,419
Cost of revenue				
Cost of sales revenue	16,046	10,146	46,501	28,369
Cost of rental revenue, including depreciation of $3,029 and $2,752 for the three months ended and $8,929 and $7,512 for the nine months ended, respectively	5,357	4,598	15,838	13,349
Total cost of revenue	21,403	14,744	62,339	41,718
Gross profit				
Gross profit-sales revenue	13,202	9,279	38,181	26,377
Gross profit-rental revenue	6,173	5,370	18,039	15,324
Total gross profit	19,375	14,649	56,220	41,701
Operating expense				
Research and development	1,116	798	2,954	2,312
Sales and marketing	8,132	5,587	22,623	17,656
General and administrative	6,413	4,697	19,066	12,654
Total operating expense	15,661	11,082	44,643	32,622
Income from operations	3,714	3,567	11,577	9,079
Other income (expense)				
Interest expense	(5)	(104)	(18)	(440)
Interest income	28	10	66	28
Change in fair value of preferred stock warrant liability	—	—	—	36
Other income (expense)	(59)	1	(215)	12
Total other expense, net	(36)	(93)	(167)	(364)
Income before provision for income taxes	3,678	3,474	11,410	8,715
Provision for income taxes	982	1,341	3,683	3,408
Net income	$2,696	$2,133	$7,727	$5,307
Basic net income per share attributable to common	$0.14	$0.12	$0.40	$0.24

stockholders (Note 2)				
Diluted net income per share attributable to common stockholders (Note 2)	$0.13	$0.11	$0.37	$0.22
Weighted-average number of shares used in calculating net income per share attributable to common stockholders:				
Basic common shares	19,428,653	18,286,208	19,303,057	15,340,877
Diluted common shares	20,783,550	20,213,102	20,690,499	17,293,833

See accompanying condensed notes to the financial statements.

Inogen, Inc.

Statement of Stockholders’ Equity

(unaudited)

(amounts in thousands, except share amounts)

	Common stock		Additional paid-in	Accumulated	Total stockholders'
	Shares	Amount	capital	deficit	equity
Balance, December 31, 2014	19,059,364	$ 19	$ 174,824	$ (56,693)	$ 118,150
Stock-based compensation	—	—	2,343	—	2,343
Employee stock purchases	31,106	—	701	—	701
Stock options exercised	496,203	—	1,001	—	1,001
Net income	—	—	—	7,727	7,727
Balance, September 30, 2015	19,586,673	$ 19	$ 178,869	$ (48,966)	$ 129,922

See accompanying condensed notes to the financial statements.

Inogen, Inc.

Statements of Cash Flows

(unaudited)

(amounts in thousands)

	Nine months ended September 30,	
	2015	2014
Cash flows from operating activities		
Net income	$7,727	$5,307
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,468	8,779
Loss on rental units and other fixed assets	889	1,203
Provision for sales returns	3,516	2,558
Provision for doubtful accounts	1,830	1,201
Provision for rental revenue adjustments	6,364	5,530
Provision for inventory obsolescence	75	125
Provision for other inventory losses	56	—
Stock-based compensation expense	2,343	1,123
Decrease in fair value of preferred stock warrant liability	—	(36)
Deferred tax assets	3,682	(999)
Changes in operating assets and liabilities:		
Accounts receivable	(13,251)	(17,119)
Inventories	(3,167)	(3,208)
Deferred costs of revenue	41	(134)
Income tax receivable	(32)	87
Prepaid expenses and other current assets	(774)	(449)
Accounts payable and accrued expenses	3,030	2,063
Accrued payroll	573	834
Warranty reserve	673	363
Deferred revenue	1,615	1,574
Income tax payable	—	2,647
Other noncurrent liabilities	(54)	(81)
Net cash provided by operating activities	$25,604	$11,368
Cash flows from investing activities		
Purchases of available-for-sale investments	(33,557)	—
Maturities of available-for-sale investments	14,529	—
Investment in intangible assets	(21)	(184)
Production and purchase of rental equipment	(7,953)	(10,132)
Purchases of property and equipment	(1,827)	(1,060)
Net cash used in investing activities	$(28,829)	$(11,376)

Inogen, Inc.

Statements of Cash Flows (continued)

(unaudited)

(amounts in thousands)

	Nine months ended September 30,	
Cash flows from financing activities	2015	2014
Proceeds from borrowings	—	6,000
Proceeds from redeemable convertible preferred stock warrants and common stock warrants exercised	—	467
Proceeds from stock options exercised	1,001	229
Proceeds from initial public offering	—	56,471
Costs associated with initial public offering	—	(4,942)
Proceeds from employee stock purchases	701	413
Repayment of debt from investment in intangible assets	(223)	(130)
Repayment of borrowings	—	(15,861)
Net cash provided by financing activities	$1,479	$42,647
Net increase (decrease) in cash and cash equivalents	(1,746)	42,639
Cash and cash equivalents, beginning of period	56,836	13,521
Cash and cash equivalents, end of period	$55,090	$56,160
Supplemental disclosures of cash flow information		
Cash paid during the period for interest	$21	$478
Cash paid during the period for income taxes, net of refunds received	32	1,673
Non-cash transactions:		
Deemed dividend on redeemable convertible preferred stock	—	987

See accompanying condensed notes to the financial statements.

Inogen, Inc.

Condensed Notes to the Financial Statements

(unaudited)

(amounts in thousands, except share and per share amounts)

1. General

a) Basis of presentation

The unaudited financial statements have been prepared on the same basis as the annual audited financial statements and reflect all normal and reoccurring adjustments necessary for the fair presentation of each of the periods presented. The results of operations for interim periods are not necessarily indicative of results to be achieved for full fiscal years or other interim periods.

Inogen, Inc. (Company or Inogen) was incorporated in Delaware on November 27, 2001. The Company is a medical technology company that primarily develops, manufactures and markets innovative portable oxygen concentrators used to deliver supplemental long-term oxygen therapy to patients suffering from chronic respiratory conditions. Traditionally, these patients have relied on stationary oxygen concentrator systems for use in the home and oxygen tanks or cylinders for mobile use, which the Company calls the delivery model. The tanks and cylinders must be delivered regularly and have a finite amount of oxygen, which requires patients to plan activities outside of their homes around delivery schedules and a finite oxygen supply. Additionally, patients must attach long, cumbersome tubing to their stationary concentrators simply to enable mobility within their homes. The Company’s proprietary Inogen One® systems concentrate the air around the patient to offer a single source of supplemental oxygen anytime, anywhere with a portable device weighing approximately 4.8 or 7.0 pounds. The Company’s Inogen One G2® and Inogen One G3™ have up to 5 and 4.5 hours of battery life, respectively, with a single battery and can be plugged into an outlet when at home, in a car, or in a public place with outlets available. The Company’s Inogen One systems reduce the patient’s reliance on stationary concentrators and scheduled deliveries of tanks with a finite supply of oxygen, thereby improving patient quality of life and fostering mobility.

Portable oxygen concentrators represent the fastest-growing segment of the Medicare oxygen therapy market between 2012 and 2014 and the Company estimates based on 2014 Medicare data that patients using portable oxygen concentrators represent approximately 6% to 8% of the total addressable oxygen market in the United States, although this does not account for cash-pay sales into the market. Based on 2014 industry data, the Company believes it was the leading worldwide manufacturer of portable oxygen concentrators, as well as the largest provider of portable oxygen concentrators to Medicare patients, as measured by dollar volume. The Company believes it is the only manufacturer of portable oxygen concentrators that employs a direct-to-consumer strategy in the United States, meaning the Company markets its products to patients, processes their physician paperwork, provides clinical support as needed and bills Medicare or insurance on their behalf. To pursue a direct-to-consumer strategy, the Company’s manufacturing competitors would need to meet national accreditation and state-by-state licensing requirements and secure Medicare billing privileges, as well as compete with the home medical equipment providers that many rely on across their entire homecare business.

Since adopting the Company’s direct-to-consumer strategy in 2009 following its acquisition of Comfort Life Medical Supply, LLC, which had an active Medicare billing number but few other assets and limited business activities, the Company has directly sold or rented its Inogen oxygen concentrators to more than 112,000 patients as of September

30, 2015.

As contemplated by the Securities and Exchange Commission (SEC) under Rule 10-01 of Regulation S-X, the accompanying financial statements and related footnotes have been condensed and do not contain certain information that will be included in the Company's annual financial statements and footnotes thereto. For further information refer to the financial statements and related footnotes included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014 filed with the SEC on April 27, 2015 (Annual Report).

b) Use of estimates

The preparation of the Company's financial statements in accordance with generally accepted accounting principles in the United States (GAAP) requires management to make estimates and assumptions that affect the amounts reported in these financial statements and accompanying condensed notes. Management bases these estimates and assumptions upon historical experience, existing and known circumstances, authoritative accounting pronouncements and other factors that management believes to be reasonable. Significant areas requiring the use of management estimates relate to inventory and rental asset valuations and write-downs, accounts receivable reserves and allowance for bad debts, returns and adjustments, stock compensation expense, impairment assessments, depreciation and amortization, income tax provision and uncertain tax positions, fair value of financial instruments, and fair values of acquired intangibles. Actual results could differ materially from these estimates.

Inogen, Inc.

Condensed Notes to the Financial Statements (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

c) Reclassifications

Certain reclassifications have been made to prior years' financial statements to conform to current period financial statements' presentation with no effect on previously reported financial position, results of operations or cash flows. These changes consisted of reclassifications to certain line items in the accompanying net cash provided by operating activities in the Statements of Cash Flows for the nine months ended September 30, 2014. Accounts payable and accrued liabilities increased from $1,982 to $2,063, and Other noncurrent liabilities decreased from $0 to ($81) for the nine months ended September 30, 2014.

d) Initial public offering (IPO)

The Company completed an IPO on February 20, 2014, and sold 3,529,411 shares to the public for $16.00 per share. In addition, the selling stockholders sold 981,902 shares for a combined total of 4,511,313 shares sold in the offering. The Company netted approximately $49,668 after the underwriters' discount and other associated expenses. In connection with the completion of the Company's IPO, the Company's 9,546,140 shares of redeemable convertible preferred stock and 66,666 shares of convertible preferred stock were automatically converted into 14,259,647 shares of common stock. Following the IPO, all warrants previously exercisable for preferred stock became exercisable for common stock. The previously reported warrant liability associated with the convertible warrants was applied to additional paid-in capital. During the nine months ended September 30, 2014, the Company recognized a deemed dividend of $987 for the time-frame the redeemable convertible preferred stock was outstanding during the period. The Company had no redeemable convertible preferred stock or convertible preferred stock outstanding as of December 31, 2014 or September 30, 2015, respectively. As of September 30, 2015, the Company had 19,586,673 shares of common stock outstanding.

e) Recent accounting pronouncements

Revenue Recognition: In May 2014, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2014-09 (ASU 2014-09), Revenue from Contracts with Customers (Topic 606). The update supersedes nearly all existing revenue recognition guidance under GAAP. The core principle of ASU 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled to those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing GAAP.

In August 2015, the FASB decided to delay the effective date of ASU 2014-09 by one year. The FASB also agreed to allow entities to choose to adopt the standard as of the original effective date. As such, the updated standard will be effective for us in the first quarter of 2018, with the option to adopt it in the first quarter of 2017. The Company is currently evaluating the impact of the Company's pending adoption of ASU 2014-09 on the Company's financial statements and has not yet determined the method by which the Company will adopt the standard.

Inventory: In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory. The ASU requires entities to measure most inventory "at the lower of cost and net realizable value" thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market. The ASU is effective prospectively for annual periods beginning after December 15, 2016, and interim periods within annual periods. Early application is permitted and should be applied prospectively. The adoption of ASU No. 2015-11 is not expected to have a material effect on the Company’s financial statements.

Interest: In April 2015, the FASB issued ASU 2015-03, Interest - Imputation of Interest (Subtopic 835-30): Simplifying the Presentation of Debt Issuance Costs. The update requires that debt issuance costs related to a recognized debt liability be presented in the balance sheet as a direct deduction from the carrying amount of that debt liability, consistent with debt discounts. This update is effective for our fiscal year beginning January 1, 2016 with early adoption permitted. The adoption of this standard is not expected to have a material effect on our financial condition, results of operations or cash flows.

Intangibles - Goodwill and Other - Internal Use Software: In April 2015, the FASB issued ASU 2015-05, Intangibles-Goodwill and Other-Internal Use Software - Customer's Accounting for Fees Paid in a Cloud Computing Arrangement. The update provides guidance on fees paid by an entity in a cloud computing arrangement and whether an arrangement includes a license to the underlying software. If a cloud computing arrangement includes a software license, then the entity should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the entity should account for the arrangement as a service contract. This update is effective for our fiscal year beginning January 1, 2016. The adoption of this standard is not expected to have a material effect on our financial condition, results of operations or cash flows.

Inogen, Inc.

Condensed Notes to the Financial Statements (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

2. Summary of significant accounting policies

Revenue

The Company generates revenue primarily from sales and rentals of its products. The Company's products consist of its proprietary line of oxygen concentrators and related accessories. Other revenue, which is included in sales revenue on the Statements of Operations, comes from service contracts, extended warranty contracts and freight revenue for product shipments.

Sales revenue

Revenue from product sales is recognized when all of the following criteria are met: (1) persuasive evidence of an arrangement exists; (2) delivery has occurred or services have been rendered; (3) the price to the customer is fixed or determinable; and (4) collectability is reasonably assured. Revenue from product sales is generally recognized upon shipment of the product. Provisions for estimated returns and discounts are made at the time revenue is recognized. Provisions for standard warranty obligations, which are included in cost of sales revenue on the Statements of Operations, are also provided for at the time revenue is recognized.

Revenue from the sale of the Company's services is recognized when no significant obligations remain undelivered and collection of the receivables is reasonably assured. The Company offers extended service contracts on its Inogen One concentrator line for periods ranging from 12 to 24 months after the end of the standard warranty period. Revenue from these extended service contracts is recognized in income on a straight-line basis over the contract period.

Accruals for estimated standard warranty expenses are made at the time that the associated revenue is recognized. The provisions for estimated returns, discounts and warranty obligations are made based on known claims and discount commitments and estimates of additional returns and warranty obligations based on historical data and future expectations. The Company's accrued warranty liability was $1,788 and $1,115 for future warranty costs as of September 30, 2015 and December 31, 2014, respectively.

The Company also offers a lifetime warranty for direct-to-consumer sales. For a fixed price, the Company agrees to provide a fully functional oxygen concentrator for the remaining life of the patient. Lifetime warranties are only offered to patients upon the initial sale of oxygen equipment by the Company and are non-transferable. Product sales with lifetime warranties are considered to be multiple element arrangements within the scope of the Accounting Standards Codification (ASC) 605-25—Revenue Recognition-Multiple-Element Arrangements.

There are two deliverables when a product that includes a lifetime warranty is sold. The first deliverable is the oxygen concentrator equipment which comes with a standard warranty of three years. The second deliverable is the lifetime warranty that provides for a functional oxygen concentrator for the remaining lifetime of the patient. These two deliverables qualify as separate units of accounting.

The revenue is allocated to the two deliverables on a relative selling price method. The Company has vendor-specific objective evidence of selling price for the equipment. To determine the selling price of the lifetime warranty, the Company uses its best estimate of the selling price for that deliverable as the lifetime warranty is neither separately priced nor is the selling price available through third-party evidence. To calculate the selling price associated with the lifetime warranties, management considered the profit margins of the overall business, the average estimated cost of lifetime warranties and the price of extended warranties. A significant estimate used to calculate the price and expense of lifetime warranties is the life expectancy of patients. Based on clinical studies, the Company estimates that 60% of patients will succumb to their disease within three years. Given the approximate mortality rate of 20% per year, the Company estimates on average all patients will succumb to their disease within five years. The Company has taken into consideration that when patients decide to buy an Inogen portable oxygen concentrator with a lifetime warranty, they typically have already been on oxygen for a period of time, which can have a large impact on their life expectancy from the time the Company’s product is deployed.

After applying the relative selling price method, revenue from equipment sales is recognized when all other revenue recognition criteria for product sales are met. Lifetime warranty revenue is recognized using the straight-line method during the fourth and fifth year after the delivery of the equipment which is the estimated usage period of the contract based on the average patient life expectancy.

Shipping and handling costs for sold products and rental assets shipped to the Company's customers are included on the Statements of Operations as part of cost of sales revenue and cost of rental revenue, respectively.

Revenue from the sales of used rental equipment is recognized upon shipment and when collectability is reasonably assured and other revenue recognition criteria are met. When a rental unit is sold, the related cost and accumulated depreciation are removed from their respective accounts, and any gains or losses are included in cost of sales revenue on the Statements of Operations.

Rental revenue

The Company recognizes equipment rental revenue over the non-cancelable lease term, which is one month, less estimated adjustments, in accordance with ASC 840—Leases. The Company has separate contracts with each patient that are not subject to a master lease agreement with any payor. The Company evaluates the individual lease contracts at lease inception and the start of each monthly renewal period to determine if there is reasonable assurance that the bargain renewal option associated with the potential capped free rental period would be exercised. Historically, the exercise of such bargain renewal option is not reasonably assured at lease inception and most subsequent monthly lease renewal periods. If the Company determines that the reasonable assurance threshold for an individual patient is met at lease inception or at a monthly lease renewal period, such determination would impact the bargain renewal period for an individual lease. The Company would first consider the lease classification issue (sales-type lease or operating lease) and then appropriately recognize or defer rental revenue over the lease term, which may include a portion of the capped rental period. The Company has deferred $0 associated with the capped rental period as of September 30, 2015 and December 31, 2014.

The lease term begins on the date products are shipped to patients and are recorded at amounts estimated to be received under reimbursement arrangements with third-party payors, including Medicare, private payors, and Medicaid. Due to the nature of the industry and the reimbursement environment in which the Company operates, certain estimates are required to record net revenue and accounts receivable at their net realizable values. Inherent in these estimates is the risk that they will have to be revised or updated as additional information becomes available. Specifically, the complexity of many third-party billing arrangements and the uncertainty of reimbursement amounts for certain services from certain payors may result in adjustments to amounts originally recorded. Such adjustments are typically identified and recorded at the point of cash application, claim denial or account review. Accounts receivable are reduced by an allowance for doubtful accounts which provides for those accounts from which payment is not expected to be received although product was delivered and revenue was earned. Upon determination that an account is uncollectible, it is written-off and charged to the allowance. Amounts billed but not earned due to the timing of the billing cycle are deferred and recognized in income on a straight-line basis over the monthly billing period. For example, if the first day of the billing period does not fall on the first of the month, then a portion of the monthly billing period will fall in the subsequent month and the related revenue and cost would be deferred based on the service days in the following month.

Rental revenue is recognized as earned, less estimated adjustments. Revenue not billed at the end of the period is reviewed for the likelihood of collections and accrued. The rental revenue stream is not guaranteed and payment will cease if the patient no longer needs oxygen or returns the equipment. Revenue recognized is at full estimated allowable amounts; transfers to secondary insurances or patient responsibility have no net effect on revenue. Rental revenue is earned for that month if the patient is on service on the first day of the 30-day period commencing on the recurring date of service for a particular claim, regardless if there is a change in condition or death after that date.

Included in rental revenue are unbilled amounts for which the revenue recognition criteria had been met as of period-end but were not yet billed to the payor. The estimate of net unbilled rental revenue is based on historical trends and estimates of future collectability. In addition, the Company estimates potential future adjustments and write-offs of these unbilled amounts and includes these estimates in the allowance for adjustments and write-offs of rental revenue which is netted against gross receivables.

Fair value of financial instruments

The Company's financial instruments consist of cash and cash equivalents, short-term investments, accounts receivable, accounts payable and accrued expenses, debt and warrants. The carrying values of cash and cash equivalents, short-term investments, accounts receivable and accounts payable and accrued expenses approximate fair values based on the short-term nature of these financial instruments.

Inogen, Inc.

Condensed Notes to the Financial Statements (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

The fair value of the Company’s debt approximates carrying value based on the Company’s current incremental borrowing rate for similar types of borrowing arrangements. Imputed interest associated with the Company’s non-interest bearing debt is insignificant and has been appropriately recognized in the respective periods.

Fair value accounting

ASC 820—Fair Value Measurements and Disclosures, creates a single definition of fair value, establishes a framework for measuring fair value in GAAP and expands disclosures about fair value measurements. ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and states that a fair value measurement should be determined based on assumptions that market participants would use in pricing the asset or liability. Assets and liabilities adjusted to fair value in the balance sheet are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Level inputs, as defined by ASC 820, are as follows:

Level input	Input definition
Level 1	Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.
Level 2	Inputs, other than quoted prices included in Level 1 that are observable for the asset or liability through corroboration with market data at the measurement date.
Level 3	Unobservable inputs that reflect management’s best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The Company obtained the fair value of its available-for-sale securities, which are not in active markets, from a third-party professional pricing service using quoted market prices for identical or comparable instruments, rather than direct observations of quoted prices in active markets. The Company's professional pricing service gathers observable inputs for all of its fixed income securities from a variety of industry data providers (e.g., large custodial institutions) and other third-party sources. Once the observable inputs are gathered, all data points are considered and the fair value is determined. The Company validates the quoted market prices provided by its primary pricing service by comparing their assessment of the fair values against the fair values provided by its investment managers. The Company's investment managers use similar techniques to its professional pricing service to derive pricing as described above. As all significant inputs were observable, derived from observable information in the marketplace or supported by observable levels at which transactions are executed in the marketplace, the Company has classified its available-for-sale securities within Level 2 of the fair value hierarchy.

The following table summarizes fair value measurements by level for the assets measured at fair value on a recurring basis:

As of September 30, 2015	Level 1	Level 2	Level 3	Total
Money market accounts	$6,849	$—	$—	$6,849
Certificates of deposit	—	23,837	—	23,837
Total assets	$6,849	$23,837	$—	$30,686

As of December 31, 2014	Level 1	Level 2	Level 3	Total
Money market accounts	$42,262	$—	$616	$42,878
Certificates of deposit	—	11,633	80	11,713
Total assets	$42,262	$11,633	$696	$54,591

Cash equivalents

The Company considers all short-term highly liquid investments with a maturity of three months or less to be cash equivalents. Cash equivalents are recorded at cost plus accrued interest, which approximates fair value. Certificates of deposit are included in cash equivalents and short-term investments based on the maturity date of the security.

Inogen, Inc.

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(amounts in thousands, except share and per share amounts)

Investments

The Company considers investments with maturities greater than three months, but less than one year, to be short-term investments. Investments that have maturities of more than one year are classified as long-term investments. Investments are classified as available-for-sale and are reported at fair value with unrealized gains or losses, if any, reported, net of tax, in accumulated other comprehensive income. The cost of investments sold is based on the specific identification method, and all income generated and realized gains or losses from investments are recorded to interest and other income (expense), net.

The Company reviews its investments to identify and evaluate investments that have an indication of possible impairment. Factors considered in determining whether a loss is 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. Credit losses and other-than-temporary impairments are declines in fair value that are not expected to recover and are charged to interest and other income (expense), net. Cash, cash equivalents and investments consist of the following:

Cash and cash equivalents	September 30, 2015	December 31, 2014
Cash	$ 43,432	$ 2,941
Money market accounts	6,849	42,262
Certificates of deposit	4,809	11,633
Total cash and cash equivalents	$ 55,090	$ 56,836
Short-term investments		
Certificates of deposit	19,028	—
Total short-term investments	$ 19,028	$ —

Accounts receivable and allowance for bad debts, returns, and adjustments

Accounts receivable are customer obligations due under normal sales and rental terms. The Company performs credit evaluations of the customers’ financial condition and generally does not require collateral. The allowance for doubtful accounts is maintained at a level that, in management’s opinion, is adequate to absorb potential losses related to accounts receivable and is based upon the Company’s continuous evaluation of the collectability of outstanding balances. Management’s evaluation takes into consideration such factors as past bad debt experience, economic conditions and information about specific receivables. The Company’s evaluation also considers the age and composition of the outstanding amounts in determining their net realizable value.

The allowance is based on estimates, and ultimate losses may vary from current estimates. As adjustments to these estimates become necessary, they are reported in earnings in the periods that they become known. The allowance is increased by bad debt provisions charged to bad debt expense, net of recoveries, in operating expense and is reduced by direct write-offs, net of recoveries.

The Company generally does not allow returns from providers for reasons not covered under its standard warranty. Therefore, provision for sales returns applies to direct-to-consumer sales only. This reserve is calculated based on actual historical return rates under the Company's 30-day return program and is applied to the sales revenue for direct-to-consumer sales for the last month of the quarter reported.

The Company also records an allowance for rental revenue adjustments and write-offs, which is recorded as a reduction of rental revenue and rental accounts receivable balances. These adjustments and write-offs result from contractual adjustments, audit adjustments, untimely claims filings or billings not paid due to another provider performing same or similar functions for the patient in the same period, all of which prevent billed revenue from becoming realizable. The reserve is based on historical revenue adjustments as a percentage of rental revenue billed and rental revenue unbilled during the related period.

When recording the allowance for doubtful accounts, the bad debt expense account (general and administrative expense account) is charged; when recording allowance for sales returns, the sales returns account (contra sales revenue account) is charged; and when recording the allowance for adjustments, the rental revenue adjustments account (contra rental revenue account) is charged.

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As of September 30, 2015 and December 31, 2014, included in accounts receivable on the balance sheets were earned but unbilled receivables of $5,718 and $3,653, respectively. These balances reflect gross unbilled receivables prior to any allowances for adjustments and write-offs.

Concentration of credit risk

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash and cash equivalents and accounts receivable. At times, cash account balances may be in excess of the amounts insured by the Federal Deposit Insurance Corporation (FDIC). However, management believes the risk of loss to be minimal. The Company performs periodic evaluations of the relative credit standing of these institutions and has not experienced any losses on its cash and cash equivalents to date.

Concentration of customers and vendors

The Company sells its products to home medical equipment providers, distributors, and resellers in the United States and in foreign countries on a credit basis. The Company sells its products to consumers on a prepayment basis. No single customer represented more than 10% of the Company’s total revenue for the nine months ended September 30, 2015 and September 30, 2014. No single customer represented more than 10% of the Company’s total accounts receivable balance as of September 30, 2015, or as of December 31, 2014.

The Company also rents products directly to consumers for insurance reimbursement, which resulted in a customer concentration relating to Medicare’s service reimbursement programs. Medicare’s service reimbursement programs accounted for 75.9% and 78.6% of rental revenue for the three months ended September 30, 2015 and September 30, 2014, respectively, and based on total revenue were 21.5% and 26.7% for the three months ended September 30, 2015 and September 30, 2014, respectively. Medicare’s service reimbursement programs accounted for 74.0% and 74.3% of rental revenue for the nine months ended September 30, 2015 and September 30, 2014, respectively, and based on total revenue were 21.1% and 25.6% for the nine months ended September 30, 2015 and September 30, 2014, respectively. Accounts receivable balances relating to Medicare’s service reimbursement programs amounted to $7,533 or 36.1% of total accounts receivable as of September 30, 2015 as compared to $4,875, or 25.2% of total accounts receivable as of December 31, 2014.

The Company currently purchases raw materials from a limited number of vendors, which resulted in a concentration of three major vendors. The three major vendors supply the Company with raw materials used to manufacture the Company’s products. For the nine months ended September 30, 2015, the Company’s three major vendors accounted for 23.0%, 17.4%, and 8.9%, respectively, of total raw material purchases. For the nine months ended September 30, 2014, the Company’s three major vendors accounted for 18.8%, 17.8% and 8.0%, respectively, of total raw material purchases.

A portion of revenue is earned from sales outside the United States. Approximately 87% and 75% of the non-U.S. revenue for the three months and nine months ended September 30, 2015, respectively, was invoiced in Euros. The Company did not begin to invoice in Euros until the fourth quarter of 2014. A breakdown of the Company’s revenue from U.S. and non-U.S. sources for the three months and nine months ended September 30, 2015 and September 30, 2014 is as follows:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2015	2014	2015	2014
U.S. revenue	$32,907	$22,572	$91,719	$65,996
Non-U.S. revenue	7,871	6,821	26,840	17,423
Total revenue	$40,778	$29,393	$118,559	$83,419

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Inventories

Inventories are stated at the lower of cost or market. Cost is determined using a standard cost method, including material, labor and manufacturing overhead, whereby the standard costs are updated at least quarterly to reflect approximate actual costs using the first-in, first out (FIFO) method and market represents the lower of replacement cost or estimated net realizable value. During the nine months ended September 30, 2015, $1,295 of inventory was transferred to rental equipment and was not included in the production and purchase of rental equipment. The Company records adjustments at least quarterly to inventory for potentially excess, obsolete, slow-moving or impaired items. Inventories consist of the following:

	September 30, 2015	December 31, 2014
Raw materials and work-in-progress	$ 8,363	$ 6,774
Finished goods	1,122	983
Less: reserves	(128)	(141)
Inventories	$ 9,357	$ 7,616

Property and equipment

Property and equipment are stated at cost. Depreciation and amortization are calculated using the straight-line method over the assets' estimated useful lives as follows:

Rental equipment	1.5-5 years
Manufacturing equipment and tooling	5 years
Computer equipment and software	3 years
Furniture and equipment	3-5 years
Leasehold improvements	Shorter of 3-10 years or life of underlying lease

Expenditures for additions, improvements and replacements are capitalized and depreciated to a salvage value of zero. Repair and maintenance costs are included in cost of revenue on the Statements of Operations. Repair and maintenance expense, which includes labor, parts and freight for rental equipment was $686 and $367 for the three months ended September 30, 2015 and September 30, 2014, respectively, and $1,897 and $1,157 for the nine months ended September 30, 2015 and September 30, 2014, respectively.

Included within property and equipment is construction in process, primarily related to the design and engineering of tooling, jigs and other machinery. In addition, this item also includes computer software that has been purchased, but has not completed the final configuration process for implementation into the Company's systems. These items have not been placed in service; therefore, no depreciation or amortization was recognized for these items in the respective periods.

Depreciation and amortization expense related to property and equipment and rental equipment is summarized below for the three months ended September 30, 2015 and September 30, 2014, respectively, and for the nine months ended September 30, 2015 and September 30, 2014, respectively.

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Rental equipment	$3,029	$2,752	$8,929	$7,512
Other property and equipment	510	396	1,475	1,142
Total depreciation and amortization	$3,539	$3,148	$10,404	$8,654

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Property and equipment and rental equipment with associated accumulated depreciation is summarized below for September 30, 2015 and December 31, 2014, respectively.

Property and equipment	September 30, 2015	December 31, 2014
Rental equipment, net of allowance	$ 54,369	$ 48,359
Other property and equipment	11,215	9,408
Property and equipment	65,584	57,767
Accumulated depreciation		
Rental equipment	27,662	21,084
Other property and equipment	6,213	4,756
Accumulated depreciation	33,875	25,840
Net property and equipment		
Rental equipment	26,707	27,275
Other property and equipment	5,002	4,652
Property and equipment, net	$ 31,709	$ 31,927

Income taxes

The Company accounts for income taxes in accordance with ASC 740—Income Taxes. Under ASC 740, income taxes are recognized for the amount of taxes payable or refundable for the current period and deferred tax liabilities and assets are recognized for the future tax consequences of transactions that have been recognized in the Company's financial statements or tax returns. A valuation allowance is provided when it is more likely than not that some portion, or all, of the deferred tax asset will not be realized.

The Company accounts for uncertainties in income tax in accordance with ASC 740-10—Accounting for Uncertainty in Income Taxes. ASC 740-10 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This accounting standard also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Company recognizes interest and penalties on taxes, if any, within operations as income tax expense. No significant interest or penalties were recognized during the periods presented.

The Company operates in multiple states. The statute of limitations has expired for all tax years prior to 2012 for federal and 2010 to 2011 for various state tax purposes. However, the net operating loss generated on the federal and state tax returns in prior years may be subject to adjustments by the federal and state tax authorities.

Income tax expense was $982 and $3,683, an effective tax rate of 26.7% and 32.3%, for the three and nine months ended September 30, 2015, respectively, compared to $1,341 and $3,408, an effective tax rate of 38.6% and 39.1%, for the comparable periods ended September 30, 2014, respectively. Variations in the tax rate year-over-year were primarily due to changes in the valuation allowance related to California net operating losses.

Accounting for stock-based compensation

The Company accounts for its stock-based compensation in accordance with ASC 718, Compensation—Stock Compensation, which establishes accounting for share-based awards, exchanged for employee services and requires companies to expense the estimated fair value of these awards over the requisite employee service period. Stock–based compensation cost is determined at the grant date using the Black-Scholes option pricing model. The value of the award that is ultimately expected to vest is recognized as expense on a straight-line basis over the employee's requisite service period.

As part of the provisions of ASC 718, the Company is required to estimate potential forfeitures of stock grants and adjust compensation cost recorded accordingly. The estimate of forfeitures will be adjusted over the requisite service period to the extent that actual forfeitures differ, or are expected to differ, from such estimates. Changes in estimated forfeitures will be recognized through a cumulative catch-up adjustment in the period of change and will also impact the amount of stock compensation expense to be recognized in future periods.

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(amounts in thousands, except share and per share amounts)

Business segments

The Company operates in only one business segment – development, manufacturing, marketing, sales, and rental of respiratory products.

Earnings per share

Earnings per share (EPS) is computed in accordance with ASC 260, Earnings per Share, and is calculated using the weighted-average number of common shares outstanding during each period. Diluted EPS assumes the conversion, exercise or issuance of all potential common stock equivalents (which can include dilution of outstanding stock options and common stock warrants) unless the effect is to reduce a loss or increase the income per share. For purposes of this calculation, common stock subject to repurchase by the Company, options and warrants are considered to be common stock equivalents and are only included in the calculation of diluted earnings per share when their effect is dilutive.

The shares used to compute basic and diluted net income per share represent the weighted-average common shares outstanding, reduced by the weighted-average unvested common shares subject to repurchase.

The computation of EPS is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Numerator—basic:				
Net income	$2,696	$2,133	$7,727	$5,307
Less deemed dividend on redeemable convertible preferred stock	—	—	—	(987)
Net income before preferred rights dividend	2,696	2,133	7,727	4,320
Less: undistributed earnings to preferred stock - basic	—	—	—	(563)
Net income attributable to common stockholders - basic	$2,696	$2,133	$7,727	$3,757
Numerator—diluted:				
Net income	$2,696	$2,133	$7,727	$5,307

Less deemed dividend on redeemable convertible preferred stock	—	—	—	(987)
Net income before preferred rights dividend	2,696	2,133	7,727	4,320
Less: undistributed earnings to preferred stock - diluted	—	—	—	(507)
Net income attributable to common stockholders - diluted	$2,696	$2,133	$7,727	$3,813
Denominator:				
Weighted-average common shares - basic common stock	19,428,653	18,286,208	19,303,057	15,340,877
Weighted-average common shares - diluted common stock	20,783,550	20,213,102	20,690,499	17,293,833
Net income per share - basic common stock	$0.14	$0.12	$0.40	$0.24
Net income per share - diluted common stock	$0.13	$0.11	$0.37	$0.22
Shares excluded from diluted net income:				
Stock options	627,688	630,055	629,136	630,055
Shares excluded from diluted net income	627,688	630,055	629,136	630,055
Denominator calculation from basic to diluted:				
Weighted-average common shares - basic common stock	19,428,653	18,286,208	19,303,057	15,340,877
Warrants	15,122	154,227	15,102	161,743
Stock options	1,339,775	1,772,667	1,372,340	1,791,213
Weighted-average common shares - diluted common stock	20,783,550	20,213,102	20,690,499	17,293,833

The computations of diluted net income attributable to common stockholders exclude common stock options which were anti-dilutive for the three months and nine months ended September 30, 2015 and September 30, 2014, respectively.

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(amounts in thousands,