FLUIDIGM CORP
Form 10-Q
August 09, 2011
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# 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 June 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: 001-34180**

# FLUIDIGM CORPORATION

**(Exact name of registrant as specified in its charter)**

| **Delaware** | **77-0513190** |
|---|---|
| **(State or other jurisdiction of** | **(I.R.S. Employer** |
| **incorporation or organization)** | **Identification Number)** |

**7000 Shoreline Court, Suite 100**

**South San Francisco, California 94080**

**(Address of principal executive offices) (Zip Code)**

**(650) 266-6000**

**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 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 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 ¨ No x

As of July 25, 2011, there were 19,992,765 shares of the Registrant s common stock outstanding.

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**FLUIDIGM CORPORATION**

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**PART I. FINANCIAL INFORMATION**

**Item 1. Financial Statements**

**FLUIDIGM CORPORATION**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

*(In thousands, except per share amounts)*

| | June 30, 2011 (Unaudited) | December 31, 2010 (Note 2) |
|---|---|---|
| **ASSETS** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 10,129 | $ 5,723 |
| Available-for-sales securities | 54,222 | 0 |
| Accounts receivable (net of allowances of $467 at both June 30, 2011 and December 31, 2010) | 10,316 | 8,100 |
| Inventories | 4,850 | 4,893 |
| Prepaid expenses and other current assets | 1,472 | 2,165 |
| Total current assets | 80,989 | 20,881 |
| Property and equipment, net | 2,539 | 2,328 |
| Investment, at cost | 1,340 | 1,340 |
| Other non-current assets | 787 | 252 |
| Total assets | $ 85,655 | $ 24,801 |
| **LIABILITIES, CONVERTIBLE PREFERRED STOCK AND STOCKHOLDERS EQUITY (DEFICIT)** | | |
| Current liabilities: | | |
| Accounts payable | $ 2,983 | $ 3,155 |
| Accrued compensation and related benefits | 1,666 | 1,904 |
| Other accrued liabilities | 3,014 | 3,379 |
| Deferred revenue, current portion | 1,786 | 1,336 |
| Long-term debt, current portion | 8,310 | 4,561 |
| Line of credit | 0 | 3,125 |
| Convertible preferred stock warrants | 0 | 1,052 |
| Total current liabilities | 17,759 | 18,512 |
| Long-term debt, net of current portion | 4,696 | 10,139 |
| Deferred revenue, net of current portion | 577 | 426 |
| Other non-current liabilities | 318 | 341 |
| Total liabilities | 23,350 | 29,418 |
| Commitments and contingencies | | |
| Convertible preferred stock issuable in series: $0.001 par value, 10,000 and 11,269 shares authorized at June 30, 2011 and December 31, 2010, respectively; 0 and 10,296 shares issued and outstanding as of June 30, 2011 and December 31, 2010, respectively | 0 | 184,550 |
| Stockholders equity (deficit): | | |
| Common stock: $0.001 par value, 200,000 and 18,327 shares authorized at June 30, 2011 and December 31, 2010, respectively; 19,986 and 1,937 shares issued and outstanding as of June 30, 2011 and | 20 | 2 |

| | | |
|---|---|---|
| December 31, 2010, respectively | | |
| Additional paid-in capital | 276,910 | 10,936 |
| Accumulated other comprehensive loss | (774) | (778) |
| Accumulated deficit | (213,851) | (199,327) |
| Total stockholders equity (deficit) | 62,305 | (189,167) |
| Total liabilities, convertible preferred stock and stockholders equity (deficit) | $ 85,655 | $ 24,801 |

See accompanying notes.

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**FLUIDIGM CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

*(In thousands, except per share amounts)*

*(Unaudited)*

| | Three Months Ended June 30, 2011 | Three Months Ended June 30, 2010 | Six Months Ended June 30, 2011 | Six Months Ended June 30, 2010 |
|---|---|---|---|---|
| Revenue: | | | | |
| Product revenue | $ 9,711 | $ 7,469 | $ 18,123 | $ 13,733 |
| Collaboration revenue | 754 | 75 | 921 | 75 |
| Grant revenue | 111 | 479 | 229 | 931 |
| Total revenue | 10,576 | 8,023 | 19,273 | 14,739 |
| Costs and expenses: | | | | |
| Cost of product revenue | 2,965 | 2,900 | 5,878 | 5,545 |
| Research and development | 3,422 | 3,447 | 6,642 | 6,635 |
| Selling, general and administrative | 7,843 | 5,902 | 15,285 | 12,023 |
| Litigation settlement | 3,000 | 0 | 3,000 | 0 |
| Total costs and expenses | 17,230 | 12,249 | 30,805 | 24,203 |
| Loss from operations | (6,654) | (4,226) | (11,532) | (9,464) |
| Interest expense | (512) | (555) | (2,272) | (1,080) |
| (Loss) gain from changes in the fair value of convertible preferred stock warrants | 0 | (5) | (1,483) | 272 |
| Gain from expiration of unexercised warrants | 0 | 0 | 765 | 0 |
| Other income (expense), net | 42 | 108 | 108 | (17) |
| Loss before income taxes | (7,124) | (4,678) | (14,414) | (10,289) |
| Provision for income taxes | (62) | (141) | (110) | (155) |
| Net loss | (7,186) | (4,819) | (14,524) | (10,444) |
| Deemed dividend related to the change in conversion rate of Series E convertible preferred stock | 0 | 0 | (9,900) | 0 |
| Net loss attributed to common stockholders | $ (7,186) | $ (4,819) | $ (24,424) | $ (10,444) |
| Net loss per share attributed to common stockholders, basic and diluted | $ (0.36) | $ (2.59) | $ (1.58) | $ (5.61) |
| Shares used in computing net loss per share attributed to common stockholders, basic and diluted | 19,975 | 1,863 | 15,464 | 1,862 |

See accompanying notes.

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**FLUIDIGM CORPORATION**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

*(In thousands)*

*(Unaudited)*

| | Six Months Ended June 30, | |
|---|---|---|
| | **2011** | **2010** |
| **Operating activities** | | |
| Net loss | $ (14,524) | $ (10,444) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 503 | 632 |
| Stock-based compensation expense | 1,328 | 846 |
| Loss (gain) from changes in the fair value of convertible preferred stock warrants, net | 1,483 | (272) |
| Gain from expiration of unexercised warrants | (765) | 0 |
| Write-off of debt discount upon note repayment | 1,157 | 0 |
| Amortization of debt discount and issuance cost | 122 | 186 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (2,245) | 2,117 |
| Inventories | 42 | (267) |
| Prepaid expenses and other assets | 174 | 209 |
| Accounts payable | (173) | (384) |
| Deferred revenue | 600 | 834 |
| Other liabilities | (610) | 516 |
| Net cash used in operating activities | (12,908) | (6,027) |
| **Investing activities** | | |
| Purchases of available-for-sale securities | (57,712) | 0 |
| Maturities of available-for-sale securities | 3,490 | 0 |
| Purchases of property and equipment | (714) | (658) |
| (Increase) decrease in restricted cash | (21) | 131 |
| Net cash used in investing activities | (54,957) | (527) |
| **Financing activities** | | |
| Proceeds from initial public offering, net of issuance costs | 76,946 | 0 |
| Proceeds from exercise of stock options | 242 | 11 |
| Proceeds from note | 5,000 | 0 |
| Repayment of note | (5,000) | 0 |
| Repayment of long-term debt | (1,831) | 0 |
| Repayment of line of credit | (3,125) | 0 |
| Net cash provided by financing activities | 72,232 | 11 |
| Effect of foreign exchange rate fluctuations on cash and cash equivalents | 39 | 10 |
| Net increase (decrease) in cash and cash equivalents | 4,406 | (6,533) |
| Cash and cash equivalents at beginning of period | 5,723 | 14,602 |
| Cash and cash equivalents at end of period | $ 10,129 | $ 8,069 |

| **Supplemental disclosures of cash flow information** | | | | |
|---|---|---|---|---|
| Conversion of convertible preferred stock to common stock upon initial public offering | $ | 184,550 | $ | 0 |
| Issuance of convertible preferred stock warrants in connection with note and warrant agreement and long-term debt | $ | 1,157 | $ | 63 |
| Extinguishment of convertible preferred stock warrants upon initial public offering | $ | 765 | $ | 0 |
| Conversion of convertible preferred stock warrants to common stock warrants | $ | 1,535 | $ | 0 |
| Net exercise of convertible preferred stock warrants | $ | 1,391 | $ | 0 |

See accompanying notes.

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**FLUIDIGM CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

## 1. Description of Business

Fluidigm Corporation (the Company) was incorporated in the State of California on May 19, 1999, to commercialize microfluidic technology initially developed at the California Institute of Technology. In July 2007, the Company was reincorporated in the State of Delaware. The Company s headquarters are located in South San Francisco, California. The Company develops, manufactures and markets microfluidic systems in the life science and agricultural biotechnology (Ag-Bio) industries. The Company s proprietary microfluidic systems consist of instruments and consumables, including chips and reagents. The Company s microfluidic systems are designed to simplify experimental workflow, increase throughput, reduce costs, and provide quality data. The Company markets systems and consumables to leading pharmaceutical and biotechnology companies, academic institutions, diagnostic laboratories, and Ag-Bio companies.

## 2. Summary of Significant Accounting Policies

### Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles (U.S. GAAP) and following the requirements of the Securities and Exchange Commission (SEC) for interim reporting. As permitted under those rules, certain footnotes or other financial information that are normally required by U.S. GAAP can be condensed or omitted. These financial statements have been prepared on the same basis as the Company s annual financial statements and, in the opinion of management, reflect all adjustments (consisting only of normal recurring adjustments) that are necessary for a fair presentation of the Company s financial information. The results of operations for the three and six months ended June 30, 2011 are not necessarily indicative of the results to be expected for the year ending December 31, 2011 or for any other interim period or for any other future year. The balance sheet as of December 31, 2010 has been derived from audited consolidated financial statements at that date but does not include all of the information required by U.S. GAAP for complete financial statements.

The preparation of these condensed consolidated financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues, expenses, and related disclosures. On an ongoing basis, the Company evaluates its estimates, including critical accounting policies or estimates related to revenue recognition, income tax provisions, stock-based compensation, inventory valuation, and warrants to purchase convertible preferred stock. The Company bases its estimates on historical experience and on various relevant assumptions that the Company believes to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ significantly from these estimates.

The accompanying condensed consolidated financial statements and related financial information should be read in conjunction with the audited consolidated financial statements and the related notes thereto for the year ended December 31, 2010 included in the Company s Annual Report on Form 10-K filed with the SEC.

### Amended and Restated Certificate of Incorporation

In February 2011, the Company amended and restated its Certificate of Incorporation. The amendment and restatement increased the total number of shares of stock authorized for issuance from 29,595,999 to 210,000,000, consisting of an increase in the number of shares of common stock authorized for issuance from 18,327,000 to 200,000,000 and a decrease in the number of shares of preferred stock authorized for issuance from 11,268,999 to 10,000,000.

**FLUIDIGM CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

In January 2011, the Company amended and restated its Certificate of Incorporation decreasing the conversion price of its Series E convertible preferred stock from $24.22 to $18.63 per share. As a result, the Company recognized a deemed dividend of $9,900,000 to reflect the fair value of the additional shares of common stock to be issued as a result of the change in conversion price of the Series E convertible preferred stock. The deemed dividend increased the net loss attributed to common stockholders in the calculation of basic and diluted net loss per share.

**Reverse Stock Split**

On February 3, 2011, the Company effected a 1 for 1.73 reverse stock split of the Company s issued and outstanding shares of common stock and convertible preferred stock, and changed the par value of the Company s common and preferred stock from $0.0035 per share to $0.001 per share. All issued and outstanding common stock, convertible preferred stock, options to purchase common stock, warrants to purchase convertible preferred stock, and per share amounts contained in these condensed consolidated financial statements have been retroactively adjusted to reflect this reverse stock split and par value change for all periods presented.

**Initial Public Offering**

On February 9, 2011, the Company s registration statement on Form S-1 relating to an initial public offering (IPO) of its common stock was declared effective by the SEC. Upon the closing of the IPO in February 2011, the Company sold 6,392,083 shares of common stock and received net cash proceeds of approximately $77.0 million. Concurrently, all outstanding shares of convertible preferred stock converted by their terms into approximately 11,480,000 shares of common stock with the related carrying value of approximately $184,550,000 reclassified to common stock and additional paid-in capital.

**Net Loss per Share Attributed to Common Stockholders**

The Company s basic and diluted net loss per share attributed to common stockholders is calculated by dividing net loss attributed to common stockholders by the weighted-average number of shares of common stock outstanding for the period. The Company s convertible preferred stock, options to purchase common stock and warrants to purchase convertible preferred stock are considered to be potential common shares but have been excluded from the calculation of diluted net loss per share as their effect is anti-dilutive.

The following potential common shares were excluded from the computation of diluted net loss per share attributed to common stockholders for the interim periods presented because including them would have been anti-dilutive (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| Convertible preferred stock | 0 | 10,239 | 0 | 10,239 |
| Options to purchase common stock | 2,314 | 1,660 | 2,229 | 1,615 |
| Warrants to purchase convertible preferred stock | 0 | 444 | 0 | 444 |

**Investment**

The Company has a minority equity investment in a privately-held company that is accounted for under the cost method of accounting. Under the cost method of accounting, investments in equity securities are carried at cost and are adjusted only for other-than-temporary declines in value. No such declines have been identified through June 30, 2011.

**Comprehensive Loss**

Comprehensive loss primarily consists of net loss and an immaterial amount of foreign currency translation adjustments for all periods presented.

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**FLUIDIGM CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**Recent Accounting Pronouncements**

Adopted

***Revenue Arrangements with Multiple Deliverables***

In September 2009, the Financial Accounting Standards Board (FASB) ratified authoritative accounting guidance regarding revenue recognition for arrangements with multiple deliverables. The guidance impacts the determination of when the individual deliverables included in a multiple element arrangement may be treated as separate units of accounting. Additionally, the guidance allows the use of management s best estimate of selling price for individual elements of an arrangement when vendor specific objective evidence or third-party evidence is unavailable. The guidance also requires arrangement consideration to be allocated at the inception of the arrangement to all deliverables using the relative-selling-price method and eliminates the use of the residual method of allocation. This guidance is effective for fiscal years beginning on or after June 15, 2010 and early adoption is permitted. The Company adopted this guidance prospectively on January 1, 2011. The adoption of this standard did not have a material impact on the Company s condensed consolidated financial statements. However, the adoption of this standard may result in revenue recognition patterns for future agreements that are materially different from those recognized for the Company s past multiple-element arrangements.

***Revenue Arrangements with Software Elements***

In October 2009, the FASB ratified authoritative accounting guidance that modifies the scope of the software revenue recognition guidance to exclude tangible products that contain both software and non-software components that function together to deliver the product s essential functionality. This guidance is effective for fiscal years beginning on or after June 15, 2010 and early adoption is permitted. This guidance must be adopted in the same period an entity adopts the amended guidance for revenue arrangements with multiple deliverables described in the preceding paragraph. The Company adopted this guidance prospectively on January 1, 2011. The adoption of this standard did not have a material impact on the Company s condensed consolidated financial statements.

***Milestone Method of Revenue Recognition***

In March 2010, the FASB ratified the milestone method of revenue recognition. Under this new standard, an entity can recognize contingent consideration earned from the achievement of a substantive milestone in its entirety in the period in which the milestone is achieved. A milestone is defined as an event (i) that can only be achieved based in whole or in part on either the Company s performance or on the occurrence of a specific outcome resulting from the Company s performance (ii) for which there is substantive uncertainty at the date the arrangement is entered into that the event will be achieved and (iii) that would result in additional payments being due to the Company. A milestone is substantive if the consideration earned from the achievement of the milestone is consistent with the Company s performance required to achieve the milestone or the increase in value to the collaboration resulting from the Company s performance, relates solely to past performance, and is reasonable relative to all of the other deliverables and payments within the arrangement. The milestone method of revenue recognition is effective for new arrangements or existing arrangements which are materially modified for fiscal years beginning on or after June 15, 2010 and early adoption is permitted. The Company adopted this guidance prospectively on January 1, 2011. The election of the milestone method did not have a material impact on the Company s condensed consolidated financial statements and is not expected to result in different accounting treatment for future substantive milestones earned after the date of this adoption. Non-substantive milestones will continue to be recognized over the remaining performance period.

Issued

***Fair Value Measurement***

In May 2011, the FASB issued changes to conform existing guidance regarding fair value measurement and disclosure between U.S. GAAP and International Financial Reporting Standards. This guidance clarifies the application of existing fair value measurements and disclosures, and changes certain principles or requirements for fair value measurements and disclosures. The amendment is effective for interim and annual periods beginning after December 15, 2011 and will be applied prospectively. The Company is currently evaluating the impact on the Company s condensed consolidated financial statements of adopting these amendments and cannot estimate the impact of adoption at this time.

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**FLUIDIGM CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

***Comprehensive Income***

In June 2011, the FASB issued changes to the presentation of comprehensive income. These changes give an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements; the option to present components of other comprehensive income as part of the statement of changes in stockholders equity was eliminated. The items that must be reported in other comprehensive income or when an item of other comprehensive income must be reclassified to net income were not changed. Additionally, no changes were made to the calculation and presentation of earnings per share. The amendment is effective for fiscal years, and interim periods within those years, beginning after December 15, 2011 and should be applied retrospectively. The Company is currently evaluating these changes to determine which option will be chosen for the presentation of comprehensive income.

***Legal Matters***

From time to time, the Company may be involved in lawsuits, arbitrations, claims, investigations and proceedings, relating to intellectual property, commercial, employment and other matters, which arise in the ordinary course of business. The Company makes provisions for liabilities when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Such provisions, if necessary, are reviewed at least quarterly and adjusted to reflect the impact of settlement negotiations, judicial and administrative rulings, advice of legal counsel, and other information and events pertaining to a particular case. Litigation is inherently unpredictable. If any unfavorable ruling were to occur in any specific period, there exists the possibility of a material adverse impact on the results of operations of that period or on the Company s cash flows and liquidity.

**3. License and Collaboration Agreements**
**License Agreements**

On June 30, 2011, the Company settled certain litigation and entered into a series of patent license agreements with Life Technologies Corporation and its subsidiary Applied Biosystems, LLC (collectively, Life). These agreements settled litigation filed by the Company against Life on June 29, 2011 in United States District Court for the Northern District of California and litigation filed by Life against the Company on June 29, 2011 in United States District Court for the District of Delaware. The agreements resulted in a net $3.0 million payment by the Company to Life, which was recognized as a litigation settlement expense in the Company s June 30, 2011 condensed consolidated statement of operations because the agreement specified that the amount paid by the Company was principally attributable to resolving Life s litigation claims with respect to a specific expiring U.S. patent and its foreign counterparts. The agreements also provide for various royalty payments on future sales of certain products by each of the parties. Such royalty payments or receipts are not expected to be material to the Company in future periods based on its current business.

Under the terms of the agreements, each party had the option, exercisable for thirty days from the date of the agreements, to limit or preclude certain patent litigation between the parties over the next two to four years. These rights were subject to certain exceptions and required an additional payment by the party exercising the option at the time of exercise. In July 2011, the Company exercised its option and paid Life $2.0 million. As a result, subject to certain exceptions, Life may not initiate litigation under its patents existing as of June 30, 2011 against the Company s customers for two years and against the Company, with respect to its current products and equivalent future products, for four years. The additional payment will be accounted for as an other asset and amortized to selling, general and administrative expense over 4 years on a straight-line basis beginning in July 2011. Life elected not to exercise its option.

In May 2011, the Company entered into an agreement with Caliper Life Sciences, Inc. to license Caliper s existing patent portfolio in certain fields, including non-invasive prenatal diagnostics, and obtained an option to extend the license to cover additional fields. Under the agreement, the Company made an up-front payment of $625,000, which is subject to adjustment, and will have royalty obligations commencing in January 2012. The Company s royalty payments are not expected to be material to the Company in future periods. Additional payments are due if the

Company exercises its option to extend the license or if the up-front payment is adjusted upwards. The up-front payment is being recognized as cost of product revenue on a straight-line basis through December 31, 2017, which is the Company s estimated useful life of the patents with respect to its current and future products.

**Collaboration Agreement**

In May 2010, the Company entered into a collaboration agreement to develop a new product and received an up-front payment of $750,000. Under the agreement, the Company is also eligible for milestone payments for the design and development of product prototypes.

In March 2011, the Company entered into an amendment to the collaboration agreement and received an additional $300,000. Under the amendment, certain milestones were modified and payment terms associated with satisfaction of the milestones were revised. The $750,000 up-front payment and the $300,000 payment received in March 2011 are being recognized on a straight-line basis through September 30, 2011, which is the Company s estimated period of performance under the amended agreement.

The Company s amended collaboration agreement provides for payments to the Company upon the achievement of milestones, such as the design and development of product prototypes. These product prototypes have not been previously produced by the Company and the achievement of these and other future milestones was uncertain at the time the Company entered into the collaboration agreement. The Company considers each of the milestones to be substantive and, accordingly, expects to recognize as revenue future payments received from such milestones as each milestone is achieved. The Company achieved two such milestones during the three months ended June 30, 2011 and recognized $0.5 million of milestone revenue. At June 30, 2011, one additional milestone remains with a potential future payment of $0.5 million.

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**FLUIDIGM CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**4. Inventories**

Inventories consist of the following as of (in thousands):

| | June 30, 2011 | December 31, 2010 |
|---|---|---|
| Raw materials | $ 1,996 | $ 2,401 |
| Work-in-process | 510 | 357 |
| Finished goods | 2,344 | 2,135 |
| | $ 4,850 | $ 4,893 |

**5. Fair Value of Financial Instruments**

The Company s financial instruments consist principally of cash and cash equivalents, available-for-sale securities, accounts receivable, accounts payable and long-term debt. The carrying values of the Company s cash equivalents, available-for-sale securities, accounts receivable and accounts payable approximated their fair values due to the short period of time to maturity or repayment. The Company s long-term debt bears interest at a rate commensurate with the Company s risk profile and stage of development, and, as a result, management believes its carrying value approximates fair value. As a basis for considering fair value, the Company follows a three-tier value hierarchy, which prioritizes the inputs used in measuring fair value as follows:

Level I: observable inputs such as quoted prices in active markets;

Level II: inputs other than quoted prices in active markets that are observable either directly or indirectly; and

Level III: unobservable inputs in which there is little or no market data, which requires the Company to develop its own assumptions.

The Company s cash equivalents are classified as Level I because they are valued using quoted market prices. The Company s available-for-sale securities are generally classified as Level II because their value is based on other observable inputs. The Company s convertible preferred stock warrants are valued using Level III inputs, the valuation of which is discussed in Note 9.

The following table sets forth the Company s financial instruments that were measured at fair value by level within the fair value hierarchy (in thousands):

| | June 30, 2011 | | | | December 31, 2010 | | | |
|---|---|---|---|---|---|---|---|---|
| | Level I | Level II | Level III | Total | Level I | Level II | Level III | Total |
| **Assets** | | | | | | | | |
| Money market funds | $ 2,189 | $ 0 | $ 0 | $ 2,189 | $ 32 | $ 0 | $ 0 | $ 32 |
| U.S. government and agency securities | 0 | 53,787 | 0 | 53,787 | 0 | 0 | 0 | 0 |
| **Total assets measured at fair value** | $ 2,189 | $ 53,787 | $ 0 | $ 55,976 | $ 32 | $ 0 | $ 0 | $ 32 |

| | | | | | | | | | | | | | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| **Liabilities** | | | | | | | | | | | | | | | |
| Convertible preferred stock warrants | $ | 0 | $ | 0 | $ | 0 | $ | 0 | $ | 0 | $ | 0 | $ | 1,052 | $ 1,052 |
| **Total liabilities measured at fair value** | $ | 0 | $ | 0 | $ | 0 | $ | 0 | $ | 0 | $ | 0 | $ | 1,052 | $ 1,052 |

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**FLUIDIGM CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

Changes in the fair value of the Company s Level III convertible preferred stock warrants during the six months ended June 30, 2011 were as follows (in thousands):

| | |
|---|---|
| Balance, beginning of period | $ 1,052 |
| Issuances | 1,157 |
| Exercises | (1,392) |
| Changes in fair value | 1,483 |
| Expiration of warrants | (765) |
| Conversion to common stock warrants | (1,535) |
| Balance, end of period | $ 0 |

The following table sets forth our financial assets that were measured at fair value as of June 30, 2011 (in thousands):

| | Amortized Cost | Gross Unrealized Gain | Gross Unrealized Loss | Estimated Fair Value |
|---|---|---|---|---|
| Money market funds | $ 2,189 | $ 0 | $ 0 | $ 2,189 |
| U.S. government and agency securities | 53,784 | 11 | (8) | 53,787 |
| Total assets measured at fair value | $ 55,973 | $ 11 | $ (8) | $ 55,976 |

The contractual maturity date of all of the Company s available-for-sale securities is within one year. The Company did not hold any available-for-sale securities as of December 31, 2010.

**6. Note and Warrant Purchase Agreement 2010**

In January 2011, the Company entered into a Note and Warrant Purchase Agreement (the Note Agreement) with existing stockholders, including certain of the Company s officers, under which the Company issued subordinated secured promissory notes (the Notes) with an aggregate principal amount of $5,000,000 bearing interest at 8% per year. The Notes matured on the earliest to occur of the closing of the next financing in which the Company issued and sold shares of capital stock of at least $25,000,000, a change of control as defined in the Note Agreement, or January 6, 2012. The Company s obligations under the Notes were secured by the assets of the Company, excluding intellectual property, and were subordinated to senior indebtedness of the loan agreement entered into in March 2005, as amended (see Note 7) and the Line of Credit (see Note 8). In connection with the Note Agreement, the Company issued warrants to acquire a total of 103,182 shares of Series E-1 convertible preferred stock with an exercise price of $0.02 per share. The fair value of these warrants, based on a contemporaneous valuation, was $1,157,000 and was recognized as an original issue discount amortizable over the expected life of the borrowing. In connection with the IPO in February 2011, the warrants were exercised for 103,182 shares of common stock and the Company repaid all principal and interest outstanding under these Notes in February and March 2011. Upon the repayment of the Notes, the unamortized discount of $1,157,000 was immediately recognized as interest expense.

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**FLUIDIGM CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**7. Long-Term Debt**

The Company entered into a long-term loan agreement in March 2005 that was subsequently amended in 2006, 2008, 2009, and 2010. In connection with this long-term loan agreement and in conjunction with the various amendments thereto, the Company issued a total of 209,960 warrants to purchase shares of convertible preferred stock to the lender. As of June 30, 2011, the outstanding balance under this long-term loan agreement was $13,000,000 with interest accruing at 13.5% per annum and the loan maturing in February 2013. Commencing in March 2011, the Company began making monthly payments of $612,000 for principal and interest and will make an additional payment of $2,263,000 in March 2012. The additional payment is being recognized as interest expense using the effective interest method through the extended maturity date of February 2013. Upon completion of the IPO in February 2011, all 209,960 warrants to purchase preferred stock that were held by the lender were converted to warrants to purchase shares of common stock. The common stock warrants have an exercise price of $12.11 and expire at various dates though 2017. As of June 30, 2011, the Company was in compliance with all loan covenants under this long-term loan agreement.

**8. Line of Credit**

In December 2010, the Company entered into a bank line of credit agreement (Line of Credit) that is collateralized by the Company s accounts receivable and provided the Company with the ability to borrow up to $4,000,000, subject to certain covenants and other restrictions. The term of the Line of Credit is two years and it bears interest at the greater of (i) 5.50% or (ii) the prime rate, as defined in the Line of Credit, plus 2.25% per year. As of December 31, 2010, the outstanding balance on the Line of Credit was $3,125,000. In February 2011, the Company repaid all outstanding borrowings under the Line of Credit. In March 2011, the Line of Credit was amended to increase the credit limit to $7,000,000. At June 30, 2011, there was no outstanding balance on the Line of Credit and the Company was in compliance with its loan covenants.

**9. Convertible Preferred Stock Warrants**

On February 10, 2011, the Company had total outstanding warrants to purchase 489,880 shares of convertible preferred stock that had been granted at various times since 2001. Warrants to purchase the Company s convertible preferred stock were recognized at fair value using the Black-Scholes option-pricing model and classified as liabilities because the warrants may have conditionally obligated the Company to transfer assets at some point in the future. The warrants were subject to re-measurement to fair value at each balance sheet date and any change in fair value was recognized in gain (loss) from changes in the fair value of convertible preferred stock warrants, in the condensed consolidated statements of operations. The fair value of these warrants was approximately $3,691,000 at February 10, 2011, which was an increase in fair value of approximately $1,483,000 since December 31, 2010. Upon the closing of the IPO, approximately 103,182 of such warrants were net exercised and the related liability of $1,391,000 was reclassified to additional paid-in capital and 209,960 of such warrants were converted into warrants to purchase common stock and the related liability of $1,535,000 was reclassified to additional paid-in capital. The remaining 176,738 warrants expired unexercised and the related liability of $765,000 was recognized as other income in the six months ended June 30, 2011.

**10. Stock-Based Compensation**

During the three months ended June 30, 2011, the Company granted to certain employees options to purchase 330,000 shares of common stock. During the six months ended June 30, 2011, the Company granted to certain employees options to purchase 828,000 shares of common stock. Of these options, 438,000 were granted with an exercise price of $8.37 per share, 385,000 were granted with exercise prices ranging from $14.31 to $14.90 per share, and the remainder were granted with an exercise price of $16.77 per share. These options had a total fair value of $5,053,000, of which $488,000 was immediately recognized as compensation expense because 66,500 of such options were fully vested upon grant while the remainder will vest over four years.

The computation of the fair value of stock options and other equity instruments using the Black-Scholes option pricing model requires inputs such as the fair value of the Company s common stock. For options granted prior to the IPO in February 2011, the Company performed a contemporaneous valuation to determine the fair value of its common stock.

The Company recognized stock-based compensation expense of $538,000 and $417,000 during the three months ended June 30, 2011 and 2010, respectively. During the six months ended June 30, 2011 and 2010, the Company recognized stock-based compensation expense of $1,328,000 and $846,000, respectively. As of June 30, 2011, the Company had $5.2 million of unrecognized stock-based compensation costs, which are expected to be recognized over an average period of 3.3 years.

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**FLUIDIGM CORPORATION**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)**

**(Unaudited)**

**11. Income Taxes**

Income tax expense for the three and six months ended June 30, 2011 was $62,000 and $110,000, respectively, and was comprised of state and foreign income taxes. The provision for income taxes for the periods differs from the 34% U.S. Federal statutory rate primarily due to maintaining a valuation allowance for U.S. losses and tax assets which the Company does not consider to be realizable.

**12. Information about Geographic Areas**

The Company has a single reporting segment and operating unit structure, which is the development, manufacturing, and commercialization of microfluidic systems for the life science and agricultural biotechnology industries.

The following table presents the Company s product revenue by geography based on the billing address of the Company s customers for each period presented (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | **2011** | **2010** | **2011** | **2010** |
| United States | $ 5,164 | $ 4,401 | $ 9,306 | $ 7,960 |
| Europe | 2,408 | 1,554 | 4,555 | 3,193 |
| Japan | 1,287 | 100 | 2,187 | 353 |
| Asia Pacific | 667 | 1,061 | 1,650 | 1,809 |
| Other | 185 | 353 | 425 | 418 |
| Total | $ 9,711 | $ 7,469 | $ 18,123 | $ 13,733 |

The Company s collaboration revenue is primarily generated in the United States and grant revenue is generated in Singapore and the United States.

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***Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.***

*The following discussion and analysis should be read together with our condensed consolidated financial statements and the notes to those statements included elsewhere in this Form 10-Q. This Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or Exchange Act, that are based on our management s beliefs and assumptions and on information currently available to our management. The forward-looking statements are contained principally in the sections entitled Risk Factors and this Management s Discussion and Analysis of Financial Condition and Results of Operations. Forward-looking statements include information concerning our possible or assumed future results of operations, business strategies, financing plans, competitive position, industry environment, potential growth opportunities and the effects of competition. Forward-looking statements include statements that are not historical facts and can be identified by terms such as anticipates, believes, could, seeks, estimates, expects, intends, may, plans, potential, predicts, projects, should, will, would or similar expressions and the negatives of those terms.*

*Forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. We discuss these risks in greater detail in Part II, Item 1A, Risk Factors, elsewhere in this Form 10-Q and in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our management s beliefs and assumptions only as of the date of this Form 10-Q.*

*Except as required by law, we assume no obligation to update these forward-looking statements, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future. You should read this Form 10-Q completely and with the understanding that our actual future results may be materially different from what we expect.*

*In this Form 10-Q, we, us and our refer to Fluidigm Corporation and its subsidiaries. We operate on a fiscal year ending December 31.*

***Overview***

We develop, manufacture and market microfluidic systems for growth markets in the life science and agricultural biotechnology, or Ag-Bio, industries. Our proprietary microfluidic systems consist of instruments and consumables, including chips and reagents. These systems are designed to significantly simplify experimental workflow, increase throughput and reduce costs, while providing the excellent data quality demanded by customers. In addition, our proprietary technology enables genetic analysis that in many instances was previously impractical. We actively market three microfluidic systems including nine different commercial chips to leading pharmaceutical and biotechnology companies, academic institutions, diagnostic laboratories and Ag-Bio companies. We have sold over 400 systems to customers in over 25 countries worldwide through the date of this report.

Our total revenue grew from $15.3 million in 2008 to $33.6 million in 2010 and to $19.3 million in the six months ended June 30, 2011. We have incurred significant net losses since our inception in 1999 and as of June 30, 2011, our accumulated deficit was $213.9 million.

We distribute our microfluidic systems through our direct sales force and support organizations located in North America, Europe and Asia-Pacific and through distributors or sales agents in several European, Latin American, African, Middle Eastern and Asia-Pacific countries. Our manufacturing operations are located in Singapore. Our facility in Singapore manufactures our instruments and fabricates all of our chips for commercial sale and some chips for our own research and development purposes. Our South San Francisco facility fabricates chips for our own research and development purposes.

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**Critical Accounting Policies, Significant Judgments and Estimates**

Our consolidated financial statements and the related notes included elsewhere in this Form 10-Q are prepared in accordance with accounting principles generally accepted in the United States. The preparation of these consolidated financial statements requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, costs and expenses and related disclosures. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Changes in accounting estimates may occur from period to period. Accordingly, actual results could differ significantly from the estimates made by our management. We evaluate our estimates and assumptions on an ongoing basis. To the extent that there are material differences between these estimates and actual results, our future financial statement presentation, financial condition, results of operations and cash flows will be affected.

We believe that certain of our critical accounting policies involve a greater degree of judgment and complexity than our other accounting policies. Accordingly, these are the policies we believe are the most critical to understanding and evaluating our consolidated financial condition and results of operations. There have been no material changes in the matters for which we make critical accounting estimates in the preparation of our condensed consolidated financial statements during the three and six-month periods ended June 30, 2011 as compared to those disclosed in our Annual Report on Form 10-K filed with the SEC on March 28, 2011.

***Revenue***

We generate revenue from sales of our products, collaboration agreements and government grants. Our product revenue consists of sales of instruments and related services, and consumables, including chips and reagents. We also have entered into collaboration agreements, research and development contracts and have received government grants to conduct research and development activities.

The following table presents our revenue by source for each period presented (in thousands):

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|---|---|---|---|---|
| | 2011 | 2010 | 2011 | 2010 |
| *Revenue:* | | | | |
| Instruments | $ 6,434 | $ 4,940 | $ 11,391 | $ 9,059 |
| Consumables | 3,277 | 2,529 | 6,732 | 4,674 |
| Product revenue | 9,711 | 7,469 | 18,123 | 13,733 |
| Collaboration revenue | 754 | 75 | 921 | 75 |
| Grant revenue | 111 | 479 | 229 | 931 |
| Total revenue | $ 10,576 | $ 8,023 | $ 19,273 | $ 14,739 |

The following table presents our product revenue by geography and as a percentage of total product revenue by geography based on the billing address of our customers for each period presented (in thousands):

| | Three Months Ended June 30, | | | | Six Months Ended June 30, | | | |
|---|---|---|---|---|---|---|---|---|
| | 2011 | | 2010 | | 2011 | | 2010 | |
| United States | $ 5,164 | 53% | $ 4,401 | 59% | $ 9,306 | 51% | $ 7,960 | 58% |
| Europe | 2,408 | 25 | 1,554 | 21 | 4,555 | 25 | 3,193 | 23 |
| Japan | 1,287 | 13 | 100 | 1 | 2,187 | 12 | 353 | 3 |
| Asia Pacific | 667 | 7 | 1,061 | 14 | 1,650 | 9 | 1,809 | 13 |
| Other | 185 | 2 | 353 | 5 | 425 | 3 | 418 | 3 |
| Total | $ 9,711 | 100% | $ 7,469 | 100% | $ 18,123 | 100% | $ 13,733 | 100% |

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Grant revenue is generated in Singapore and the United States. Collaboration revenue is primarily generated in the United States. As we expand our business internationally, we expect our product revenue from outside of the United States to increase as a percentage of our total product revenue.

Our customers include pharmaceutical and biotechnology companies, academic research institutions, diagnostic laboratories and Ag-Bio companies worldwide. Revenue from the five largest customers comprised 16% and 12% of our total revenue in the three and six-months ended June 30, 2011, respectively and 20% and 17% of our total revenue for the three and six-months ended June 30, 2010, respectively.

**Comparison of the Three Months Ended June 30, 2011 and June 30, 2010**

***Total Revenue***

Total revenue increased by $2.6 million, or 32%, to $10.6 million for the three months ended June 30, 2011 as compared to $8.0 million for the three months ended June 30, 2010.

***Product Revenue***

Product revenue increased by $2.2 million, or 30%, to $9.7 million for the three months ended June 30, 2011 as compared to $7.5 million for the three months ended June 30, 2010. Consumables revenue increased by $0.7 million, or 30%, resulting from the higher installed base of our instruments, and instrument revenue increased by $1.5 million, or 30%. Our instrument system unit sales volume increased by 21%, primarily driven by increased sales of our Access Array instrument which launched in the second half of 2009. The average selling price for instruments was higher for the three months ended June 30, 2011 compared to the three months ended June 30, 2010 due to increased sales in Japan and Europe where average selling prices are higher, partially offset by increased sales of our Access Array instrument which has a lower average selling price than our BioMark and EP1 instruments.

We expect unit sales of both instruments and consumables to continue to increase in future periods as we continue our efforts to grow our customer base and expand our geographic market coverage. However, we expect the average selling prices of our instruments to fluctuate over time based on product mix and currency fluctuations.

***Collaboration Revenue***

Collaboration revenue was $0.8 million for the three months ended June 30, 2011 compared to $0.1 million in the three months ended June 30, 2010. The increase in collaboration revenue of $0.7 million is due to the achievement of two milestones from a fixed-fee research and development agreement that we entered into in May 2010. The arrangement provided for an up-front fee of $0.7 million which is being recognized over the term of the agreement, projected to be fifteen months. In March 2011, we amended the collaboration agreement and received an additional $0.3 million payment. Under the amendment, certain milestones and the payment terms associated with satisfaction of the milestones were modified. The total up-front and additional payment of $1.05 million is being recognized on a straight-line basis over the estimated performance period, through September 30, 2011. The arrangement also provides for milestone payments, which payments have been and are expected to be recognized as we achieve milestones.

***Grant Revenue***

Grant revenue consists of incentive grants from Singapore Economic Development Board, or EDB, and California Institute for Regenerative Medicine, or CIRM. Grant revenue decreased $0.4 million, or 77%, to $0.1 million for the three months ended June 30, 2011 compared to $0.5 million for the three months ended June 30, 2010. The decrease relates to a reduction in activity under the EDB grant agreements as we achieved certain milestones and reached the end of the grant periods.

Under our agreements with EDB, we were eligible to receive incentive grant payments from EDB, provided we satisfied certain agreed upon targets. Our agreements with EDB provided for incentive funding eligibility through May 2011. From January 1, 2008 through December 31, 2010, we recognized $4.3 million of grant revenue from EDB. During the three months ended June 30, 2011, we recognized an additional $4,000 of grant revenue from EDB. These agreements further provided EDB with the right to demand repayment of a portion of past grants in the event that we did not meet our obligations under the applicable agreements. Our first grant agreement with EDB was completed in July 2010 and has been officially closed by EDB with no adjustments. Our second grant agreement was completed in May 2011, and, based on correspondence with EDB, we believe that we have satisfied our obligations applicable to our EDB grant revenue through June 30, 2011.

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We expect total grant revenue for 2011 and future periods to decrease significantly compared to 2010 as the first of our EDB grant agreements was completed in July 2010 and our second EDB grant agreement was completed in May 2011. We expect this decrease will be partially offset by grant revenue from CIRM resulting from a new grant of $1.9 million to be recognized over three years beginning in May 2011.

***Cost of Product Revenue***

The following table presents the cost of our product revenue and our product margin for each period presented (in thousands, other than percentages):

| | Three Months Ended June 30, | |
|---|---|---|
| | **2011** | **2010** |
| Cost of product revenue | $ 2,965 | $ 2,900 |
| Product margin | 69% | 61% |

Cost of product revenue includes manufacturing costs incurred in the production process, including component materials, assembly labor and overhead; installation; warranty; service; and packaging and delivery costs. In addition, cost of product revenue includes royalty costs for licensed technologies included in our products, provisions for slow-moving and obsolete inventory and stock-based compensation expense. Costs related to collaboration and grant revenue are included in research and development expense.

Cost of product revenue increased $0.1 million, or 2%, to $3.0 million for the three months ended June 30, 2011 from $2.9 million for the three months ended June 30, 2010 due to increased product sales. Cost of product revenue as a percentage of related revenue decreased to 31% for the three months ended June 30, 2011 compared to 39% for the three months ended June 30, 2010. This decrease was due to lower instrument costs, higher average selling prices, higher utilization of chip manufacturing capacity, and improved chip yields.

***Operating Expenses***

The following table presents our operating expenses for each period presented (in thousands):

| | Three Months Ended June 30, | |
|---|---|---|
| | **2011** | **2010** |
| Research and development | $ 3,422 | $ 3,447 |
| Selling, general and administrative | 7,843 | 5,902 |
| Litigation settlement | 3,000 | 0 |
| Total operating expenses | $ 14,265 | $ 9,349 |

***Research and Development***

Research and development expense consists primarily of personnel costs, independent contractor costs, prototype and material expenses and other allocated facilities and information technology expenses. We have made substantial investments in research and development since our inception. Our research and development efforts have focused primarily on the tasks required to enhance our technologies and to support development and commercialization of new and existing products and services.

Research and development expense was $3.4 million for each of the three months ended June 30, 2011 and June 30, 2010. During the three months ended June 30, 2011, decreases in compensation costs and related expenses of $0.2 million were offset by increases in consulting and professional fees of $0.2 million, as compared to the three months ended June 30, 2010. We believe that our continued investment in research and development is essential to our long-term competitive position and these expenses may increase in future periods.

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***Selling, General and Administrative***

Selling, general and administrative expense consists primarily of personnel costs for our sales and marketing, business development, finance, legal, human resources and general management, as well as professional services, such as legal and accounting services.

Selling, general and administrative expense increased $1.9 million, or 33%, to $7.8 million for the three months ended June 30, 2011, compared to $5.9 million for the three months ended June 30, 2010. The increase was primarily due to increased compensation costs and related expenses of $1.5 million resulting from increased headcount to support our business and revenue growth, increased legal and professional fees of $0.6 million, increased other costs of $0.4 million to support our public company requirements, partially offset by lower bad debt expense of $0.3 million and lower rent expense of $0.1 million resulting from our new lease on more favorable terms for our headquarters facility in South San Francisco, California. We expect selling, general and administrative expense to increase in future periods as we continue to grow our sales, technical support, marketing and administrative headcount, support increased product sales, broaden our customer base and incur additional costs to support our expanded global footprint and the overall growth in our business. We also expect legal, accounting and compliance costs to increase as a result of our becoming a public company.

***Litigation Settlement***

On June 30, 2011, we settled certain litigation and entered into a series of patent license agreements resulting in a net $3.0 million payment by us to Life Technologies and their subsidiary Applied Biosystems, LLC, referred to collectively as Life. The payment was recognized as litigation settlement expense in our June 30, 2011 condensed consolidated statement of operations because the agreement specified that the amount paid by us was principally attributable to resolving Life s litigation claims with respect to a specific expiring U.S. patent and its foreign counterparts. We had no similar settlement in the three months ended June 30, 2010.

***Interest Expense and Other Income and Expense, Net***

We receive interest income from our cash and cash equivalents and available-for-sale securities. Conversely, we incur interest expense from our long-term debt, bank line of credit, promissory notes and the amortization of debt discounts related to these items. Until the completion of the IPO, we also recognized income or expense as a result of changes in the fair value of outstanding warrants to purchase shares of our convertible preferred stock. The following table presents these items for each period presented (in thousands):

| | Three Months Ended June 30, | |
|---|---|---|
| | **2011** | **2010** |
| Interest expense | $ (512) | $ (555) |
| Loss from changes in the fair value of convertible preferred stock warrants | | (5) |
| Other income, net | 42 | 108 |

Interest expense was $0.5 million for the three months ended June 30, 2011 compared to $0.6 million for the three months ended June 30, 2010. The decrease is primarily due to a reduction in loan principal as we began making principal payments on our long-term debt in March 2011. We expect interest expense to decrease in 2011 as we repay our outstanding debt.

Other income decreased $66,000, to $42,000 for the three months ended June 30, 2011 compared to $108,000 for the three months ended June 30, 2010 primarily due to unfavorable changes in foreign currency exchange gains and losses.

**Comparison of the Six Months Ended June 30, 2011 and June 30, 2010**

***Total Revenue***

Total revenue increased by $4.5 million, or 31%, to $19.3 million for the six months ended June 30, 2011 as compared to $14.7 million for the six months ended June 30, 2010.

***Product Revenue***

Product revenue increased by $4.4 million, or 32%, to $18.1 million for the six months ended June 30, 2011 as compared to $13.7 million for the six months ended June 30, 2010. Consumables revenue increased by $2.1 million, or 44%, resulting from our higher installed base of instruments, and instrument revenue increased by $2.3 million, or 26%. Our instrument system unit sales volume increased by 28%, primarily driven by increased sales of our Access Array instrument. The average selling price for instruments was higher for the six months ended June 30, 2011 compared to the six months ended June 30, 2010 due to increased sales in Japan and Europe where average selling prices are higher partially offset by increased sales of our Access Array instrument which has a lower average selling price than our BioMark and EP1 instruments.

***Collaboration Revenue***

Collaboration revenue increased by $0.8 million to $0.9 million for the six months ended June 30, 2011 compared to $0.1 million for the six months ended June 30, 2010. The increase in collaboration revenue is due to the achievement of three milestones related to a fixed-fee research and development agreement that we entered into in May 2010. The arrangement provided for an up-front fee of $0.7 million which is being recognized over the term of the agreement, projected to be 15 months. In March 2011, we amended the collaboration agreement and received an additional $0.3 million payment. Under the amendment, certain milestones and the payment terms associated with satisfaction of the milestones were modified. The total up-front and additional payment of $1.1 million is being recognized on a straight-line basis over the estimated performance period, through September 30, 2011. The arrangement also provides for milestone payments, which payments have been and are expected to be recognized as we achieve each milestone.

***Grant Revenue***

Grant revenue consists of incentive grants from the Singapore Economic Development Board, or EDB, and the California Institute for Regenerative Medicine, or CIRM. Grant revenue decreased $0.7 million, or 75%, to $0.2 million for the six months ended June 30, 2011 compared to $0.9 million for the six months ended June 30, 2010. The decrease relates to a reduction in activity under the EDB grant agreements as we achieved certain milestones and reached the end of the grant periods.

Under our agreements with EDB, we were eligible to receive incentive grant payments from EDB, provided we satisfied certain agreed upon targets. Our agreements with EDB provided for incentive funding eligibility through May 2011. From January 1, 2008 through December 31, 2010, we recognized $4.3 million of grant revenue from EDB. During the six months ended June 30, 2011, we recognized an additional $31,000 of grant revenue from EDB. These agreements further provided EDB with the right to demand repayment of a portion of past grants in the event that we did not meet our obligations under the applicable agreements. Our first grant agreement with EDB was completed in July 2010 and has been officially closed by EDB with no adjustments. Our second grant agreement with EDB was completed in May 2011 and based on correspondence with EDB, we believe that we have satisfied our obligations applicable to our EDB grant revenue through June 30, 2011.

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***Cost of Product Revenue***

The following table presents the cost of our product revenue and our product margin for each period presented (in thousands, other than percentages):

| | Six Months Ended June 30, | |
|---|---|---|
| | 2011 | 2010 |
| Cost of product revenue | $ 5,878 | $ 5,545 |
| Product margin | 68% | 60% |

Cost of product revenue includes manufacturing costs incurred in the production process, including component materials, assembly labor and overhead; installation; warranty; service; and packaging and delivery costs. In addition, cost of product revenue includes royalty costs for licensed technologies included in our products, provisions for slow-moving and obsolete inventory and stock-based compensation expense. Costs related to collaboration and grant revenue are included in research and development expense.

Cost of product revenue increased $0.3 million, or 6%, to $5.9 million for the six months ended June 30, 2011 compared to $5.5 million for the six months ended June 30, 2010 due to increased product sales. Cost of product revenue as a percentage of related revenue decreased to 32% for the six months ended June 30, 2011 compared to 40% for the six months ended June 30, 2010. This decrease was due to lower instrument costs, higher average selling prices, higher utilization of chip manufacturing capacity and improved chip yields.

***Operating Expenses***

The following table presents our operating expenses for each period presented (in thousands):

| | Six Months Ended June 30, | |
|---|---|---|
| | 2011 | 2010 |
| Research and development | $ 6,642 | $ 6,635 |
| Selling, general and administrative | 15,285 | 12,023 |
| Litigation settlement | 3,000 | 0 |
| Total operating expenses | $ 24,927 | $ 18,658 |

***Research and Development***

Research and development expense consists primarily of personnel costs, independent contractor costs, prototype and material expenses and other allocated facilities and information technology expenses. We have made substantial investments in research and development since our inception. Our research and development efforts have focused primarily on the tasks required to enhance our technologies and to support development and commercialization of new and existing products and services.

Research and development expense was $6.6 million for each of the six months ended June 30, 2011 and June 30, 2010. During the six months ended June 30, 2011, increases in compensation costs and related expenses of $0.1 million and increases in consulting and professional fees of $0.1 million were offset by decreases in equipment related costs and depreciation of $0.2 million as older equipment became fully depreciated, as compared to the six months ended June 30, 2010.

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***Selling, General and Administrative***

Selling, general and administrative expense consists primarily of personnel costs for our sales and marketing, business development, finance, legal, human resources and general management, as well as professional services, such as legal and accounting services.

Selling, general and administrative expense increased $3.3 million, or 27%, to $15.3 million for the six months ended June 30, 2011, compared to $12.0 million for the six months ended June 30, 2010. The increase was primarily due to increased compensation costs and related expenses of $2.7 million resulting from increased headcount to support our business and revenue growth, increased other costs of $0.6 million to support our public company requirements and increased legal and professional fees of $0.6 million, partially offset by lower bad debt expense of $0.3 million and lower rent expense of $0.3 million resulting from our new lease on more favorable terms for our headquarters facility in South San Francisco, California.

***Litigation Settlement***

On June 30, 2011, we settled certain litigation and entered into a series of patent license agreements resulting in a net $3.0 million payment by us to Life Technologies and their subsidiary Applied Biosystems, LLC (Life). The payment was recognized as litigation settlement expense in our June 30, 2011 condensed consolidated statement of operations because the agreement specified that the amount paid by us was principally attributable to resolving Life s litigation claims with respect to a specific expiring U.S. patent and its foreign counterparts. We had no similar settlement in the six months ended June 30, 2010.

***Interest Expense and Other Income and Expense, Net***

We receive interest income from our cash and cash equivalents and available-for-sale securities. Conversely, we incur interest expense from our long-term debt, bank line of credit, promissory notes and the amortization of debt discounts related to these items. Until the completion of our IPO, we also recognized income or expense as a result of changes in the fair value of outstanding warrants to purchase shares of our convertible preferred stock. The following table presents these items for each period presented (in thousands):

| | **Six Months Ended June 30,** | |
|---|---|---|
| | **2011** | **2010** |
| Interest expense | $ (2,272) | $ (1,080) |
| Gain (loss) from changes in the fair value of convertible preferred stock warrants | (1,483) | 272 |
| Gain from expiration of unexercised warrants | 765 | |
| Other income (expense), net | 108 | (17) |

Interest expense was $2.3 million for the six months ended June 30, 2011 compared to $1.1 million for the six months ended June 30, 2010. The increase is primarily due to $1.2 million of non-cash interest expense in connection with a $5.0 million note and warrant agreement entered into in January 2011. We repaid all principal and interest outstanding under this note in February 2011 upon the completion of our IPO. There was no similar transaction or recognition of expense in the six months ended June 30, 2010.

Gain (loss) from changes in the fair value of preferred stock was a loss of $1.5 million for the six months ended June 30, 2011 compared to a $0.3 million gain for the six months ended June 30, 2010. The loss in 2011 was due to an increase in the warrant liability fair value through the completion of our IPO on February 10, 2011. Upon completion of our IPO, our outstanding preferred stock warrants were either converted into warrants to purchase common stock or expired unexercised, or were exercised for shares of our common stock. Liabilities related to the expired warrants were reversed and resulted in a gain reflected in other income; liabilities related to the warrants that were converted into warrants to purchase common stock and warrants that were exercised were reclassified to additional paid-in-capital.

Other income increased $125,000 to $108,000 for the six months ended June 30, 2011 compared to a $17,000 loss for the six months ended June 30, 2010 primarily due to favorable changes in foreign currency exchange gains and losses.

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**Liquidity and Capital Resources**

***Sources of Liquidity***

As of June 30, 2011, we had $10.1 million of cash and cash equivalents and $54.2 million of available-for-sale securities. As of June 30, 2011, our working capital was $63.2 million. In February 2011, we completed our IPO of common stock which resulted in net proceeds to us of approximately $77.0 million, net of underwriting discounts, commissions and offering expenses. Following the completion of our IPO, we paid the balance on our bank line of credit of $3.1 million, which is collateralized by our accounts receivable and provides us the ability to borrow up to $7.0 million, subject to certain covenants and other restrictions, and paid all principal and interest outstanding of $5.0 million on the note and warrant agreement we entered into in January 2011.

As of June 30, 2011, the outstanding balance under our loan and security agreement was $13.0 million. The loan and security agreement has a maturity date of February 2013 and bears interest of 13.5% per annum upon which interest only payments were paid monthly through February 2011. Commencing in March 2011, we began making monthly payments of $0.6 million for principal and interest and will make an additional payment of $2.3 million in March 2012. The additional payment is being accreted as interest expense through the maturity date of February 2013. As of June 30, 2011, we were in compliance with all loan covenants.

The following table presents our cash flow summary for each period presented (in thousands):

| | Six Months Ended June 30, | |
|---|---|---|
| | **2011** | **2010** |
| *Cash flow summary* | | |
| Net cash used in operating activities | $ (12,908) | $ (6,027) |
| Net cash used in investing activities | (54,957) | (527) |
| Net cash provided by financing activities | 72,232 | 11 |
| Net increase (decrease) in cash and cash equivalents | 4,406 | (6,533) |

***Net Cash Used in Operating Activities***

We derive cash flows from operations primarily from cash collected from the sale of our products, collaboration and license agreements and grants from certain government entities. Our cash flows from operating activities are also significantly influenced by our use of cash for operating expenses to support the growth of our business. We have historically experienced negative cash flows from operating activities as we have expanded our business and built our infrastructure domestically and internationally and this may continue in the future.

Net cash used in operating activities was $12.9 million during the six months ended June 30, 2011. Net cash used in operating activities primarily consisted of our net loss of $14.5 million, changes in our operating assets and liabilities in the amount of $2.2 million, and non-cash expense items such as stock-based compensation of $1.3 million, depreciation and amortization of our property and equipment of $0.5 million, loss from changes in the fair value of convertible stock warrants of $1.5 million, gain from expiration of unexercised warrants of $0.8 million, write off of debt discounts upon note repayment of $1.2 million and amortization of debt discount and issuance costs of $0.1 million.

Net cash used in operating activities was $6.0 million during the six months ended June 30, 2010. Net cash used in operating activities primarily consisted of our net loss of $10.4 million, changes in our operating assets and liabilities in the amount of $3.0 million, and non-cash expense items such as stock-based compensation of $0.8 million, depreciation and amortization of our property and equipment of $0.6 million, and amortization of debt discount and issuance costs of $0.2 million, partially offset by a gain from changes in the fair value of convertible stock warrants of $0.2 million.

***Net Cash Used in Investing Activities***

Historically, our primary investing activities have consisted of capital expenditures for laboratory, manufacturing and computer equipment and software to support our expanding infrastructure and work force; and purchases, sales and maturities of our available-for-sale securities. We expect to continue to expand our manufacturing capability, primarily in Singapore, and expect to incur additional costs for capital expenditures related to these efforts in future periods.

We used $55.0 million of cash in investing activities during the six months ended June 30, 2011 to invest a portion of the net proceeds from our IPO in available-for-sale securities of $54.2 million and for purchases of capital equipment to support our infrastructure and manufacturing

operations of $0.7 million.

We used $0.5 million of cash in investing activities during the six months ended June 30, 2010 primarily for purchases of capital equipment to support our infrastructure and manufacturing operations of $0.6 million, partially offset by a decrease in restricted cash of $0.1 million related to the favorable lease negotiations of our headquarters facility in South San Francisco, California.

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***Net Cash Provided by Financing Activities***

Prior to our IPO, we funded our operations principally through issuances of convertible preferred stock and long term debt.

We generated $72.2 million of cash from financing activities during the six months ended June 30, 2011 primarily from net proceeds from our IPO of approximately $77.0 million and $5.0 million from subordinated secured promissory notes with existing stockholders and proceeds from exercise of stock options of $0.2 million, partially offset by the pay off of our line of credit balance of $3.1 million and repayment of the outstanding principal, interest on the subordinated secured promissory notes of $5.0 million and repayment of long-term debt of $1.8 million.

***Capital Resources***

At June 30, 2011, our working capital was $63.2 million, including cash, cash equivalents and available-for-sale securities of $64.3 million. We have a bank line of credit agreement that is collateralized by our accounts receivable and provides us the ability to draw up to $7.0 million, subject to certain covenants and restrictions. During the six months ended June 30, 2011, our capital expenditures were $0.7 million. We are estimating capital expenditures to be higher in 2011 compared to 2010 primarily for the expansion of our manufacturing capacity, research and development equipment and sales demonstration and product support instruments to service our global customer base.

We believe our existing cash and cash equivalents will be sufficient to meet our working capital and capital expenditure needs for at least the next 18 months. However, we may need to raise additional capital to expand the commercialization of our products, fund our operations and further our research and development activities. Our future funding requirements will depend on many factors, including market acceptance of our products, the cost of our research and development activities, the cost of filing and prosecuting patent applications, the cost of defending, in litigation or otherwise, any claims that we infringe third-party patents or violate other intellectual property rights, the cost and timing of regulatory clearances or approvals, if any, the cost and timing of establishing additional sales, marketing and distribution capabilities, the cost and timing of establishing additional technical support capabilities, the effect of competing technological and market developments and the extent to which we acquire or invest in businesses, products and technologies, although we currently have no commitments or agreements relating to any of these types of transactions.

We may require additional funds in the future and we may not be able to obtain such funds on acceptable terms, or at all. If we raise additional funds by issuing equity securities, our stockholders may experience dilution. Debt financing, if available, may involve covenants restricting our operations or our ability to incur additional debt. Any debt or additional equity financing that we raise may contain terms that are not favorable to us or our stockholders. If we raise additional funds through collaboration and licensing arrangements with third parties, it may be necessary to relinquish some rights to our technologies or our products, or grant licenses on terms that are not favorable to us. If we are unable to raise adequate funds, we may have to liquidate some or all of our assets, or delay, reduce the scope of or eliminate some or all of our development programs. If we do not have, or are not able to obtain, sufficient funds, we may have to delay development or commercialization of our products or license to third parties the rights to commercialize products or technologies that we would otherwise seek to commercialize. We also may have to reduce marketing, customer support or other resources devoted to our products or cease operations.

**Off-Balance Sheet Arrangements**

As of June 30,