

ENDOLOGIX INC /DE/  
Form 10-K  
February 29, 2008

**Table of Contents**

**UNITED STATES SECURITIES AND EXCHANGE COMMISSION**  
**Washington, D.C. 20549**  
**Form 10-K**

(Mark One)

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

**For the fiscal year ended December 31, 2007**

**or**

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

**For the transaction period from \_\_\_\_\_ to \_\_\_\_\_.**

**Commission file number: 000-28440**

**Endologix, Inc.**

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

**Delaware**

*(State or other jurisdiction of  
incorporation or organization)*

**68-0328265**

*(IRS Employer  
Identification No.)*

**11 Studebaker, Irvine, California 92618**

*(Address of principal executive offices, including zip code)*

Registrant's telephone number, including area code: **(949) 595-7200**

Securities registered pursuant to Section 12(b) of the Act:

Title of each class  
**Common Stock, \$0.001 par value**

Name of each exchange on which registered  
**The NASDAQ Stock Market, LLC**

Securities registered pursuant to Section 12(g) of the Act: **None**

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☒

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☒

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 ☒ No ☐

Indicate by check mark if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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

Large accelerated filer ☐

Accelerated filer ☒

Non-accelerated filer ☐

Smaller reporting  
company ☐

(Do not check if a smaller reporting company)

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

As of June 29, 2007, the aggregate market value of the voting stock held by non-affiliates of the Registrant was approximately \$117,471,000 (based upon the closing price for shares of the Registrant's Common Stock as reported by the NASDAQ Global Market for June 29, 2007, the last trading date of the Registrant's most recently completed second fiscal quarter).

On February 13, 2008, approximately 42,957,891 shares of the Registrant's Common Stock, \$0.001 par value, were outstanding.

#### **DOCUMENTS INCORPORATED BY REFERENCE**

Portions of Part III of this Annual Report on Form 10-K are incorporated by reference into the Registrant's Proxy Statement for its Annual Meeting of Stockholders to be held on May 22, 2008.

---

**ENDOLOGIX, INC.**  
**ANNUAL REPORT ON**  
**Form 10-K**  
**For the Fiscal Year Ended December 31, 2007**  
**TABLE OF CONTENTS**

	<b>Page</b>
<b><u>PART I</u></b>	
<u>Item 1 Business</u>	2
<u>Item 1A Risk Factors</u>	11
<u>Item 1B Unresolved Staff Comments</u>	17
<u>Item 2 Properties</u>	17
<u>Item 3 Legal Proceedings</u>	17
<u>Item 4 Submission of Matters to a Vote of Security Holders</u>	17
<b><u>PART II</u></b>	
<u>Item 5 Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities</u>	18
<u>Item 6 Selected Financial Data</u>	19
<u>Item 7 Management's Discussion and Analysis of Financial Condition and Results of Operation</u>	19
<u>Item 7A Quantitative and Qualitative Disclosures About Market Risk</u>	26
<u>Item 8 Financial Statements and Supplementary Data</u>	26
<u>Item 9 Changes in and Disagreements With Accountants on Accounting and Financial Disclosure</u>	27
<u>Item 9A Controls and Procedures</u>	27
<u>Item 9B Other Information</u>	28
<b><u>PART III</u></b>	
<u>Item 10 Directors and Executive Officers of the Registrant</u>	28
<u>Item 11 Executive Compensation</u>	28
<u>Item 12 Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters</u>	28
<u>Item 13 Certain Relationships and Related Transactions</u>	29
<u>Item 14 Principal Accountant Fees and Services</u>	29
<b><u>PART IV</u></b>	
<u>Item 15 Exhibits, Financial Statement Schedules</u>	30
<b><u>SIGNATURES</u></b>	32
<u>EXHIBIT 10.10.1</u>	
<u>EXHIBIT 21.1</u>	
<u>EXHIBIT 23.1</u>	
<u>EXHIBIT 31.1</u>	
<u>EXHIBIT 31.2</u>	
<u>EXHIBIT 32.1</u>	
<u>EXHIBIT 32.2</u>	

**Table of Contents**

*This Annual Report on Form 10-K contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. You can identify forward-looking statements generally by the use of forward-looking terminology such as believes, expects, may, will, intends, plans, should, could, seeks, pro forma, anticipates, estimates, continues, or thereof, including their use in the negative, or by discussions of strategies, opportunities, plans or intentions. In addition, any statements that refer to projections of our future financial performance, trends in our businesses, or other characterizations of future events or circumstances are forward-looking statements. We have based these forward-looking statements largely on our current expectations based on information currently available to us and projections about future events and trends affecting the financial condition of our business. These forward-looking statements are subject to a number of risks, uncertainties, and assumptions including, among other things:*

*market acceptance of our Powerlink® System;*

*the level and availability of third party payor reimbursement for our products;*

*our ability to effectively manage our anticipated growth;*

*our ability to protect our intellectual property rights and proprietary technology;*

*research and development of our products;*

*development and management of our business and anticipated trends of our business;*

*our ability to attract, retain and motivate qualified personnel;*

*our ability to attract and retain customers;*

*the market opportunity for our products and technology;*

*the nature of regulatory requirements that apply to us, our suppliers and competitors and our ability to obtain and maintain any required regulatory approvals;*

*our future capital expenditures and needs;*

*our ability to effectively compete;*

*general economic and business conditions; and*

*other risks set forth under Risk Factors in Item 1A of this Annual Report on Form 10-K.*

*The forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause actual results to differ in significant ways from any future results expressed or implied by the forward-looking statements. Unless otherwise required by law, we undertake no obligation to publicly update or revise any forward-looking statements, either as a result of new information, future events or otherwise after the date of this Annual Report on Form 10-K.*

**Table of Contents**

**PART I**

**Item 1. Business**

***Introduction***

We develop, manufacture, sell and market minimally invasive therapies for the treatment of vascular disease. Our products are catheter-based alternative treatments for abdominal aortic aneurysm, or AAA. AAA is a weakening of the wall of the aorta, the largest artery of the body. Once AAA develops, it continues to enlarge and if left untreated becomes increasingly susceptible to rupture. The overall patient mortality rate for ruptured AAAs is approximately 75%, making it a leading cause of death in the United States today.

The Powerlink® System is a catheter and endoluminal stent graft, or ELG, system. The self-expanding cobalt chromium alloy stent cage is covered by ePTFE, a common surgical graft material. The Powerlink ELG is implanted in the abdominal aorta, which is accessed through the femoral artery. Once deployed into its proper position, the blood flow is shunted away from the weakened or aneurysmal section of the aorta, reducing pressure and the potential for the aorta to rupture. Our clinical trials demonstrate that implantation of our products will reduce the mortality and morbidity rates associated with conventional AAA surgery, as well as provide a clinical alternative to many patients that could not undergo conventional surgery. Sales of our Powerlink System in the United States, Europe, and South America are the primary sources of our reported revenues.

Prior to developing the Powerlink System, we developed various catheter-based systems to treat cardiovascular disease. We licensed our proprietary Focus balloon technology to Guidant Corporation for use in Guidant's coronary stent delivery systems.

We were incorporated in California in March 1992 under the name Cardiovascular Dynamics, Inc. and reincorporated in Delaware in June 1993. In January 1999, we merged with privately held Radiance Medical Systems, Inc. and changed our name to Radiance Medical Systems, Inc. and in May 2002, we merged with privately held Endologix, Inc., and changed our name to Endologix, Inc.

***Industry Background***

Atherosclerosis is the thickening and hardening of arteries. Some hardening of arteries occurs naturally as people grow older. Atherosclerosis involves deposits of fatty substances, cholesterol, cellular waste products, calcium and other substances on the inner lining of an artery. Atherosclerosis is a slow, complex disease that starts in childhood and often progresses with age.

Atherosclerosis also can reduce the integrity and strength of the vessel wall, causing the vessel wall to expand or balloon out, which is known as an aneurysm. Aneurysms are commonly diagnosed in the aorta, which is the body's largest artery. The highest incidence of aortic aneurysms occurs in the segment below the opening of the arteries that feed the kidneys, the renal arteries, to where the aorta divides into the two iliac arteries that travel down the legs. Once diagnosed, patients with AAA require either a combination of medical therapy and non-invasive monitoring, or they must undergo a major surgery procedure to repair the aneurysm.

For years, physicians have been interested in less invasive methods to treat AAA disease as an alternative to the current standard of surgical repair. The high morbidity and mortality rates of surgery are well documented, yet medical pharmacological management for this condition carries the catastrophic risk of aneurysm rupture. Physicians and commercial interests alike began investigating catheter-based alternatives to repair an aneurysm from within, utilizing surgical grafts in combination with expandable wire cages or scaffolds to exclude blood flow and pressure from the weakened segment of the aorta.

We believe the appeal of the Powerlink System for patients, physicians, and health-care payors is compelling. The conventional treatment is a highly invasive, open surgical procedure requiring a large incision in the patient's abdomen, withdrawal of the patient's intestines to provide access to the aneurysm, and the cross clamping of the aorta to stop blood flow. This procedure typically lasts two to four hours and is performed under general anesthesia. This surgery has an operative mortality rate estimated to range from 4% to 10%. In addition, complication rates vary

## **Table of Contents**

depending upon patient risk classification, ranging from 15% for low-risk patients to 40% for high-risk patients. The typical recovery period for conventional AAA surgery includes a hospital stay of 10 to 15 days and post-hospital convalescence of 8 to 12 weeks. Our minimally invasive treatment of AAA requires only a small incision in the femoral artery of the leg, minimizing both hospital lengths of stay and the amount of time required for convalescence. Many patients can be treated utilizing only a local or regional anesthesia.

### ***Market Opportunity***

In the United States alone, an estimated 1.5 million people have an AAA, and yet there are only about 200,000 new diagnoses each year. Although AAA is one of the most serious cardiovascular diseases, many AAAs are never detected. Approximately 75% of AAA patients do not have symptoms at the time of their initial diagnosis, and AAAs generally are discovered inadvertently during procedures to diagnose unrelated medical conditions. Once an AAA develops, it continues to enlarge and if left untreated, becomes increasingly susceptible to rupture. The overall patient mortality rate for ruptured aneurysms is approximately 75%.

Patients diagnosed with an AAA larger than five centimeters can be classified into one of three categories: those patients opting for elective surgery, patients who refuse surgery due to the clinical risks of an open procedure, and those who are considered at high risk for an open procedure. These high-risk patients and those refusing surgery will populate the initial patient pool for less invasive techniques. We believe that ELGs could be applied to as many as 60%-70% of the approximately 30,000 surgeries performed in the United States each year.

We estimate that this year, of the approximately 200,000 patients diagnosed with AAA, approximately 30,000 will undergo conventional open surgery, 30,000 will be treated with a commercially available ELG, and the remainder will remain under watchful waiting.

An article published in the New England Journal of Medicine on January 31, 2008 addressed the comparison between open surgical repair and the endovascular treatment of AAA. This was a significant paper in that researchers reviewed more than 45,000 Medicare records and came to three conclusions:

First, these findings support clinical study data showing that endovascular repair significantly reduces morbidity and mortality, versus open surgical repair. Importantly, these findings are based on a patient population that typically has a significantly higher co-morbidity rate compared with those patients treated by open surgery.

Second, patients treated by endovascular repair were discharged to their homes in significantly greater numbers than those treated by surgery. This advantage has substantial clinical and economic benefits for patients and payors alike.

Finally, the study points to the fact that open surgical repair entails risk of re-hospitalization due to problems associated with surgical incision. Patients had to be re-admitted over time for surgical complications associated with the laparotomy, such as adhesions and bowel resections, at a much higher rate than those undergoing endovascular repair.

AAAs generally are more prevalent in people over the age of 65 and are more common in men than in women. In addition to the current pool of potential patients, we expect that the number of persons seeking treatment for their condition will increase based on demographic factors. In 2007, the age 65 and over population in the United States numbered approximately 40.0 million, or 13.3% of the total population, and is expected to be 71.0 million by 2030. It is growing at a higher rate than the overall United States population.

We believe that the market opportunity outside of the United States for these technologies is approximately equal in size to that in the United States.

## **Table of Contents**

### ***Our Strategy***

Our objective is to become a premier supplier of endovascular surgery products that repair diseased or damaged vascular structures as an alternative to open surgery. As part of our core strategy, we intend to:

*Demonstrate a Significant Technology Advantage.* Our strategy has been to develop technology that addresses the limitations of the early generation AAA devices, and execute clinical studies to substantiate the superiority of the technology. Being first to market has not been an advantage in the AAA market thus far, as other devices approved for marketing in the United States have undergone post-approval recalls and/or temporary sales suspensions.

*Execute a Global Marketing Strategy and Address Key Markets.* We have obtained the right to affix the CE Mark, and utilize distributors in markets outside the United States. We have sought to limit our capital commitments by establishing sales through distributors due to limitations on the size of the markets, and lower average sales price and device reimbursement in international markets.

*Continue to Develop Core Competencies and Develop Synergistic Collaborations.* We believe we have demonstrated core competencies in developing catheter-based solutions that address a large unmet clinical need that we identified after close consultation with key physicians. Our focus at this time is the AAA. In the future, we may develop additional devices to expand the application of our core competencies.

### ***Our Products***

#### ***Powerlink System***

Our Powerlink System consists of a self-expanding cobalt chromium alloy stent cage covered with ePTFE, a common surgical graft material. The Powerlink ELG is implanted in the abdominal aorta, gaining access through a small incision into the femoral artery. Once deployed into its proper position, the blood flow is shunted away from the weakened, or aneurysmal, section of the aorta, reducing pressure and the potential for the aorta to rupture.

We believe the Powerlink System is a superior design that overcomes the inherent limitations of early generation AAA devices and offers the following advantages:

*One-Piece, Bifurcated ELG.* This eliminates many of the problems associated with early generation multi-piece systems. Our products eliminate much of the guidewire manipulation required during the procedure to assemble the component parts of a modular system, thereby simplifying the procedure. In addition, in the follow-up period, there can be no limb component separation with a one-piece system. We believe this should result in continued long-term exclusion of the aneurysm, and improved clinical results.

*Fully Supported.* The main body and limbs of the Powerlink System are fully supported by a cobalt chromium alloy cage. The cobalt chromium alloy cage greatly reduces or eliminates the risk of kinking of the stent graft in even tortuous anatomies, eliminating the need for additional procedures or costly peripheral stents. Kinking may result in reduced blood flow and limb thrombosis.

*Unique, Minimally Invasive Delivery Mechanism.* The Powerlink System requires only a small surgical incision in one leg. The other leg needs only placement of a non-surgical introducer sheath, three millimeters in diameter. Other ELGs typically need surgical exposure of the femoral artery in both legs to introduce the multiple components. Our unique delivery mechanism and downsizing of the catheter permits our technology to be used in patients having small or very tortuous access vessels.

*Self-Expanding.* The stent is formed from cobalt chromium alloy in a proprietary configuration that is protected by our patent portfolio. This proprietary design expands to the proper size of the target aorta and eliminates the need for hooks or barbs for attachment. Based on our results to date, the Powerlink System has an excellent record of successful deployments.

*Single Wire and Long Main Body Design.* The long main body of the stent cage is made of a continuous piece of wire shaped into its appropriate configuration. Migration of individual stent graft components is eliminated. In addition, the long main body places the Powerlink System near or at the aortic bifurcation, which minimizes the risk of device migration during the follow-up period.

**Table of Contents***Limitations of Earlier Technology*

Our technology is dramatically different than devices currently available commercially. Despite enthusiasm by physicians and patients alike for minimally invasive technology, we believe early generation devices have achieved a limited market penetration due to design limitations and related complications. The published clinical literature details many of the deficiencies of these approaches. In our opinion, early generation devices were limited because assembly was required by the surgeon. Multi-piece, or modular, systems require assembly by the mating of multiple components to form a bifurcated stent graft within the aneurysm sac. These systems can be more difficult to implant and lead to longer operative times. In addition, there are a number of reports of component detachment during the follow-up period. Component detachment can lead to a leak and a re-pressurization of the sac. We believe this increases the risk of AAA rupture, often requiring a highly invasive, open surgical procedure to repair the detachment.

*Powerlink System Products*

Variations in patient anatomies require an adaptive technology. We designed our Powerlink System, with multiple aortic cuffs, limb extensions, bifurcated main body lengths and diameters to simplify procedures, improve clinical results, and drive product adoption by offering physicians a full line of products that are adaptable for treatment of the majority of patients with AAA disease.

*Powerlink Infrarenal Bifurcated Systems.* The Powerlink Infrarenal Bifurcated System is available in multiple diameters and lengths and can treat patients that have an aortic neck up to 26 millimeters in diameter. The infrarenal device is made of a cobalt chromium alloy cage covered by thin-walled ePTFE for placement below the renal arteries. The self-expanding cage permits the graft to be used in a wide range of neck diameters, which allows us to treat a wide variety of anatomies with a standard device. We obtained the CE Mark for this product in Europe in August 1999, and obtained United States Food and Drug Administration, or FDA, pre-marketing approval in October 2004. We commenced commercial sales in the United States in December 2004 and executed a focused United States launch throughout 2005. In 2006, we accelerated the launch with the addition of twenty-one sales representatives, three regional managers and one national manager. At the end of 2007, we were staffed with a tenured domestic sales force of forty-seven sales representatives, nine regional managers, one area sales manager, and one national sales manager.

*Powerlink Suprarenal Bifurcated System.* The Powerlink Suprarenal Bifurcated System is similar to the infrarenal device, except that the wire stent in the suprarenal device is extended above the graft material to allow the physician to anchor the top of the device above the renal arteries without obstructing them. The suprarenal device is available in multiple diameters and lengths and can treat patients that have an aortic neck up to 32 millimeters in diameter. The suprarenal model has a segment of uncovered stent at the proximal end that permits the operator to place the device more proximally, over the opening of the renal arteries in patients with short or angulated aortic necks. The uncovered stent permits continuous blood flow to the renal arteries, thereby mitigating the risk of kidney complications. We obtained the CE Mark for this product in Europe in August 1999, and are currently enrolling patients in an arm of a Phase II pivotal trial in the United States.

*Powerlink Aortic Cuffs and Limb Extensions.* The Powerlink Aortic Cuffs and Limb Extensions permit the physician to treat a greater number of patients. Aortic cuffs are available in 25, 28 and 34 millimeters in diameter and multiple lengths. They also are available in the infrarenal or suprarenal configurations. Limb extensions are 20 millimeters and 16 millimeters in diameter with various lengths, allowing the physician to customize the technology to a given individual. We have obtained the CE Mark for these products in Europe in October 1999 (Limb Extensions), December 1999 (25/28 Cuffs) and May 2002 (34 Cuff). We obtained United States FDA marketing approval in October 2004 for the 25 and 28 millimeter infrarenal cuffs, and the 20 and 16 millimeter limb extensions.

***Clinical Trials****Powerlink Systems*

We continue to conduct clinical trials for the suprarenal Powerlink System and for other products related to the Powerlink System. As of December 31, 2007, 153 of the 193 patients required had been enrolled for the second arm of a United States Pivotal Phase II clinical trial for the suprarenal Powerlink System. As of July 31, 2007, all of the required 60 patients were enrolled in a United States Pivotal Phase II clinical trial utilizing a 34 mm proximal cuff in conjunction with a commercial bifurcated Powerlink ELG to treat patients with large aortic necks. As of December



## **Table of Contents**

31, 2007, 18 of the required 63 patients had been enrolled in a clinical trial for a 34mm infrarenal bifurcated device, also designed to treat patients with large aortic necks. Currently, only one commercial device supplied by a competitor, is capable of treating aortic necks larger than 26mm.

### ***Marketing and Sales***

#### ***Powerlink System***

*United States.* We began a focused launch of the Powerlink System in the United States with six sales representatives and two clinical specialists in late 2004. We have expanded our domestic sales force to forty-seven sales representatives, nine regional managers, one area sales manager, and one national sales manager as of December 31, 2007. The primary customer and decision maker for these devices in the United States is the vascular surgeon. The market is fairly concentrated with estimates of 1,000 to 1,500 potential general and vascular surgeons, and a limited number of interventional cardiologists and radiologists, in approximately 1,000 hospitals.

*Europe.* The market for ELGs in Europe is influenced by vascular surgeons, interventional radiologists and, to a lesser extent, interventional cardiologists who perform catheter directed treatment of AAA. The European market is less concentrated than the domestic market. We have obtained the right to affix the CE Mark to our family of Powerlink products. Europe represents a smaller market opportunity due to capitated hospital budgets and a selling price that is typically less than in the United States. We currently sell our devices through LeMaitre Vascular as well as other exclusive independent distributors. We will participate in and share the costs of attending key cardiovascular conferences in Europe. We expect to continue to interface with key opinion leaders in Europe

*Japan.* We received Shonin approval, which is equivalent to FDA approval of a PMA application in the United States, in February 2008. We commenced commercial sales to Japan in February 2008 through our distributor.

*Rest of World.* We have obtained regulatory approval and have active distribution partners in a number of countries, including Argentina, Brazil, Chile, Colombia, Mexico, South Africa, and Turkey. In addition, we have obtained regulatory approval but have not initiated the distribution process in several other countries, including Australia, Canada, and the European countries of Norway, Poland, Portugal, and Spain. We may or may not pursue these markets depending on the availability of a suitable distribution partner. We are pursuing regulatory approval in China and we intend to select a distribution partner in that market during 2008.

#### ***Legacy Products***

In June 1998, we entered into a technology license agreement with Guidant, an international interventional cardiology products company, granting a 10 year license to manufacture and distribute stent delivery products using our Focus technology. The original territory for the license was the United States and Canada, but has expanded with the expiration of distribution relations in other countries. If for any calendar year, after timely written notice by us to Guidant of a shortfall in royalty payments below the annual minimum royalty required, they elect not to pay us at least the minimum royalty, we can cancel the agreement. Also, as Guidant has paid to date the aggregate payment amount required under the contract, they can at any time, with or without cause, terminate the agreement upon thirty days notice. In the year ended December 31, 2007, we recorded \$250,000 in royalties. We anticipate that license revenue will decline sharply in 2008 as the minimum royalty provision of the agreement expired at December 31, 2007. The license will be fully paid up in June 2008.

In September 2006, we licensed to BioLucent Inc., a privately held medical device company, rights under certain patents held by us. In September 2007, Hologic Inc. purchased BioLucent, Inc. Pursuant to this acquisition, we received a one-time payment of \$500,000 in exchange for a fully paid up license. For the year ended December 31, 2007, we recorded \$504,000 in royalties and fees, including the one-time payment of \$500,000 under the agreement.

### ***Manufacturing***

We manufacture our products at our facilities in Irvine, California. During 2005, we relocated both our manufacturing and headquarters functions to a 30,200 square foot leased facility.

## **Table of Contents**

Our current manufacturing process is labor intensive and involves shaping and forming a cobalt chromium wire cage, sewing graft material together to form the outside skin of the device and suturing the graft material on to the cage.

In February 1999, we entered into a supply agreement with Bard Peripheral Vascular, Inc., a subsidiary of C.R. Bard, Inc., or Bard Peripheral, for the supply of ePTFE. The supply agreement had an initial term through December 2007, at which time it automatically renewed on a year-by-year basis, unless either party gave the other party notice of its intention not to renew within 30 days from the expiration date of the applicable renewal period. Under the terms of a third amendment to the supply agreement, dated September 21, 2007, the minimum purchase requirement for the 2007 year was reduced from \$2,875,000 to \$2,200,000, we agreed to pay \$550,000 in consideration for the reduction, and both parties agreed to terminate the agreement on December 31, 2007. The \$550,000 paid to reduce the 2007 commitment was recorded as an operating expense in the quarter ended September 30, 2007.

In April 2007, we received FDA approval for in-house manufactured ePTFE graft material. We are now capable of producing all of our requirements for this material at a cost which is significantly lower than our previous acquisition cost under the supply agreement with Bard Peripheral.

### ***Patents and Proprietary Information***

We have an aggressive program to develop intellectual property in the United States, Europe and Asia. We are building a portfolio of apparatus and method patents covering various aspects of our current and future technology. In the AAA area, we have 17 United States patents issued, covering 361 claims, and 22 pending United States patent applications. Our current AAA related patents begin expiring in 2017 and the last patent expires in 2019. We intend to continue to file for patent protection to strengthen our intellectual property position as we continue to develop our technology.

In addition to our AAA intellectual property, we own or have the rights to 38 issued United States patents, one issued European patent, and one issued Japanese patent relating to intravascular radiation, stents, and various catheter technologies. The non-AAA patents begin expiring in 2012 and the last patent expires in 2018. Our technology license to Guidant is supported by seven United States patents and one Japanese patent. These patents begin expiring in 2014 and the last patent expires in 2016.

Our policy is to protect our proprietary position by, among other methods, filing United States and foreign patent applications to protect technology, inventions and improvements that are important to the development of our business. We require our employees, consultants and advisors to execute confidentiality agreements in connection with their employment, consulting or advisory relationships. We also require employees, consultants and advisors who may work on our products to agree to disclose and assign to us all inventions conceived during the work day, using our property or which relate to our business.

### ***Competition***

Any product we develop that gains regulatory clearance or approval will have to compete for market acceptance and market share. We believe that the primary competitive factors in the market for AAA devices are:

clinical effectiveness;

product safety, ease of use, reliability and durability;

ability to receive regulatory approval;

distribution capability; and

price.

We expect that significant competition in the endovascular grafting market will develop over time. Three manufacturers, Medtronic, W.L. Gore, and Cook have obtained FDA marketing approval for their ELGs. However,

**Table of Contents**

we believe that our technology offers significant clinical advantages over these other currently available technologies. The cardiovascular device industry is marked by rapid technological improvements and, as a result, physicians are open to improved designs. Significant market share and revenue can be captured by designs demonstrating superior clinical outcomes. We believe deliverability of the device, dependability of the clinical results and the durability of the product design are the most important product characteristics. The Powerlink System is the only available one-piece bifurcated, fully supported ELG, and we believe that the Powerlink System offers improved deliverability, dependability, and durability.

Companies that are first to market in the United States with a new medical technology must underwrite the significant and expensive challenge of physician training and proctoring. In addition, first generation companies bear the costs of addressing reimbursement issues. We believe that our Powerlink System represents next generation technology that is poised to take advantage of a well-prepared market.

We believe that earlier generation devices experienced material failures and complications due to their reliance on multi-piece designs that did not include a stent cage to support the entire graft, or designs with hooks or barbs to hold their devices in place (See the section above entitled *Limitations of Earlier Technology* for a discussion of these factors). We believe that our grafts may offer a competitive advantage. Our Powerlink System is a single- piece, fully supported design that uses radial force and anatomical placement near the aortic bifurcation to maintain fixation. The following chart that details the stent graft characteristics of the minimally-invasive AAA stent grafts being sold in the United States.

**FDA Approved  
Stent Graft Characteristics**

<b>Manufacturer/Product Name</b>	<b>Design</b>	<b>Fixation</b>
Endologix/ Powerlink	Single piece	Radial force and anatomical fixation
Medtronic/ AneuRx	Modular	Radial force only
Cook/ Zenith	Modular	Radial force and barbs
WL Gore/ Excluder	Modular	Radial force and barbs

In addition to the competitors mentioned above, Terumo-Vascutek, Aptus Medical, and Lombard Medical are believed to have development programs.

Most of our competitors have substantially greater capital resources than we do and also have greater resources and expertise in the areas of research and development, obtaining regulatory approvals, manufacturing and marketing. We cannot assure you that competitors and potential competitors will not succeed in developing, marketing and distributing technologies and products that are more effective than those we will develop and market or that would render our technology and products obsolete or noncompetitive. We may be unable to compete effectively against such competitors and other potential competitors based upon their manufacturing, marketing and sales resources.

Any product we develop that gains regulatory clearance or approval will have to compete for market acceptance and market share. An important factor in such competition may be the timing of market introduction of competitive products. Accordingly, we expect the relative speed with which we can develop products, gain regulatory approval and reimbursement acceptance and supply commercial quantities of the product to the market to be an important competitive factor. In addition, we believe that the primary competitive factors for products addressing AAA include deliverability, safety, efficacy, ease of use, reliability, service and price. We also believe that physician relationships, especially relationships with leaders in the vascular surgery and interventional cardiology community are important competitive factors.

***Third-Party Reimbursement***

In the United States, medical institutions are the primary purchasers of our products. Medical institutions then bill various third-party payors, such as Medicare, Medicaid, and other government programs and private insurance plans, for the healthcare services and products provided to patients. Government agencies, private insurers and other payors determine whether to provide coverage for a particular procedure and reimburse hospitals for medical

## **Table of Contents**

treatment at a fixed rate based on the diagnosis-related group established by the United States Centers for Medicare and Medicaid Services, or CMS. The fixed rate of reimbursement is based on the procedure performed, and is unrelated to the specific devices used in that procedure.

Reimbursement of interventional procedures utilizing our products currently is covered under a diagnosis-related group. Some payors may deny reimbursement if they determine that the device used in a treatment was unnecessary, inappropriate or not cost-effective, experimental or used for a non-approved indication. Therefore, we cannot assure you that reimbursement for any new product we develop will be available to hospitals and other users, or that future reimbursement policies of payors will not hamper our ability to sell current or new products on a profitable basis.

In October 2000, the CMS issued a guideline regarding the proper coding of our procedures for billing purposes. CMS instructed that code 39.71, for endovascular graft repair of aneurysm, be utilized. For purposes of hospital reimbursement, the majority of patients using the Powerlink System device will be classified under DRG 237, Major Cardiovascular Procedures with Complication/ Co morbidity. In the latest data published by CMS, the national average reimbursement for DRG 237, which includes hospital costs, exceeded \$24,000. In Europe, reimbursement for the procedure, including the device, typically comes from the hospital's general fund and is usually from about half to three-quarters of the reimbursement available in the United States.

Outside the United States, market acceptance of products depends partly upon the availability of reimbursement within the prevailing healthcare payment systems. Reimbursement systems vary significantly by country, and by region within some countries, and reimbursement approvals must be obtained on a country-by-country basis. Reimbursement is obtained from a variety of sources, including government sponsored healthcare and private health insurance plans.

Some countries have centrally organized healthcare systems, but in most cases there is a degree of regional autonomy either in deciding whether to pay for a particular procedure or in setting the reimbursement level. The manner in which new devices enter the healthcare system depends on the system. There may be a national appraisal process leading to a new procedure or product coding, or it may be a local decision made by the relevant hospital department. The latter is particularly the case where a global payment is made that does not detail specific technologies used in the treatment of a patient. Most foreign countries also have private insurance plans that may reimburse patients for alternative therapies. Although not as prevalent as in the United States, managed care is gaining prevalence in certain European countries.

Following our receipt of Shonin approval for the Powerlink System in Japan in February 2008, we believe that the level of reimbursement in Japan will approximate that of the United States. However, we will be receiving a negotiated transfer price from our distributor, not the full reimbursement price.

### ***Government Regulation***

The manufacturing and marketing of our products are subject to extensive and rigorous government regulation in the United States and in other countries. Prior to commercialization, new products must meet rigorous governmental agency requirements for pre-clinical and clinical testing and patient follow-up. Federal regulations control the ongoing safety, efficacy, manufacture, storage, labeling, record-keeping, and marketing of all medical devices. We cannot sell or market our products without United States or foreign government regulatory approvals.

Devices such as our Powerlink System are subject to the rigorous PMA review process with the FDA to assure safety and effectiveness. The PMA must be approved by the FDA prior to sale and marketing of the device in the United States. The PMA process is complex, expensive and time-consuming and requires the submission of extensive clinical data. The Powerlink System was approved through this PMA process in October 2004.

FDA regulations require us to register as a medical device manufacturer with the FDA. Additionally, the California Department of Health Services, or CDHS, requires us to register as a medical device manufacturer within the state. Because of this, the FDA and the CDHS inspect us on a routine basis for compliance with Quality System Records, or QSR regulations. These regulations require that we manufacture our products and maintain related documentation in a prescribed manner with respect to manufacturing, testing and control activities. We have undergone and expect to continue to undergo regular QSR inspections in connection with the manufacture of our

## **Table of Contents**

products at our facilities. Further, the FDA requires us to comply with various FDA regulations regarding labeling. The Medical Device Reporting laws and regulations require us to provide information to the FDA on deaths or serious injuries alleged to have been associated with the use of our devices, as well as product malfunctions that likely would cause or contribute to death or serious injury if the malfunction were to recur. In addition, the FDA prohibits an approved device from being marketed for unapproved applications.

Failure to comply with applicable regulatory requirements can, among other consequences, result in fines, injunctions, civil penalties, suspensions or loss of regulatory approvals, product recalls, seizure of products, operating restrictions and criminal prosecution. In addition, government regulations may be established in the future that could prevent or delay regulatory clearance or approval of our products.

We are subject to other federal, state and local laws, regulations and recommendations relating to safe working conditions, laboratory and manufacturing practices. We cannot accurately predict the extent of government regulation that might result from any future legislation or administrative action.

Our international sales are subject to regulatory requirements in the countries in which our products are sold. The regulatory review process varies from country to country and may in some cases require the submission of clinical data. We most likely would rely on distributors in such foreign countries to obtain the requisite regulatory approvals. We cannot assure you, however, that we would obtain such approvals on a timely basis or at all. In addition, the FDA must approve the export to certain countries of devices that require a PMA but are not yet approved domestically.

In Europe, we need to comply with the requirements of the Medical Devices Directive, or MDD, and affix the CE Mark on our products to attest to such compliance. To achieve compliance, our products must meet the Essential Requirements of the MDD relating to safety and performance and we must successfully undergo verification of our regulatory compliance, or conformity assessment, by a Notified Body selected by us. The level of scrutiny of such assessment depends on the regulatory class of the product.

In December 1998, we received ISO 9001:1994/ EN46001:1996 certification from our Notified Body with respect to the manufacturing of all of our products in our facilities. In September 2002, we received ISO 9001:1994/ EN46001:1996 and ISO 13485:1996 certification. In December 2005, we received ISO13485:2003 certification. We are subject to continued surveillance by our Notified Body and will be required to report any serious adverse incidents to the appropriate authorities. We also must comply with additional requirements of individual nations.

### ***Product Liability***

The manufacture and marketing of medical devices carries the risk of financial exposure to product liability claims. Our products are used in situations in which there is a high risk of serious injury or death. Such risks will exist even with respect to those products that have received, or in the future may receive, regulatory approval for commercial sale. We are currently covered under a product liability insurance policy with coverage limits of \$10.0 million per occurrence and \$10.0 million per year in the aggregate. We cannot assure you that our product liability insurance is adequate or that such insurance coverage will remain available at acceptable costs. We also cannot assure you that we will not incur significant product liability claims in the future.

### ***Employees***

As of December 31, 2007, we had 168 employees, including 72 in manufacturing, 10 in research and development, 8 in regulatory and clinical affairs, 65 in sales, marketing and customer service and 13 in administration. We believe that the success of our business will depend, in part, on our ability to attract and retain qualified personnel. Our employees are not subject to a collective bargaining agreement, and we believe we have good relations with our employees.

### ***Research and Development***

We spent \$6.4 million in 2007, \$6.8 million in 2006, and \$5.8 million in 2005, on research and development, including clinical studies. Our focus is to continually develop innovative and cost effective medical device

## **Table of Contents**

technology for the treatment of vascular disease. To achieve the dynamics required to rapidly implement these projects, our research and development is structured into three main development areas: New Product Development, Current Product Enhancements and Process Improvements. The objective is to bring a specific focus to each critical area of development and to facilitate multiple projects on parallel paths.

### ***Availability of Reports***

We make available on our web site at [www.endologix.com](http://www.endologix.com) our annual reports on Form 10-K, quarterly reports on Form 10-Q, current reports on Form 8-K, and any amendments to such reports, as soon as reasonably practicable after such reports are electronically filed with, or furnished to, the Securities and Exchange Commission. We will also provide electronic or paper copies of such reports free of charge, upon request made to our Corporate Secretary.

### **Item 1A. Risk Factors**

*The following risks could affect our business, financial results and results of operations. These risk factors should be considered in connection with evaluating the forward-looking statements contained in this Annual Report on Form 10-K because these factors could cause actual results and conditions to differ materially from those projected in the forward-looking statements.*

#### ***Our success depends on the safety and efficacy of the Powerlink System in general use.***

While we have demonstrated the safety and efficacy of the Powerlink System in our clinical studies with our clinical investigators, market acceptance will depend on similar results with the Powerlink System in general use. Any significant difficulties or adverse events encountered in general use will impair the success of the Powerlink System and our business.

#### ***Our success depends on the growth in the number of AAA patients treated with endovascular devices.***

Of the estimated 1.5 million people with AAA in the United States, only about 200,000 new diagnoses are made each year, and of that amount only about 30,000 are treated with an endovascular device. Our success with our Powerlink System will depend on an increasing percentage of patients with AAA being diagnosed at earlier stages and an increasing percentage of those receiving endovascular, as opposed to open surgical procedures. Initiatives to increase screening for AAA are underway but are out of our control and such general screening programs may never gain wide acceptance. The failure to diagnose more patients with AAA, at an earlier stage, will negatively impact sales of the Powerlink System.

#### ***Our success depends on convincing a concentrated customer base of vascular surgeons and a limited number of interventional radiologists and cardiologists to use our product over alternative products and treatment modalities.***

The physicians currently treating AAA have choices in treatment approach, one of which is endovascular AAA stent graft placement. There are several competing endovascular stent grafts to choose from and that number may increase. Increasing revenues from sales of Powerlink Systems will depend on our marketing and sales team demonstrating that the Powerlink System is a superior treatment alternative to watchful waiting, open surgery and competitive products. We believe that this will require continued demonstration through clinical data and personal experience of the efficacy of the Powerlink System.

While we have committed, and intend to continue to commit substantial resources to our marketing efforts, our competitors have superior resources to market and promote their endovascular stent graft products. The most prominent devices that pose a competitive challenge to us include:

Medtronic's AneuRx (in US)/Talent (in Europe), W.L. Gore's Excluder, and Cook's Zenith AAA system, which are available both in the United States and Europe;

other AAA graft Systems by Lombard Medical and Terumo, are widely available outside the United States but currently have more limited availability within the United States; and

other technologies in various phases of development, including pharmaceutical solutions.

## **Table of Contents**

Any of these treatments could prove to be more effective or may achieve greater market acceptance than the Powerlink System. Even if these treatments are not as effective as the Powerlink System, many of the companies pursuing these treatments and technologies have:

significantly greater financial, management and other resources;

more extensive research and development capability;

more established market positions; and

larger sales and marketing organizations.

In addition, we believe that many of the purchasers and potential purchasers of our competitors' products prefer to purchase medical devices from a single source. Accordingly, our competitors may have an advantage over us because of their size and range of product offerings. Any failure of our Powerlink System to achieve clinical and commercial acceptance over our competitors' products will harm our business.

***If our products or processes infringe upon the intellectual property of third parties, the sale of our products may be challenged and we may have to defend costly and time-consuming infringement claims.***

We may need to engage in expensive and prolonged litigation to assert or defend any of our intellectual property rights or to determine the scope and validity of rights claimed by other parties. With no certainty as to the outcome, litigation could be too expensive for us to pursue. Our failure to prevail in such litigation or our failure to pursue litigation could result in the loss of our rights that could hurt our business substantially. In addition, the laws of some foreign countries do not protect our intellectual property rights to the same extent as the laws of the United States, if at all.

Our failure to obtain rights to intellectual property of third parties or the potential for intellectual property litigation could force us to do one or more of the following:

stop selling, making or using our products that use the disputed intellectual property;

obtain a license from the intellectual property owner to continue selling, making, licensing or using our products, which license may not be available on reasonable terms, or at all;

redesign our products, processes or services; and

subject us to significant liabilities to third parties.

If any of the foregoing occurs, we may be unable to manufacture and sell our products or license our technology and may suffer severe financial harm. Whether or not an intellectual property claim is valid, the cost of responding to it, in terms of legal fees and expenses and the diversion of management resources, could harm our business.

***If third-party payors do not provide reimbursement for the use of the Powerlink System, our revenues may be negatively impacted.***

Our success in marketing the Powerlink System depends in large part on whether domestic and international government health administrative authorities, private health insurers and other organizations will reimburse customers for the cost of our product. Reimbursement systems in international markets vary significantly by country and by region within some countries, and reimbursement approvals must be obtained on a country-by-country basis. Further, many international markets have government managed healthcare systems that control reimbursement for new devices and procedures. In most markets there are private insurance systems as well as government-managed

## Table of Contents

systems. If sufficient reimbursement is not made available for the Powerlink System, or any other product that we may develop, in either the United States or internationally, the demand for our products will be adversely affected. ***Substantially all of our revenue is generated from a single product, the Powerlink System, and any declines in the sale of this product will negatively impact our business.***

We have focused heavily on the development and commercial launch of a single technology, the Powerlink System, because of limited resources. If we are unable to successfully commercialize the existing Powerlink System and reach positive cash flow from operations, we will be constrained in our ability to fund development and commercialization of improvements and other product lines.

***We have a history of losses and we may incur losses in the future.***

From our formation in 1992 to December 31, 2007, we have incurred an accumulated deficit of approximately \$131.7 million, including a net loss of \$15.1 million for the year ended December 31, 2007. We only began generating significant revenues from product sales in 2005.

***Our future operating results are difficult to predict and may vary significantly from quarter to quarter, which may negatively impact our stock price in the future.***

We have only commercially distributed the Powerlink System in the United States since late 2004. Given this limited history, it is difficult to predict future revenues derived from sales of the Powerlink System. Because of this and the uncertain effects of the following factors, our quarterly revenues and results of operations may fluctuate in the future:

physician acceptance of the Powerlink System;

the conduct and results of clinical trials;

the timing and expense of obtaining future regulatory approvals;

fluctuations in our expenses associated with expanding our operations;

the introduction of new products by our competitors;

changes in our pricing policies or in the pricing policies of our competitors or suppliers; and,

changes in third-party payors' reimbursement policies.

Because of these and possibly other factors, it is likely that in some future period our operating results will not meet investor expectations or those of public market analysts.

Any unanticipated change in revenues or operating results is likely to cause our stock price to fluctuate since such changes reflect new information available to investors and analysts. New information may cause investors and analysts to revalue our stock, which could cause a decline in the trading price of our stock.

***Our business is subject to extensive governmental regulation that could make it more expensive and time consuming for us to introduce new or improved products.***

Our products must comply with regulatory requirements imposed by the FDA and similar agencies in foreign countries. These requirements involve lengthy and detailed laboratory and clinical testing procedures, sampling activities, an extensive FDA review process, and other costly and time-consuming procedures. It often takes several years to satisfy these requirements, depending on the complexity and novelty of the product. We also are subject to numerous additional licensing and regulatory requirements relating to safe working conditions, manufacturing practices, environmental protection, fire hazard control and disposal of hazardous or potentially hazardous substances. Some of the most important requirements we face include:

FDA approval process;

**Table of Contents**

California Department of Health Services requirements;

ISO 9001:1994 and ENISO 13485:2003; and,

European Union CE Mark requirements.

Government regulation may impede our ability to conduct continuing clinical trials of Powerlink System enhancements and to manufacture the Powerlink System and other prospective products. Government regulation also could delay our marketing of new products for a considerable period of time and impose costly procedures on our activities. The FDA and other regulatory agencies may not approve any of our future products on a timely basis, if at all. Any delay in obtaining, or failure to obtain, such approvals could negatively impact our marketing of any proposed products and reduce our product revenues.

Our products remain subject to strict regulatory controls on manufacturing, marketing and use. We may be forced to modify or recall our product after release in response to regulatory action or unanticipated difficulties encountered in general use. Any such action could have a material effect on the reputation of our products and on our business and financial position.

Further, regulations may change, and any additional regulation could limit or restrict our ability to use any of our technologies, which could harm our business. We could also be subject to new federal, state or local regulations that could affect our research and development programs and harm our business in unforeseen ways. If this happens, we may have to incur significant costs to comply with such laws and regulations, which will harm our results of operations.

***If we fail to develop and maintain our direct sales force, our business could suffer.***

We have a nationally staffed and still growing domestic direct sales force and we utilize a network of third-party distributors for sales outside of the United States. As we launch new products and increase our marketing efforts with respect to existing products, we will need to retain and develop our direct sales personnel to build upon their experience, tenure with our products, and their business relationships. There is significant competition for sales personnel experienced in relevant medical device sales. If we are unable to attract, motivate, develop, and retain qualified sales personnel and thereby maintain our sales force, we may not be able to increase our revenues. Both Medtronic and W.L. Gore have filed lawsuits against us claiming that we have induced their former employees to breach post-employment covenants with them. To the extent we are unsuccessful in defending such claims, and lose qualified sales personnel, our sales may suffer.

***Our third-party distributors may not effectively distribute our products.***

We depend on medical device distributors and strategic relationships for the marketing and selling of our Powerlink System internationally. We depend on these distributors' efforts to market our product, yet we are unable to control their efforts completely. If our distributors fail to market and sell our products effectively, our operating results and business may suffer substantially, or we may have to make significant additional expenditures or concessions to market our products.

***If we fail to properly manage our anticipated growth, our business could suffer.***

We may experience periods of rapid growth and expansion, which could place a significant strain on our limited personnel and other resources. In particular, the increase in our direct sales force requires significant management and other supporting resources. Any failure by us to manage our growth effectively could have an adverse effect on our ability to achieve our development and commercialization goals. To achieve our revenue goals, we must successfully increase production output as required by customer demand. We may in the future experience difficulties in increasing production, including problems with production yields and quality control and assurance, component supply, and shortages of qualified personnel. These problems could result in delays in product availability and increases in expenses. Any such delay or increased expense could adversely affect our ability to generate revenues. Future growth will also impose significant added responsibilities on management, including the need to identify, recruit, train and integrate additional employees. In addition, rapid and significant growth will place

## **Table of Contents**

a strain on our administrative and operational infrastructure. In order to manage our operations and growth we will need to continue to improve our operational and management controls, reporting and information technology systems, and financial internal controls procedures. If we are unable to manage our growth effectively, it may be difficult for us to execute our business strategy and our operating results and business could suffer.

***We rely solely on an in-house process to supply our graft material for the Powerlink System, and any disruption in our ability to produce this material could delay or prevent us from producing the product for sale.***

Currently, we rely solely on an in-house manufacturing process to produce graft material, which is a primary component for the Powerlink System. Our reliance on a sole source exposes our operations to disruptions in supply caused by:

failure to comply with regulatory requirements;

fire, flood or earthquake, or other natural disaster; and,

a supply interruption in the underlying raw material for the process.

Although we retain a significant stock of the graft material, the occurrence of any of the above disruptions in supply or other unforeseen events that could cause a disruption in our process to manufacture graft material may cause us to halt or experience a disruption in manufacturing the Powerlink System. Because we do not have alternative suppliers, our sales and operating results would be harmed in the event of a disruption.

***If we are unable to protect our intellectual property, our business may be negatively affected.***

The market for medical devices is subject to frequent litigation regarding patent and other intellectual property rights. It is possible that our patents or licenses may not withstand challenges made by others or protect our rights adequately.

Our success depends in large part on our ability to secure effective patent protection for our products and processes in the United States and internationally. We have filed and intend to continue to file patent applications for various aspects of our technology. However, we face the risks that:

we may fail to secure necessary patents prior to or after obtaining regulatory clearances, thereby permitting competitors to market competing products; and

our already-granted patents may be re-examined, re-issued or invalidated.

We also own trade secrets and confidential information that we try to protect by entering into confidentiality agreements with other parties. However, the confidentiality agreements may not be honored or, if breached, we may not have sufficient remedies to protect our confidential information. Further, our competitors may independently learn our trade secrets or develop similar or superior technologies. To the extent that our consultants, key employees or others apply technological information to our projects that they develop independently or others develop, disputes may arise regarding the ownership of proprietary rights to such information, and such disputes may not be resolved in our favor. If we are unable to protect our intellectual property adequately, our business and commercial prospects likely will suffer.

***If we are unable to effectively manage our inventory held on consignment by our intended customers, we will not achieve our expected results.***

Our Powerlink System is sold on a consignment basis to certain hospitals which purchase our product as they use it. In these consignment locations, we do not have physical possession of our products. We therefore must rely on information from our customers as well as periodic inspections by our sales personnel to determine when our products have been used. Our efforts to strengthen our monitoring and management of consigned inventory may not

**Table of Contents**

be adequate to meaningfully reduce the risk of inventory loss. If we are not able to effectively manage appropriate consigned inventory levels, we may suffer inventory losses which will reduce our operating results.

***We may face product liability claims that could result in costly litigation and significant liabilities.***

Manufacturing and marketing of our commercial products, and clinical testing of our products under development, may expose us to product liability claims. Although we have, and intend to maintain, product liability insurance, the coverage limits of our insurance policies may not be adequate and one or more successful claims brought against us may have a material adverse effect on our business and results of operations. Additionally, adverse product liability actions could negatively affect the reputation and sales of our products, our ability to obtain and maintain regulatory approval for our products and may divert management's attention from other matters.

***We may need to raise additional funds in the future to fund our operations.***

Although we believe that our existing cash resources will be sufficient to meet our anticipated cash needs for operations and planned capital requirements through at least December 31, 2008, we may require additional capital to fund on-going operations. Our cash requirements in the future may be significantly different from our current estimates and depend on many factors, including:

the results of our commercialization efforts for the Powerlink System;

the time and costs involved in obtaining additional regulatory approvals;

the costs involved in obtaining and enforcing patents or any litigation by third parties regarding intellectual property;

the establishment of high volume manufacturing and increased sales and marketing capabilities; and,

our success in entering into collaborative relationships with other parties.

To finance these activities, we may seek funds through borrowings or through additional rounds of financing, including private or public equity or debt offerings and collaborative arrangements with corporate partners. We may be unable to raise funds on favorable terms, or at all. In addition, the sale of additional equity or convertible debt securities could result in additional dilution to our stockholders. If we borrow additional funds or issue debt securities, these securities could have rights superior to holders of our common stock, and could contain covenants that will restrict our operations. We might have to obtain funds through arrangements with collaborative partners or others that may require us to relinquish rights to our technologies, product candidates or products that we otherwise would not relinquish. If adequate funds are not available, we might have to delay, scale back or eliminate one or more of our development programs, which could significantly impair our ability to operate our business.

***Our operations are currently conducted at a single location that may be at risk from earthquakes or other natural disasters.***

We currently conduct all of our manufacturing, development and management activities at a single location in Irvine, California, near known earthquake fault zones. We have taken precautions to safeguard our facilities, including insurance, health and safety protocols, and off-site storage of computer data. However, any future natural disaster, such as an earthquake, could cause substantial delays in our operations, damage or destroy our equipment or inventory, and cause us to incur additional expenses. A disaster could seriously harm our business and results of operations. The insurance coverage we maintain may not be adequate to cover our losses in any particular case.

***The price of our stock may fluctuate unpredictably in response to factors unrelated to our operating performance.***

The stock market periodically experiences significant price and volume fluctuations that are unrelated to the operating performance of particular companies. These broad market fluctuations may cause the market price of our

**Table of Contents**

common stock to drop. In particular, the market price of securities of small medical device companies, like ours, has been very unpredictable and may vary in response to:

announcements by us or our competitors concerning technological innovations;

introductions of new products;

FDA and foreign regulatory actions;

developments or disputes relating to patents or proprietary rights;

failure of our results of operations to meet the expectations of stock market analysts and investors;

changes in stock market analyst recommendations regarding our common stock;

changes in healthcare policy in the United States or other countries; and

general stock market conditions.

***Some provisions of our charter documents may make takeover attempts difficult, which could depress the price of our stock and inhibit your ability to receive a premium price for your shares.***

Provisions of our amended and restated certificate of incorporation could make it more difficult for a third party to acquire control of our business, even if such change in control would be beneficial to our stockholders. Our amended and restated certificate of incorporation allows our board of directors to issue up to five million shares of preferred stock and to fix the rights and preferences of such shares without stockholder approval. Any such issuance could make it more difficult for a third party to acquire our business and may adversely affect the rights of our stockholders. In addition, our board of directors is divided into three classes for staggered terms of three years. These provisions may delay, deter or prevent a change in control of us, adversely affecting the market price of our common stock.

**Item 1B. Unresolved Staff Comments**

None.

**Item 2. Properties**

Currently, we lease a facility aggregating approximately 30,200 square feet in Irvine, California under a lease agreement that expires in April 2010 and may be renewed for two additional five-year periods, at our option. We believe that our current facilities will be adequate and suitable for our operations for the foreseeable future.

**Item 3. Legal Proceedings**

We are a party to ordinary disputes arising in the normal course of business, including an intellectual property infringement claim as well as claims with respect to our employment of former employees of our competitors. Management is of the opinion that the outcome of these matters will not have a material adverse effect on our consolidated financial position, results of operations, or cash flows.

**Item 4. Submission of Matters to a Vote of Security Holders**

None.

**Table of Contents****PART II****Item 5. Market for Registrant's Common Equity, Related Stockholder Matters and Issuer Purchases of Equity Securities**

Our common stock trades on the NASDAQ Global Market under the symbol ELGX. The following table sets forth the high and low sale prices for our common stock as reported on the NASDAQ Global Market for the periods indicated.

	<b>High</b>	<b>Low</b>
Year Ended December 31, 2006		
First Quarter	\$7.35	\$4.32
Second Quarter	4.88	3.17
Third Quarter	4.24	3.24
Fourth Quarter	4.33	3.22
Year Ended December 31, 2007		
First Quarter	\$4.75	\$3.15
Second Quarter	4.69	3.82
Third Quarter	4.54	3.13
Fourth Quarter	4.19	2.56

On February 15, 2008, the closing sale price of our common stock on the NASDAQ Global Market was \$3.15 per share and there were 227 record holders of our common stock.

\* \$100 invested  
on 12/31/02 in  
stock or  
index-including  
reinvestment of  
dividends.

Fiscal year ending December 31.

***Dividend Policy***

We have never paid any dividends. We currently intend to retain all earnings, if any, for use in the expansion of our business and therefore do not anticipate paying any dividends in the foreseeable future. Additionally, the terms of our

**Table of Contents**

credit facility with Silicon Valley Bank, which was entered into on February 21, 2007, prohibits us from paying cash dividends without their consent.

**Item 6. Selected Financial Data**

The following selected consolidated financial data has been derived from our audited consolidated financial statements. The audited consolidated financial statements for the fiscal years ended December 31, 2007, 2006, and 2005 are included elsewhere in this Annual Report on Form 10-K. The information set forth below should be read in conjunction with the Management's Discussion and Analysis of Financial Condition and Results of Operations and consolidated financial statements and notes thereto included herein.

	Year Ended December 31,				
	2007	2006	2005	2004	2003
	(In thousands, except per share data)				
<b>Consolidated Statement of Operations</b>					
<b>Data:</b>					
Revenue:					
Product	\$ 27,017	\$ 14,422	\$ 6,889	\$ 3,019	\$ 1,395
License	754	250	250	1,213	2,595
Total revenue	27,771	14,672	7,139	4,232	3,990
Cost of sales:					
Cost of product sales	10,539	6,330	3,859	1,851	625
Total cost of sales	10,539	6,330	3,859	1,851	625
Gross profit	17,232	8,342	3,280	2,381	3,365
Operating costs and expenses:					
Research and development	6,372	6,765	5,817	6,159	6,711
Marketing and sales	20,142	14,579	8,794	2,718	787
General and administrative	6,380	5,585	4,801	3,548	2,075
Termination of supply agreement	550				
Minority interest					(16)
Total operating costs and expenses	33,444	26,929	19,412	12,425	9,557
Loss from operations	(16,212)	(18,587)	(16,132)	(10,044)	(6,192)
Total other income	1,137	1,044	614	361	277
Net loss	\$ (15,075)	\$ (17,543)	\$ (15,518)	\$ (9,683)	\$ (5,915)
Basic and diluted net loss per share	\$ (0.35)	\$ (0.44)	\$ (0.46)	\$ (0.31)	\$ (0.23)
Shares used in computing basic and diluted net loss per share	42,796	40,010	33,951	31,149	25,845

	2007	2006	December 31,	2004	2003
			2005		
	(In thousands)				

**Consolidated Balance Sheet****Data:**

Cash, restricted cash and cash equivalents	\$ 9,228	\$ 6,771	\$ 8,691	\$ 4,831	\$ 4,402
Marketable securities available-for-sale		13,417	8,959	17,085	8,377
Working capital	18,365	26,933	22,520	23,477	15,020
Total assets	40,043	52,686	47,944	44,512	35,343
Accumulated deficit	(131,738)	(116,663)	(99,120)	(83,602)	(73,919)
Total stockholders' equity	34,675	46,505	42,207	41,551	33,875

**Item 7. Management's Discussion and Analysis of Financial Condition and Results of Operations**

The following discussion and analysis should be read in conjunction with Selected Financial Data and our consolidated financial statements and the related notes included in this Annual Report on Form 10-K. This discussion contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of various factors including the risks we discuss in Item 1A of Part I, Risk Factors and elsewhere in this Annual Report on Form 10-K.

## **Table of Contents**

### ***Overview***

#### ***Our Business***

We are engaged in the development, manufacturing, marketing and sales of minimally invasive therapies for the treatment of vascular disease. Our primary focus is the marketing and sale of the Powerlink System, a catheter-based alternative treatment to surgery for abdominal aortic aneurysms, or AAA. AAA is a weakening of the wall of the aorta, the largest artery of the body. Once AAA develops, it continues to enlarge and if left untreated becomes increasingly susceptible to rupture. The overall patient mortality rate for ruptured abdominal aortic aneurysms is approximately 75%, making it a leading cause of death in the United States.

Prior to the acquisition of former Endologix and the restructuring that occurred during the third and fourth quarters of 2001, we were researching, developing and marketing a radiation therapy catheter for the treatment of blockages in arteries after angioplasty, or restenosis. Prior to that we developed, manufactured and marketed other catheter and stent products for treatment of cardiovascular disease.

Between 1999 and 2003, our source of revenues shifted gradually from direct sales of previous catheter and stent products to royalties from licenses of our stent delivery technology. In June 1998, we licensed to Guidant Corporation rights to manufacture and distribute products using our Focus technology for the delivery of stents in exchange for milestone and royalty payments.

Our license revenue increased in 2007 over 2006 due to our licensing agreement with BioLucent, Inc. Under that agreement, we received \$504,000 in royalties and fees, including a one-time payment of \$500,000 in exchange for a fully paid-up license to certain of our patents. License revenue from Guidant remained at the contractual minimum level of \$250,000 for 2007 and 2006. The minimum payment requirement of the agreement expired at December 31, 2007. We expect de minimus royalties under this agreement in 2008, prior to its expiration in June 2008, and that the sales of our Powerlink System will be our only material source of revenue.

For the years ended December 31, 2007 and 2006, we incurred net losses of \$15.1 million and \$17.5 million, respectively. As of December 31, 2007, we had an accumulated deficit of approximately \$131.7 million.

We believe that our current cash balance, in combination with cash receipts generated from sales of the Powerlink System and borrowings available under our credit facility, will be sufficient to fund ongoing operations through at least December 31, 2008. If we do not realize expected revenue and gross margin levels, or if we are unable to manage our operating expenses in line with our revenues, or if we cannot maintain our days sales outstanding accounts receivable ratio, we may not be able to fund our operations through December 31, 2008.

In the event that we require additional funding to continue our operations, we will attempt to raise the required capital through either debt or equity arrangements. We cannot provide any assurance that the required capital would be available on acceptable terms, if at all, or that any financing activity would not be dilutive to our current stockholders. If we are not able to raise additional funds, we may be required to significantly curtail our operations and this would have an adverse effect on our financial position, results of operations and cash flows.

#### ***Summary of Accounting Policies and Use of Estimates***

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, we evaluate our estimates, including those related to collectibility of customer accounts, whether the cost of inventories can be recovered, the value assigned to and estimated useful life of intangible assets, the realization of tax assets and estimates of tax liabilities, contingent liabilities and the potential outcome of litigation. We base our estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions.

## **Table of Contents**

The following critical accounting policies and estimates were used in the preparation of the consolidated financial statements:

### *Revenue Recognition and Accounts Receivable*

We comply with the revenue recognition guidelines in SEC Staff Accounting Bulletin No. 104, Revenue Recognition. We recognize revenue when all of the following criteria are met:

Persuasive evidence of an arrangement exists;

The sales price is fixed or determinable;

Collection of the relevant receivable is probable at the time of sale; and

Products have been shipped or used and the customer has taken ownership and assumed risk of loss.

We earn royalty revenue, which is included in license revenue in the consolidated statement of operations, as a result of the sale of product rights and technologies to third parties. Royalties are recognized upon the sale of products subject to the royalty by the third party.

We do not offer rights of return and we have no post delivery obligations other than our specified warranty.

We maintain allowances for doubtful accounts for estimated losses resulting from the inability of our customers to make required payments. These estimates are based on our review of the aging of customer balances, correspondence with the customer, and the customer's payment history. If additional information becomes available to us indicating the financial condition of the customer is deteriorating, additional allowances may be required.

### *Inventories*

We write down our inventory for estimated obsolescence or unmarketable inventory equal to the difference between the cost of inventory and the estimated realizable value based upon assumptions about future demand, as driven by economic and market conditions, and the product's shelf life. If actual demand, or economic or market conditions are less favorable than those projected by management, additional inventory write-downs may be required.

### *Goodwill, Intangible Assets and Long-Lived Assets*

We record an impairment charge, or expense, for long-lived assets whenever events or changes in circumstances indicate that the value recorded for the asset may not be recoverable. Future changes in operations could cause us to write down the asset value and record an expense to better reflect our current estimate of its value. Goodwill and indefinite-lived intangible assets are tested for impairment annually, or more frequently if events or changes in circumstances indicate that the goodwill or indefinite-lived intangible assets are impaired. Factors that may impact whether there is a potential goodwill impairment include a significant decrease in our stock price and our evaluation of a control premium that may be used when estimating our total fair value. Our stock price may decline, or other factors may arise, which could result in goodwill impairment in future periods. Factors that may impact whether there is a potential impairment to our indefinite-lived intangible assets include legal and regulatory considerations.

### *Income Taxes*

We reduce our deferred tax asset to zero due to uncertainties concerning the future realization of the related tax benefits, primarily due to our history of losses. In the event we were to determine that we would be able to realize some or all of the tax benefit of the deferred tax asset, the valuation allowance would be reduced, resulting in a tax benefit in the period such determination was made.

### *Stock-based compensation*

Effective at the beginning of our fiscal year 2006, we adopted Statement of Financial Accounting Standards, or SFAS No. 123R, Share-Based Payments, or SFAS 123R. This statement requires us to recognize the cost of employee and director services received in exchange for the stock options it has awarded. Under SFAS 123R, we are required to recognize compensation expense over an award's vesting period based on the award's fair value at the date of grant. We elected to adopt SFAS 123R on a modified prospective basis; accordingly, the financial statements

**Table of Contents**

for the periods prior to January 1, 2006 do not include stock based compensation under the fair value method. We use the Black-Scholes option pricing model to value stock option grants. The fair value for awards that are expected to vest is then amortized on a straight-line basis over the requisite service period of the award, which is generally the option vesting term. The amount of expense attributed is net of an estimated forfeiture rate, which is updated as appropriate. This option pricing model requires the input of highly subjective assumptions, including the expected volatility of our common stock, pre-vesting forfeiture rate and an option's expected life. The financial statements include such amounts based on our best estimates and judgments.

***Results of Operations******Comparison of Years Ended December 31, 2007 and 2006***

**Product Sales.** Sales increased 87% to \$27.0 million in 2007 from \$14.4 million in 2006 primarily due to the expansion and increased productivity of our domestic field sales personnel, and increased market acceptance of the Powerlink System. Domestic sales increased from \$12.4 million to \$23.0 million, and sales to distributors outside the United States doubled from \$2.0 million in 2006 to \$4.0 million in 2007. Our distribution agreement with Edwards LifeSciences AG, or Edwards LifeSciences, was not renewed beyond the original expiration of December 31, 2006. Sales to Edwards LifeSciences in 2006 were \$1.2 million. We replaced the Edwards LifeSciences distribution agreement with a three-year distribution agreement with LeMaitre Vascular. This agreement named LeMaitre Vascular as the exclusive distributor of the Powerlink System in ten European countries, including Austria, Belgium, the Czech Republic, France, Germany, Luxembourg, the Netherlands, Sweden, Switzerland, and the United Kingdom. Sales to LeMaitre in 2007 were \$2.1 million.

**License Revenue.** License revenue increased 202% to \$754,000 in 2007 from \$250,000 in 2006, due to our licensing agreement with BioLucent, Inc. Under that agreement, we received \$504,000 in royalties and fees, including a one-time payment of \$500,000 in exchange for a fully paid up license to certain of our patents in a certain field of use. License revenue from Guidant remained at the contractual minimum level of \$250,000 for 2007, equal to 2006. We expect that license revenue will decline sharply in 2008 as the minimum royalty provision of the agreement expired at December 31, 2007. The license will be fully paid up in June 2008. Beginning on January 1, 2008, sales of our Powerlink System will be our only material source of revenue.

**Cost of Product Revenue.** The cost of product revenue increased 66% to \$10.5 million from \$6.3 million in 2006. This increase is directly attributable to the higher unit volume of product sales in 2007 compared to 2006.

**Gross Profit.** Gross profit increased 107% to \$17.2 million in 2007 from \$8.3 million in 2006. The increase in gross profit resulted from higher product sales in 2007 as compared to 2006, license revenue from BioLucent Inc., and a reduction in the per unit cost of product due to substitution of lower-cost in-house produced graft material in a portion of the products sold in 2007. Gross profit as a percentage of revenue increased to 62% in 2007 from 57% in 2006 for these reasons. Also, the percentage in 2006 was impacted by a second quarter charge of \$326,000, related to the final phase of an earlier limited, voluntary product recall.

We believe that gross profit dollars will increase in future years due to higher commercial sales of the Powerlink System both in and outside of the United States. We also expect that gross profit as a percentage of product revenues will increase further, into the 70% to 75% range as the substitution of in-house produced ePTFE graft material for higher cost purchased graft material becomes virtually complete in 2008.

**Research, Development and Clinical.** Research, development and clinical expenses decreased by 6% to \$6.4 million from \$6.8 million in 2006. The decrease primarily resulted from lower costs associated with clinical trials in the 2007 period. We incurred a charge of \$417,000 in 2007 and \$347,000 in 2006, for stock compensation expense pursuant to the adoption of SFAS 123R at January 1, 2006. We expect that research, development, and clinical expense will range between \$6.0 to \$6.6 million in 2008, to support new product and process development projects and ongoing clinical trials.

**Marketing and Sales.** Marketing and sales expenses increased by 38% to \$20.1 million from \$14.6 million in 2006. This increase was due to staffing increases in sales and marketing functions in support of the commercial sales of the infrarenal Powerlink System in the United States market. We incurred a charge of \$878,000 in 2007 and

## **Table of Contents**

\$448,000 in 2006, respectively, for stock compensation expense pursuant to the adoption of SFAS 123R at January 1, 2006. We expect that sales and marketing expense will continue to increase in 2008, but at a lesser rate than in 2007, due to increased productivity of our tenured sales representatives within their territories.

*General and Administrative.* General and administrative expenses increased by 14% to \$6.4 million from \$5.6 million in 2006. The increase was due primarily to increases in patent and legal fees and insurance expenses. In addition, compensation expense totaling \$894,000 in 2007 as compared to \$767,000 in 2006, pursuant to the adoption of SFAS 123R at January 1, 2006. We expect general and administrative expense to remain in the \$6.4 to \$7.0 million range in 2008.

*Termination of Supply Agreement.* Termination of supply agreement expense was \$550,000 in 2007. The expense was due to the third amendment of our supply agreement with Bard Peripheral, dated September 21, 2007, which reduced the minimum purchase requirement for the 2007 year from \$2.9 million to \$2.2 million, and wherein both parties agreed to terminate the agreement on December 31, 2007. In consideration for the reduction in the minimum purchase requirement for the 2007 year, we paid \$550,000 to Bard Peripheral.

*Other Income.* Other income increased 9% to \$1.1 million from \$1.0 million in 2006. The increase in other income was a result of a realized gain of \$412,000 on our investment in BioLucent, Inc., offset by less interest income due to a lower invested cash balance. In 2006, we had a higher cash balance due to a registered direct public offering of our common stock that resulted in net proceeds of \$18.8 million in June 2006.

### *Comparison of Years Ended December 31, 2006 and 2005*

*Product Sales.* Sales increased 109% to \$14.4 million in 2006 from \$6.9 million in 2005 primarily due to our investment in our domestic field sales personnel, and increased market acceptance of the Powerlink System. United States sales increased from \$4.8 million to \$12.4 million, and sales to distributors outside the United States did not change from \$2.0 million in 2006 and 2005. Sales to Edwards LifeSciences decreased to \$1.2 million in 2006 from \$1.5 million in 2005.

*License Revenue.* License revenue remained unchanged at \$250,000 in 2006 and 2005, which represented the contractual minimum annual amount from Guidant.

*Cost of Product Revenue.* The cost of product revenue increased 64% to \$6.3 million from \$3.9 million in 2005. This increase is attributable to the higher unit volume of product sales in 2006 compared to 2005.

*Gross Profit.* Gross profit increased 154% to \$8.3 million in 2006 from \$3.3 million in 2005. The increase in gross profit resulted from higher product sales in 2006 as compared to 2005.

Gross profit on product sales increased 167% to \$8.1 million from \$3.0 million in 2005 because product sales volume more than doubled in 2006 from 2005. Gross profit, as a percentage of product sales increased to 56% in 2006 from 44% in 2005. This increase in gross profit margin was due to an increase in product sales in the United States. Direct product sales in the United States have a higher gross profit margin compared to international product sales, which are sold through distributors. Additionally, the percentage in 2005 was impacted by a product recall and a facility relocation which resulted in period charges to cost of sales in the fourth quarter of approximately \$1.0 million. A charge of \$326,000 related to the final phase of the product recall was incurred in the second quarter of 2006.

*Research, Development and Clinical.* Research, development and clinical expenses increased by 16% to \$6.8 million from \$5.8 million in 2005. The increase primarily resulted from continued product research and development of our Powerlink System product and complementary technologies, and continued enrollment in the suprarenal arm of the pivotal United States clinical trials. A \$347,000 charge for stock compensation expense pursuant to the adoption of SFAS 123R at January 1, 2006, also contributed to the increase.

*Marketing and Sales.* Marketing and sales expenses increased by 66% to \$14.6 million from \$8.8 million in 2005. This increase was due to staffing increases in sales and marketing support functions in support of the expanded commercial launch of the infrarenal Powerlink System in the United States market. In addition, the

## **Table of Contents**

increase was partially due to a \$448,000 charge for stock compensation expense pursuant to the adoption of SFAS 123R at January 1, 2006.

*General and Administrative.* General and administrative expenses increased by 16% to \$5.6 million from \$4.8 million in 2005. The increase was due to stock compensation expense totaling \$767,000, pursuant to the adoption of SFAS 123R at January 1, 2006.

*Other Income.* Other income increased 70% to \$1.0 million from \$614,000 in 2005, driven by higher interest income. The increase in interest income was accounted for by a higher average invested cash balance in 2006, which resulted from a registered direct public offering of our common stock that resulted in net proceeds of \$18.8 million in June 2006.

## **Liquidity and Capital Resources**

For the years ended December 31, 2007 and 2006, we incurred net losses of \$15.1 million and \$17.5 million, respectively. As of December 31, 2007, we had an accumulated deficit of approximately \$131.7 million. Historically, we have relied on the sale and issuance of equity securities to provide a significant portion of funding for our operations. In April 2006, we filed a shelf registration statement with the SEC that would permit us to sell from time to time, up to a total of \$50.0 million of common stock. In June 2006, we completed an offering of our common stock, which resulted in net proceeds of \$18.8 million, leaving \$30.2 million available under the shelf registration. Additionally, in July 2003, March 2004 and July 2005, we completed three private placements of our common stock, resulting in aggregate net proceeds of \$39.2 million.

In February 2007, we entered into a revolving credit facility, whereby we may borrow up to \$5 million. All outstanding amounts under the credit facility bear interest at a variable rate equal to the lender's prime rate plus 0.5%, which is payable on a monthly basis. The unused portion is subject to an unused revolving line facility fee, payable quarterly, in arrears, on a calendar year basis, in an amount equal to one quarter of one percent per annum of the average unused portion of the revolving line, as determined by the bank. The credit facility also contains customary covenants regarding operations of our business and financial covenants relating to ratios of current assets to current liabilities and tangible net worth during any calendar quarter and is collateralized by all of our assets with the exception of our intellectual property. All amounts owing under the credit facility will become due and payable on February 21, 2009. As of December 31, 2007, we did not have any outstanding borrowings under this credit facility.

At December 31, 2007, we had cash, cash equivalents, restricted cash equivalents and marketable securities available for sale of \$9.2 million. We believe that current cash and cash equivalents and marketable securities, together with cash receipts generated from sales of the Powerlink System and available borrowings under our credit facility, will be sufficient to meet anticipated cash needs for operating and capital expenditures through at least December 31, 2008. Nevertheless, we expect to continue to incur substantial costs and cash outlays in 2008 and beyond to support Powerlink System research and development, and United States marketing of the Powerlink System. If we fail to increase our penetration of the AAA market, or if we fail to reduce certain discretionary expenditures, as necessary, we may need to seek additional sources of financing.

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

- the rate of market acceptance of the Powerlink System;

- our requirements for additional manufacturing capacity;

- our requirements for additional IT infrastructure and systems;

- our requirements for additional facility space; and

- the success of our clinical trials and our research and development programs for future products and processes.

**Table of Contents**

*Accounts Receivable.* Trade accounts receivable, net, increased 64% to \$4.5 million at December 31, 2007 from \$2.8 million at December 31, 2006. The increase was due to the increase in sales in 2007.

*Inventories.* Inventories decreased 14% to \$8.1 million at December 31, 2007 from \$9.4 million at December 31, 2006. The decrease was primarily a result of lower cost basis of the ePTFE graft material.

*Accounts Payable and Accrued Expenses.* Accounts payable and accrued expenses decreased 15% to \$4.3 million at December 31, 2007 from \$5.0 million at December 31, 2006. The decrease is attributable primarily to the termination of the supply agreement with Bard Peripheral for a key component of the Powerlink System.

*Cash Used in Operations.* Cash used in operations decreased 30% to \$11.7 million for the year ended December 31, 2007 from \$16.6 million for the year ended December 31, 2006.

*Cash Provided by (used in) Investing Activities.* Cash provided by investing activities was \$13.4 million for the year ended December 31, 2007 as compared to cash used in investing activities of \$5.4 million for the year ended December 31, 2006. This change was primarily due to decreased investment in marketable securities in 2007 as compared to 2006.

*Cash Provided by Financing Activities.* Cash provided by financing activities decreased 96% to \$724,000 for the year ended December 31, 2007 from \$20.0 million for the year ended December 31, 2006. In 2006, we completed a registered direct public offering of 6,061,000 shares of our common stock at a purchase price of \$3.30 per share, which resulted in net proceeds of approximately \$18,750, after deducting the offering expenses.

**Off-Balance Sheet Arrangements**

We do not maintain any off-balance sheet arrangements.

**Commitments**

As of December 31, 2007, expected future cash payments related to contractual obligations were as follows:

	<b>Total</b>	<b>2008</b>	<b>2009</b>	<b>2010</b>	<b>Thereafter</b>
			<b>(In thousands)</b>		
Contractual Obligations					
Operating lease obligations	\$ 777	\$ 344	\$ 346	\$ 87	\$
Total	\$ 777	\$ 344	\$ 346	\$ 87	\$

**Recent Accounting Pronouncements**

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, or SFAS 157, Fair Value Measurements, which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. Earlier adoption is permitted, provided the company has not yet issued financial statements, including for interim periods, for that fiscal year. We are currently evaluating the impact of SFAS 157 on our consolidated financial statements.

In July 2006, the FASB issued Financial Interpretation ( FIN ) No. 48, Accounting for Uncertainty in Income Taxes, which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN 48 provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Income tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. This interpretation also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. We adopted the provisions of FIN 48

## **Table of Contents**

on January 1, 2007. We did not recognize any additional liability for unrecognized tax benefit as a result of the implementation. We will recognize interest and penalties related to unrecognized tax benefits within the income tax expense line in the accompanying consolidated statement of operations. As of December 31, 2007 we have not recognized liabilities for penalty and interest as we do not have liability for unrecognized tax benefits.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, or SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for our fiscal year beginning January 1, 2008. We are currently evaluating the impact that the adoption of SFAS No. 159 will have on our consolidated financial statements.

In June 2007, the FASB's Emerging Issues Task Force reached a consensus on EITF Issue No. 07-3, Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities that would require nonrefundable advance payments made by the Company for future R&D activities to be capitalized and recognized as an expense as the goods or services are received by the Company. EITF Issue No. 07-3 is effective with respect to new arrangements entered into beginning January 1, 2008. We are currently evaluating the impacts and disclosures of this standard, but would not expect EITF Issue No. 07-3 to have a material impact on our consolidated financial statements.

In December 2007, the FASB's Emerging Issues Task Force issued EITF 07-01, Accounting for Collaborative Arrangements Related to the Development and Commercialization of Intellectual Property, or EITF 07-01. EITF-07-01 prescribes the accounting for collaborations. It requires certain transactions between collaborators to be recorded in the income statement on either a gross or net basis within expenses when certain characteristics exist in the collaboration relationship. EITF 07-01 is effective for all collaborations existing after January 1, 2008. We are evaluating the impact this standard will have on our financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), or SFAS 141(R), Business Combinations (revised - 2007). SFAS 141(R) is a revision to previously existing guidance on accounting for business combinations. The statement retains the fundamental concept of the purchase method of accounting, and introduces new requirements for the recognition and measurement of assets acquired, liabilities assumed and noncontrolling interests. The statement is effective for fiscal years beginning after December 15, 2008. We do not expect adoption of this standard to have a material impact on our consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, or SFAS 160, Noncontrolling Interests in Consolidated Financial Statements. The Statement requires that noncontrolling interests be reported as stockholders equity. The Statement also establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary as long as that ownership change does not result in deconsolidation. SFAS 160 is required to be applied prospectively in 2009, except for the presentation and disclosure requirements which are to be applied retrospectively. The statement is effective for fiscal years beginning after December 15, 2008. We are currently evaluating the impact of SFAS 160 and do not expect a material impact to our consolidated financial statements.

### ***Item 7A. Quantitative and Qualitative Disclosures About Market Risk***

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

***Interest Rate and Market Risk.*** Our exposure to market risk for changes in interest rates relates primarily to our investment profile. We do not use derivative financial instruments in our investment portfolio. We place our investments with high credit quality issuers and, by policy, limit the amount of credit exposure to any one issuer. We are averse to principal loss and try to ensure the safety and preservation of our invested funds by limiting default risk, market risk, and reinvestment risk. We attempt to mitigate default risk by investing in only the safest and highest credit quality securities and by constantly positioning our portfolio to respond appropriately to a significant reduction in a credit rating of any investment issuer or guarantor. At December 31, 2007, our investment portfolio included only money market instruments.

*Foreign Currency Transaction Risk.* We do not currently have material foreign currency exposure as the majority of our assets are denominated in U.S. currency and our foreign-currency based transaction exchange risk is not material. For the years ended December 31, 2007, 2006, and 2005, we recorded \$51,000, \$25,000, and (\$7,000), respectively, of foreign currency transaction gains (losses).

**Item 8. Financial Statements and Supplementary Data**

The financial statements required by this Item 8 are set forth at the pages indicated at Item 15(a)(1).

26

---

**Table of Contents****Summarized Quarterly Data  
(Unaudited)**

	<b>March 31</b>	<b>June 30</b>	<b>September 30</b>	<b>December 31</b>
	<b>(in thousands, except per share amounts)</b>			
<b>2007:</b>				
Product sales	\$ 6,250	\$ 6,258	\$ 6,592	\$ 7,917
Total revenues	6,308	6,318	7,152	7,993
Gross profit	3,729	3,680	4,720	5,103
Net loss	(4,440)	(3,713)	(3,394)	(3,528)
Basic and diluted net loss per share	(0.10)	(0.09)	(0.08)	(0.08)
<b>2006:</b>				
Product sales	\$ 2,675	\$ 3,446	\$ 3,748	\$ 4,553
Total revenues	2,733	3,495	3,801	4,643
Gross profit(1)	1,614	1,697	2,269	2,762
Net loss	(4,112)	(4,388)	(4,192)	(4,851)
Basic and diluted net loss per share	(0.11)	(0.11)	(0.10)	(0.11)

(1) During the second quarter of 2006, we incurred approximately \$326,000 in costs due to an earlier product recall.

**Item 9. Changes in and Disagreements with Accountants on Accounting and Financial Disclosure**

None.

**Item 9A. Controls and Procedures****Management's Report on Internal Control Over Financial Reporting**

Our management is responsible for establishing and maintaining adequate internal control over financial reporting as defined in Rules 13a-15(f) and 15d-15(f) under the Securities Exchange Act of 1934, as amended. Our internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of the financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. This process includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of our assets; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures are being made only in accordance with authorizations of our management and directors; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use or disposition of our assets that could have a material effect on our financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of the internal control over financial reporting to future periods are subject to risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

Our management assessed the effectiveness of our internal control over financial reporting as of December 31, 2007. In making this assessment, it used the criteria set forth by the Committee of Sponsoring Organizations of the

Treadway Commission in Internal Control-Integrated Framework. Based on our assessment, we have concluded that, as of December 31, 2007, our internal control over financial reporting was effective based on those criteria.

The effectiveness of our internal control over financial reporting as of December 31, 2007 has been audited by PricewaterhouseCoopers LLP, an independent registered public accounting firm, as stated in their report, which is included herein.

**Disclosure controls and procedures**

We carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of our disclosure controls and procedures as of the end of the period covered by this report, pursuant to Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended. Based on that evaluation, our chief executive officer and chief financial officer

**Table of Contents**

have concluded that our disclosure controls and procedures, as of the end of the period covered by this report, were effective.

**Changes in internal control over financial reporting**

There has been no change in our internal control over financial reporting during the fourth fiscal quarter that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

**Item 9B. Other Information**

None.

**PART III****Item 10. Directors and Executive Officers of the Registrant**

The information required hereunder is incorporated herein by reference to our Proxy Statement to be filed within 120 days of December 31, 2007 and delivered to stockholders in connection with our Annual Meeting of Stockholders to be held on May 22, 2008.

**Item 11. Executive Compensation**

The information required hereunder is incorporated herein by reference to our Proxy Statement to be filed within 120 days of December 31, 2007 and delivered to stockholders in connection with our Annual Meeting of Stockholders to be held on May 22, 2008.

**Item 12. Security Ownership of Certain Beneficial Owners and Management and Related Stockholder Matters**

Certain information required hereunder is incorporated herein by reference to our Proxy Statement to be filed within 120 days of December 31, 2007 and delivered to stockholders in connection with our Annual Meeting of Stockholders to be held on May 22, 2008.

**Equity Compensation Plan Information**

The following table sets forth information regarding outstanding options and rights and shares reserved for future issuance under our existing equity compensation plans as of December 31, 2007:

Plan Category	Number of Securities to be Issued upon Exercise of Outstanding Options (a)	Weighted Average Exercise Price of Outstanding Options (b)	Number of Securities Remaining Available for Future Issuance Under Equity Compensation Plans (Excluding Securities Reflected in Column A) (c)
Equity compensation plans approved by security holders:			
2006 Stock Incentive Plan	2,206,850	\$ 3.85	607,315
1996 Stock Option/ Stock Issuance Plan	1,855,889	\$ 4.92	
Employee Stock Purchase Plan			128,220
Equity compensation plans not approved by security holders: 1997			
Supplemental Stock Option Plan	62,000	\$ 4.61	
Total	4,124,739	\$ 4.34	735,535

**Table of Contents**

**Item 13. *Certain Relationships and Related Transactions***

The information required hereunder is incorporated herein by reference to our Proxy Statement to be filed within 120 days of December 31, 2007 and delivered to stockholders in connection with our Annual Meeting of Stockholders to be held on May 22, 2008.

**Item 14. *Principal Accountant Fees and Services***

The information required hereunder is incorporated herein by reference to our Proxy Statement to be filed within 120 days of December 31, 2007 and delivered to stockholders in connection with our Annual Meeting of Stockholders to be held on May 22, 2008.

**Table of Contents**

**PART IV**

**Item 15. Exhibits, Financial Statement Schedules**

(a) The following documents are filed as a part of this Annual Report on Form 10-K:

**1. Financial Statements.**

Report of Independent Registered Public Accounting Firm

Consolidated Balance Sheets December 31, 2007 and 2006

Consolidated Statements of Operations for the years ended December 31, 2007, 2006 and 2005

Consolidated Statements of Stockholders Equity for the years ended December 31, 2007, 2006 and 2005

Consolidated Statements of Cash Flows for the years ended December 31, 2007, 2006 and 2005

Notes to Consolidated Financial Statements for the years ended December 31, 2007, 2006 and 2005

**2. Financial Statement Schedule.**

Schedule II Valuation and Qualifying Accounts

Schedules not listed above have been omitted because they are not applicable or are not required to be set forth herein as such information is included in the Consolidated Financial Statements or the notes thereto.

**3. Exhibits.**

The following exhibits are filed as part of this Annual Report on Form 10-K:

<b>Exhibit Number</b>	<b>Description</b>
3.1	Amended and Restated Certificate of Incorporation (Incorporated by reference to Exhibit 4.1 to Endologix Registration Statement on Form S-8, filed with the SEC on August 7, 2006).
3.2	Amended and Restated Bylaws (Incorporated by reference to Exhibit 3.2 to Endologix Annual Report on Form 10-K filed with the SEC on March 29, 2001).
4.1	Specimen Certificate of Common Stock (Incorporated by reference to Exhibit 4.1 to Amendment No. 2 to Endologix Registration Statement on Form S-1, No. 333-04560, filed with the SEC on June 10, 1996).
10.1(2)	Employee Stock Purchase Plan and forms of agreement thereunder (Incorporated by reference to Exhibit 4.1 to Endologix Registration Statement on Form S-8, No. 333-114465, filed with the SEC on April 14, 2004).
10.2(2)	1997 Supplemental Stock Option Plan (Incorporated by reference to Exhibit 99.1 to Endologix Registration Statement on Form S-8, No. 333-42161, filed with the SEC on December 12, 1997).
10.4(2)	1996 Stock Option/Stock Issuance Plan (Incorporated by reference to Exhibit 4.1 to Endologix Registration Statement on Form S-8, No. 333-122491, filed with the SEC on February 2, 2005).
10.5(2)	

Edgar Filing: ENDOLOGIX INC /DE/ - Form 10-K

1997 Stock Option Plan assumed by Endologix pursuant to its acquisition of Radiance Medical Systems, Inc. on January 14, 1999 (Incorporated by reference to Exhibit 99.2 to Endologix Registration Statement on Form S-8, No. 333-72531, filed with the SEC on February 17, 1999).

- 10.6(2) 2006 Stock Incentive Plan (Incorporated by reference to Exhibit 10.1 to Endologix Current Report on Form 8-K, filed with the SEC on May 26, 2006).
- 10.6.1(2) Stock Option Agreement under 2006 Stock Incentive Plan (Incorporated by reference to Exhibit 10.1 to Endologix Quarterly Report on Form 10-Q, filed with the SEC on November 9, 2006).
- 10.6.2(1) Restricted Stock Award Agreement under 2006 Stock Incentive Plan (Incorporated by reference to Exhibit 10.2 to Endologix Quarterly Report on Form 10-Q, filed with the SEC on November 9, 2006).

**Table of Contents**

<b>Exhibit Number</b>	<b>Description</b>
10.7(2)	2006 Employee Stock Purchase Plan (Incorporated by reference to Exhibit 10.2 to Endologix Current Report on Form 8-K, filed with the SEC on May 26, 2006).
10.9	Form of Indemnification Agreement entered into with Endologix officers and directors (Incorporated by reference to Exhibit 10.41 to Endologix Quarterly Report on Form 10-Q, filed with the SEC on November 13, 2002).
10.10(2)	Form of Employment Agreement with certain officers of Endologix (Incorporated by reference to Exhibit 10.42 to Endologix Annual Report on Form 10-K, filed with the SEC on March 27, 2003).
10.10.1	Schedule of officers of Endologix party to the Employment Agreement.
10.11	Standard Industrial/Commercial Single-Tenant Lease Net, dated November 2, 2004, by and between Endologix and Del Monico Investments, Inc. (Incorporated by reference to Exhibit 10.46 to Endologix Current Report on Form 8-K, filed with the SEC on November 24, 2004).
10.12	Stock Purchase Agreement, dated July 5, 2005, by and between Endologix and the investors named therein (Incorporated by reference to Exhibit 10.48 to Endologix Current Report on Form 8-K, filed with the SEC on July 8, 2005).
10.13	Loan and Security Agreement, dated as of February 21, 2007, by and between Endologix and Silicon Valley Bank (Incorporated by reference to Exhibit 10.13 to Endologix Quarterly Report on Form 10-Q, filed with the SEC on May 9, 2007).
14	Code of Ethics for Chief Executive Officer and Principal Financial Officers (Incorporated by reference to Exhibit 14 to Endologix Annual Report on Form 10-K filed with the SEC on March 26, 2004).
21.1	List of Subsidiaries.
23.1	Consent of Independent Registered Public Accounting Firm.
24.1	Power of Attorney (included on signature page hereto).
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934.
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934.
32.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(b)/15d-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
32.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(b)/15d-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.

(1)

Portions of this exhibit are omitted and were filed separately with the Securities and Exchange Commission pursuant to Endologix application requesting confidential treatment under Rule 24b-2 of the Securities Exchange Act of 1934.

- (2) These exhibits are identified as management contracts or compensatory plans or arrangements of Endologix pursuant to Item 15(a)(3) of Form 10-K.

**Table of Contents****SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the registrant has duly caused this amendment to be signed on its behalf by the undersigned, thereunto duly authorized.

ENDOLOGIX, INC.

By: /s/ PAUL MCCORMICK  
Paul McCormick  
Chief Executive Officer and Director  
(Principal Executive Officer)

Date: February 29, 2008

**POWER OF ATTORNEY**

We, the undersigned directors and officers of Endologix, Inc., do hereby constitute and appoint Paul McCormick and Robert J. Krist, and each of them, as our true and lawful attorney-in-fact and agents with power of substitution, to do any and all acts and things in our name and behalf in our capacities as directors and officers and to execute any and all instruments for us and in our names in the capacities indicated below, which said attorney-in-fact and agent may deem necessary or advisable to enable said corporation to comply with the Securities Exchange Act of 1934, as amended, and any rules, regulations and requirements of the Securities and Exchange Commission, in connection with this Annual Report on Form 10-K, including specifically but without limitation, power and authority to sign for us or any of us in our names in the capacities indicated below, any and all amendments (including post-effective amendments) hereto; and we do hereby ratify and confirm all that said attorney-in-fact and agent, shall do or cause to be done by virtue hereof.

Pursuant to the requirements of the Securities Exchange Act of 1934, this report has been signed below by the following persons on behalf of the registrant and in the capacities and on the dates indicated.

<b>Signature</b>	<b>Title</b>	<b>Date</b>
/s/ PAUL MCCORMICK  (Paul McCormick)	Chief Executive Officer and Director (Principal Executive Officer)	February 29, 2008
/s/ ROBERT J. KRIST  (Robert J. Krist)	Chief Financial Officer, and Secretary (Principal Financial and Accounting Officer)	February 29, 2008
/s/ FRANKLIN D. BROWN  (Franklin D. Brown)	Chairman and Director	February 29, 2008
/s/ RODERICK DE GREEF  (Roderick de Greef)	Director	February 29, 2008
/s/ EDWARD DIETRICH, M.D.  (Edward Diethrich, M.D.)	Director	February 29, 2008
/s/ JEFFREY F. O DONNELL	Director	February 29, 2008

(Jeffrey F. O Donnell)

/s/ GREGORY D. WALLER

Director

February 29, 2008

(Gregory D. Waller)

32

---

**Table of Contents**

**Report of Independent Registered Public Accounting Firm**

To the Board of Directors and Stockholders of Endologix, Inc.:

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of operations, stockholders' equity and cash flows present fairly, in all material respects, the financial position of Endologix, Inc. and its subsidiaries at December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007 in conformity with accounting principles generally accepted in the United States of America. In addition, in our opinion, the financial statement schedule listed in the accompanying index, appearing under item 15(9)(2), presents fairly, in all material respects, the information set forth therein when read in conjunction with the related consolidated financial statements. Also in our opinion, the Company maintained, in all material respects, effective internal control over financial reporting as of December 31, 2007, based on criteria established in *Internal Control - Integrated Framework* issued by the Committee of Sponsoring Organizations of the Treadway Commission (COSO). The Company's management is responsible for these financial statements and financial statement schedule, for maintaining effective internal control over financial reporting and for its assessment of the effectiveness of internal control over financial reporting, included in the Management's Report on Internal Control over Financial Reporting appearing under Item 9A. Our responsibility is to express opinions on these financial statements, on the financial statement schedule, and on the Company's internal control over financial reporting based on our integrated audits. We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audits to obtain reasonable assurance about whether the financial statements are free of material misstatement and whether effective internal control over financial reporting was maintained in all material respects. Our audits of the financial statements included examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, and evaluating the overall financial statement presentation. Our audit of internal control over financial reporting included obtaining an understanding of internal control over financial reporting, assessing the risk that a material weakness exists, and testing and evaluating the design and operating effectiveness of internal control based on the assessed risk. Our audits also included performing such other procedures as we considered necessary in the circumstances. We believe that our audits provide a reasonable basis for our opinions.

As discussed in Note 1 to the consolidated financial statements, the company changed the manner in which it accounts for share-based compensation in 2006.

A company's internal control over financial reporting is a process designed to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles. A company's internal control over financial reporting includes those policies and procedures that (i) pertain to the maintenance of records that, in reasonable detail, accurately and fairly reflect the transactions and dispositions of the assets of the company; (ii) provide reasonable assurance that transactions are recorded as necessary to permit preparation of financial statements in accordance with generally accepted accounting principles, and that receipts and expenditures of the company are being made only in accordance with authorizations of management and directors of the company; and (iii) provide reasonable assurance regarding prevention or timely detection of unauthorized acquisition, use, or disposition of the company's assets that could have a material effect on the financial statements.

Because of its inherent limitations, internal control over financial reporting may not prevent or detect misstatements. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

/s/ PricewaterhouseCoopers LLP

PricewaterhouseCoopers LLP  
Orange County, California  
February 29, 2008



**Table of Contents**

**ENDOLOGIX, INC.**  
**CONSOLIDATED BALANCE SHEETS**

	December 31,	
	2007	2006
	(In thousands, except share and per share amounts)	
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 8,728	\$ 6,271
Restricted cash equivalents	500	500
Marketable securities available-for-sale, including unrealized gains of \$0 and \$3		12,217
Accounts receivable, net of allowance for doubtful accounts of \$100 and \$38	4,527	2,763
Other receivables	234	198
Inventories	8,054	9,356
Other current assets	581	637
Total current assets	22,624	31,942
Property and equipment, net	3,771	4,516
Marketable securities available-for-sale		1,200
Goodwill	4,631	4,631
Intangibles, net	8,913	10,319
Other assets	104	78
Total assets	\$ 40,043	\$ 52,686
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	\$ 4,259	\$ 5,009
Total current liabilities	4,259	5,009
Long-term liabilities	1,109	1,172
Total liabilities	5,368	6,181
Commitments and contingencies (Notes 11 and 15)		
Stockholders equity:		
Preferred stock, \$0.001 par value; 5,000,000 shares authorized, no shares issued and outstanding		
Common stock, \$0.001 par value; 60,000,000 shares authorized, 43,453,000 and 43,144,000 shares issued, and 42,958,000 and 42,649,000 outstanding	43	43
Additional paid-in capital	166,912	163,698
Accumulated deficit	(131,738)	(116,663)
Treasury stock, at cost, 495,000 shares	(661)	(661)
Accumulated other comprehensive income	119	88
Total stockholders equity	34,675	46,505

Total liabilities and stockholders' equity	\$ 40,043	\$ 52,686
--	-----------	-----------

The accompanying notes are an integral part of these Consolidated Financial Statements.  
F-2

---

**Table of Contents**

**ENDOLOGIX, INC.**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

	Year Ended December 31,		
	2007	2006	2005
	(In thousands, except per share amounts)		
Revenue:			
Product	\$ 27,017	\$ 14,422	\$ 6,889
License	754	250	250
Total revenue	27,771	14,672	7,139
Cost of sales:			
Cost of product revenue	10,539	6,330	3,859
Gross profit	17,232	8,342	3,280
Operating costs and expenses:			
Research and development	6,372	6,765	5,817
Marketing and sales	20,142	14,579	8,794
General and administrative	6,380	5,585	4,801
Termination of supply agreement	550		
Total operating costs and expenses	33,444	26,929	19,412
Loss from operations	(16,212)	(18,587)	(16,132)
Other income (expense):			
Interest income	664	1,019	623
Other income (expense), net	473	25	(9)
Total other income	1,137	1,044	614
Net loss	\$ (15,075)	\$ (17,543)	\$ (15,518)
Basic and diluted net loss per share	\$ (0.35)	\$ (0.44)	\$ (0.46)
Shares used in computing basic and diluted net loss per share	42,796	40,010	33,951

The accompanying notes are an integral part of these Consolidated Financial Statements.

F-3

Table of Contents

**ENDOLOGIX, INC.**  
**CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY**

	Common Stock Shares	Amount	Additional Paid-In Capital	Accumulated Deficit (In thousands, except share amounts)	Treasury Shares	Amount	Accumulated Other Comprehensive Income	Stockholders' Equity	Comprehensive Loss
<b>Balance at December 31, 2004</b>	32,362,000	\$ 32	\$ 125,704	\$ (83,602)	(495,000)	\$ (661)	\$ 78	\$ 41,551	\$ (9,753)
Exercise of common stock options	133,000	1	493					494	
Employee stock purchase plan	34,000		165					165	
Sale of common stock	4,150,000	4	15,450					15,454	
Amortization of deferred compensation			91					91	
Net loss				(15,518)				(15,518)	(15,518)
Unrealized holding gain arising during the period							20	20	20
Unrealized exchange rate loss							(50)	(50)	(50)
<b>Balance at December 31, 2005</b>	36,679,000	\$ 37	\$ 141,903	\$ (99,120)	(495,000)	\$ (661)	\$ 48	\$ 42,207	\$ (15,548)
Exercise of common stock options	317,000		934					934	
Employee stock purchase plan	77,000		319					319	
Sale of common stock	6,061,000	6	18,747					18,753	
Amortization of stock compensation expense	10,000		37					37	
Grant of stock options			1,764					1,764	

Amortization expense of non-employee stock options		(6)				(6)			
Net loss			(17,543)			(17,543)		(17,543)	
Unrealized holding gain arising during the period						23	23		23
Unrealized exchange rate gain						17	17		17

**Balance at  
December 31,  
2006**

43,144,000 \$ 43 \$ 163,698 \$ (116,663) (495,000) \$ (661) \$ 88 \$ 46,505 \$ (17,503)

Exercise of common stock options	123,000		228					228	
Employee stock purchase plan	180,000		491					491	
Stock issuance expense									
Amortization of stock compensation expense			2,430					2,430	
Grant of stock awards	6,000		23					23	
Amortization expense of non-employee stock options			42					42	
Net loss				(15,075)				(15,075)	(15,075)
Unrealized holding loss arising during the period						(3)	(3)		(3)
Unrealized exchange rate gain						34	34		34

**Balance at  
December 31,  
2007**

43,453,000 \$ 43 \$ 166,912 \$ (131,738) (495,000) \$ (661) \$ 119 \$ 34,675 \$ (15,044)

The accompanying notes are an integral part of these Consolidated Financial Statements.

**Table of Contents**

**ENDOLOGIX, INC.**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	<b>Year Ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
	<b>(In thousands)</b>		
Operating activities:			
Net loss	\$ (15,075)	\$ (17,543)	\$ (15,518)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation and amortization	2,322	2,303	1,736
Stock-based compensation and deferred compensation	2,444	1,665	91
Realized gain on investments	(412)		
Gain on disposal of assets			(7)
Changes:			
Accounts receivable	(1,764)	(1,515)	(901)
Inventories	1,614	(1,854)	(3,388)
Other receivables and other assets	(6)	(84)	16
Accounts payable, accrued expenses and long term liabilities	(813)	444	1,747
Net cash used in operating activities	(11,690)	(16,584)	(16,224)
Investing activities:			
Purchases of available-for-sale securities	(1,850)	(18,823)	(10,733)
Maturities of available-for-sale securities	15,650	14,388	18,878
Increase in restricted cash equivalents			(500)
Capital expenditures for property and equipment	(437)	(924)	(4,132)
Net cash provided by (used in) investing activities	13,363	(5,359)	3,513
Financing activities:			
Proceeds from sale of common stock, net of expenses		18,753	15,454
Proceeds from sale of common stock under employee stock purchase plan	496	319	165
Proceeds from exercise of stock options	228	934	494
Net cash provided by financing activities	724	20,006	16,113
Effect of exchange rate changes on cash and cash equivalents	60	17	(42)
Net increase (decrease) in cash and cash equivalents	2,457	(1,920)	3,360
Cash and cash equivalents, beginning of year	6,271	8,191	4,831
Cash and cash equivalents, end of year	\$ 8,728	\$ 6,271	\$ 8,191

The accompanying notes are an integral part of these Consolidated Financial Statements.

**Table of Contents**

**ENDOLOGIX, INC.**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(in thousands, except share or performance unit and per share amounts)**

**1. Business, Basis of Presentation and Summary of Critical Accounting Policies**

***Business and Basis of Presentation***

Endologix, Inc. (the Company) was incorporated in California in March 1992 and reincorporated in Delaware in June 1993. In January 1999, the Company merged with privately held Radiance Medical Systems, Inc. (former Radiance), and changed its name to Radiance Medical Systems, Inc. In May 2002, the Company merged with privately held Endologix, Inc., and changed its name to Endologix, Inc.

Since the merger in May 2002, the Company has been engaged in the development, manufacture, sales and marketing of minimally invasive therapies for the treatment of vascular disease. The Company's primary focus is the development of the Powerlink System, a catheter-based alternative treatment for abdominal aortic aneurysms, or AAA. AAA is a weakening of the wall of the aorta, the largest artery of the body.

Prior to the merger in May 2002 the Company was developing proprietary devices to deliver radiation to prevent the recurrence of blockages in arteries following balloon angioplasty, vascular stenting, arterial bypass surgery and other interventional treatments of blockages in coronary and peripheral arteries. The Company also manufactured, licensed and sold angioplasty catheters and stent products primarily through medical device distributors.

The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany transactions have been eliminated in consolidation. The Company operates in a single business segment.

***Liquidity and Capital Resources***

The accompanying financial statements have been prepared assuming the Company will continue as a going concern. For the years ended December 31, 2007, 2006, and 2005, the Company incurred net losses of \$15,075, \$17,543, and \$15,518, respectively. As of December 31, 2007, the Company had an accumulated deficit of \$131,738. The Company believes that the current cash and cash equivalents balance, in combination with cash receipts generated from sales of the Powerlink System and borrowings available under its credit facility, will be sufficient to fund ongoing operations through at least December 31, 2008. If the Company does not realize the expected revenue and gross margin levels, or if the Company is unable to manage its operating expenses in line with its revenues, or if it cannot maintain its days sales outstanding accounts receivable ratio, it may not be able to fund its operations through December 31, 2008.

In the event that the Company requires additional funding to continue operations, it will attempt to raise the required capital through either debt or equity arrangements. The Company cannot provide any assurance that the required capital would be available on acceptable terms, if at all, or that any financing activity would not be dilutive to its current stockholders. If the Company is not able to raise additional funds, it may be required to significantly curtail its operations and this would have an adverse effect on its financial position, results of operations and cash flows. The financial statements do not include any adjustments that might result from the outcome of these uncertainties.

***Summary of Accounting Policies and Use of Estimates***

The preparation of financial statements in conformity with generally accepted accounting principles requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, the Company evaluates its estimates, including those related to collectibility of customer accounts, whether the cost of inventories can be recovered, the value assigned to and estimated useful life of intangible assets, the

**Table of Contents**

**ENDOLOGIX, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(in thousands, except share or performance unit and per share amounts)**

realization of tax assets and estimates of tax liabilities, contingent liabilities and the potential outcome of litigation. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ from these estimates under different assumptions or conditions.

*Cash and Cash Equivalents*

Cash and cash equivalents includes cash on hand, demand deposits and money market funds with original maturities of three months or less from the date of purchase.

*Marketable Securities Available-For-Sale*

The Company accounts for its investments pursuant to Statement of Financial Accounting Standards ( SFAS ) No. 115, Accounting for Certain Investments in Debt and Equity Securities.

The Company has classified its entire investment portfolio as available-for-sale. Available-for-sale securities are stated at fair value with unrealized gains and losses included in accumulated other comprehensive income, net of realized gains and losses. Management evaluates the classification of its securities based on the Company's short-term cash needs. The amortized cost of debt securities is adjusted for amortization of premiums and accretions of discounts to maturity. Such amortization is included in interest income.

*Accounts Receivables*

Trade accounts receivable are recorded at the invoiced amount and do not bear interest. The allowance for doubtful accounts is the Company's best estimate of the amount of probable credit losses in existing accounts receivable. The Company determines the allowance based on historical write-off experience. The Company reviews the allowance for doubtful accounts monthly. Past due balances over 90 days and over a specified amount are reviewed individually for collectibility. Account balances are charged off against the allowance when the Company believes it is probable the receivable will not be recovered.

*Inventories*

The Company values inventory at the lower of the actual cost to purchase or manufacture the inventory or the market value for such inventory. Cost is determined on the first-in, first-out method. The Company regularly reviews inventory quantities in process and on hand and records a provision for obsolete inventory based on actual loss experience and a forecast of product demand compared to the remaining shelf life.

*Property and Equipment*

Property and equipment are stated at cost and depreciated on a straight-line basis over the estimated useful lives of the assets, with the exception of the Company's in-house ePTFE manufacturing equipment, which is depreciated by a per unit produced basis and approximates a six year useful life. Leasehold improvements are amortized over the term of the lease or the estimated useful life of the asset, whichever is shorter. Maintenance and repairs are expensed as incurred while renewals or betterments are capitalized. Upon sale or disposition of property and equipment, any gain or loss is included in the statement of operations. The estimated useful lives for furniture and equipment range from three to seven years and the estimated useful life for leasehold improvements is five years.

**Table of Contents**

**ENDOLOGIX, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(in thousands, except share or performance unit and per share amounts)**

*Intangible Assets*

In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill and other intangible assets with indefinite lives are not subject to amortization but are tested for impairment annually or whenever events or changes in circumstances indicate that the asset might be impaired. The Company most recently performed its annual impairment analysis as of June 30, 2007 and will continue to test for impairment annually as of June 30. No impairment was indicated.

The developed technology is being amortized over its estimated useful life of 10 years. During the years ended December 31, 2007, 2006 and 2005, the Company recorded \$1,406, \$1,405 and \$1,405 in amortization expense for the developed technology and expects to record \$1,405 each year thereafter, until the asset is fully amortized.

*Long-Lived Assets*

In accordance with SFAS No. 144, long-lived assets and intangible assets with determinate lives are reviewed for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. The Company evaluates potential impairment by comparing the carrying amount of the asset with the estimated undiscounted future cash flows associated with the use of the asset and its eventual disposition. Should the review indicate that the asset is not recoverable, the Company's carrying value of the asset would be reduced to its estimated fair value, which is measured by future discounted cash flows.

*Fair Value of Financial Instruments*

The carrying amount of all financial instruments approximates fair value because of the short maturities of the instruments.

*Concentrations of Credit Risk and Significant Customers*

The Company maintains its cash and cash equivalents in deposit accounts and in money market securities administered by a major financial institution.

The Company sells its products primarily to hospitals and distributors worldwide. The Company performs credit evaluations of its customers' financial condition and generally does not require collateral from customers. Management believes that an adequate allowance for doubtful accounts has been provided.

In 2005, revenues from Edwards LifeSciences AG was \$1,498, which represented 21% of total revenues. No other single customer accounted for more than 10% of the Company's revenues in 2005. No single customer accounted for more than 10% of the Company's total revenue in either 2006 or 2007.

As of December 31, 2007 and December 31, 2006, no single customer accounted for more than 10% of the Company's accounts receivable balance.

**Table of Contents**

**ENDOLOGIX, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands, except share or performance unit and per share amounts)

*Product Sales by Geographic Region*

The Company had product sales by region as follows:

	<b>Year Ended December 31,</b>		
	<b>2007</b>	<b>2006</b>	<b>2005</b>
United States	\$ 23,049	\$ 12,366	\$ 4,844
Netherlands		1,183	1,498
Germany	2,050		
Other European countries	1,008	617	409
Latin America	699	164	72
Other	211	92	66
	\$ 27,017	\$ 14,422	\$ 6,889

Sales to commercial hospital accounts represented 98%, 97% and 95% of United States product sales in 2007, 2006 and 2005, respectively. The remaining United States product sales were sales to hospitals conducting clinical trials for the Powerlink System.

*Revenue Recognition*

The Company complies with the revenue recognition guidelines in SEC Staff Accounting Bulletin No. 104, Revenue Recognition . The Company recognizes revenue when all of the following criteria are met:

Persuasive evidence of an arrangement exists

The sales price is fixed or determinable

Collection of the relevant receivable is probable at the time of sale

Products have been shipped or used and the customer has taken ownership and assumed risk of loss

The Company earns royalty revenue, which is included in license revenue in the consolidated statement of operations, as a result of the sale of product rights and technologies to third parties. Royalties are recognized upon the sale of products subject to the royalty, by the third party.

The Company does not offer rights of return or price protection and has no post delivery obligations other than its specified warranty.

*Shipping Costs*

Shipping costs billed to customers are included in revenue with the related costs in costs of goods sold.

*Foreign Currency*

The assets and liabilities of foreign subsidiaries are translated at the rates of exchange at the balance sheet date. The income and expense items of these subsidiaries are translated at average monthly rates of exchange. The resulting translation gains and losses are included as a component of accumulated other comprehensive income on the consolidated balance sheet. Gains and losses resulting from foreign currency transactions, which are denominated in a currency other than the respective entity's functional currency are included in the consolidated statement of operations.

*Stock-Based Compensation*

The Company adopted Statement of Financial Accounting Standards (SFAS) No. 123R, Share-Based Payments (SFAS 123R), on January 1, 2006. This statement requires the Company to recognize the cost of employee and director services received in exchange for the stock options it has awarded. Under SFAS 123R the Company is required to recognize compensation expense over an award's vesting period based on the award's fair value at the date of grant. The Company has elected to adopt SFAS 123R on a modified prospective basis; accordingly, the financial

statements for the periods prior to January 1, 2006 do not include stock based compensation under the fair value method. The Company uses the Black-Scholes option pricing model to value its stock option grants.

F-9

---

**Table of Contents**

**ENDOLOGIX, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(in thousands, except share or performance unit and per share amounts)**

Prior to January 1, 2006, the Company applied APB Opinion No. 25, Accounting for Stock Issued to Employees for measurement and recognition of stock based transactions with its employees and directors. If the Company had recognized compensation expense for its stock based transactions based on the fair value method prescribed by SFAS 123, net loss and net loss per share for the year ended December 31, 2005 would have been as follows:

	<b>2005</b>
Net loss, as reported	\$ (15,518)
Add: Stock-based employee compensation expense included in reported net loss	60
Deduct: Total stock-based employee compensation expense determined under fair value based method for all awards	(2,314)
Pro forma net loss	\$ (17,772)
Basic and diluted net loss per share, as reported	\$ (0.46)
Basic and diluted net loss per share, pro forma	\$ (0.52)
Expected Life (in years)	4.8
Expected Volatility	78.01%
Risk Free Interest Rate	3.9%
Dividend Yield	0.0%

The Company accounted for non-employee stock-based awards, in which goods or services are the consideration received for the stock options issued, in accordance with the provisions of SFAS No. 123 and related interpretations. Compensation expense for non-employee stock-based awards is recognized in accordance with FASB Interpretation 28, Accounting for Stock Appreciation Rights and Other Variable Stock Options or Award Plans, an Interpretation of APB Opinions No. 15 and 25 (FIN 28). Under FIN 28, the Company had recorded compensation expense based on the then-current fair values of the stock options at each financial reporting date. Compensation was recorded during the service period and was adjusted in subsequent periods for changes in the stock options' fair value.

In the past, the Company granted Performance Units under its 2004 Performance Compensation Plan (the Performance Plan). Under the Performance Plan, these units are granted at a discount to the fair market value (as defined in the Performance Plan) of the Company's common stock on the grant date (Base Value). The Performance Units vest over three years. The difference between the twenty-day average closing market price of the Company's common stock and the Base Value of the vested Performance Unit will be payable in cash at the first to occur of (a) a change of control (as defined in the Performance Plan), (b) the termination of employment for any reason other than Cause, or (c) upon exercise of the Performance Unit, which cannot occur until eighteen months from the grant date.

In 2007, 2006 and 2005, the Company granted a total of 0, 0, and 180,000 Performance Units, respectively. The weighted average Base Value for the 2005 grants was \$3.33. The Company recorded compensation expense of \$5 in 2007, a reduction in compensation expense of \$562 in 2006, and \$579 in compensation expense during 2005 based on vested service in accordance with FIN 28, which has been included in marketing and sales expense in the consolidated statements of operations. The Company will record changes in the estimated compensation expense until the Performance Units are paid in cash.

*Income Taxes*

The Company follows SFAS No. 109, Accounting for Income Taxes, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been recognized in different periods for financial statement purposes versus tax return purposes. Under this method, deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each year-end based on enacted tax laws and statutory rates applicable to the

periods in which the differences are expected to affect taxable income. Valuation allowances are

F-10

---

**Table of Contents**

**ENDOLOGIX, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(in thousands, except share or performance unit and per share amounts)**

established, when necessary, to reduce deferred tax assets when it is more likely than not that a portion of such assets will not be recoverable.

*Net Loss Per Share*

Net loss per common share is computed using the weighted average number of common shares outstanding during the periods presented. Because of the net losses during the years ended December 31, 2007, 2006 and 2005, options to purchase the common stock of the Company were excluded from the computation of net loss per share because the effect would have been antidilutive.

If anti-dilutive stock options were included, the number of shares used to compute net loss per share would have been increased by approximately 2,874,000 shares, 2,026,000 shares, and 1,323,000 shares for the years ended December 31, 2007, 2006 and 2005, respectively. Of these amounts, 2,678,000, 1,712,000, and 772,000 shares had an exercise price above the average closing price for the years ended December 31, 2007, 2006 and 2005, respectively.

*Research and Development Costs*

Research and development costs are expensed as incurred.

*Comprehensive Income (Loss)*

The Company accounts for elements of comprehensive income (loss) pursuant to SFAS No. 130, Reporting Comprehensive Income. Comprehensive income (loss) includes unrealized holding gains and losses and other items that have been previously excluded from net income (loss) and reflected instead in stockholders' equity. Comprehensive income (loss) includes net loss, the effect of foreign currency translation adjustments, and unrealized holding gains (losses) on marketable securities classified as available-for-sale.

*Product Warranty*

Within six months of shipment, customers may request replacement of products they receive that do not meet the manufacturer's product specifications. No other warranties are offered and the Company disclaims responsibility for any consequential or incidental damages associated with the use of the products. Historically, the Company has not experienced a significant amount of returns as a result of its product warranty policy.

*Recent Accounting Pronouncements*

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157, or SFAS 157, Fair Value Measurements, which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. Earlier adoption is permitted, provided the company has not yet issued financial statements, including for interim periods, for that fiscal year. The Company is currently evaluating the impact of SFAS 157 on its consolidated financial statements.

In July 2006, the FASB issued Financial Interpretation (FIN) No. 48, Accounting for Uncertainty in Income Taxes, which clarifies the accounting for uncertainty in income taxes recognized in the financial statements in accordance with SFAS No. 109, Accounting for Income Taxes. FIN 48 provides that a tax benefit from an uncertain tax position may be recognized when it is more likely than not that the position will be sustained upon examination, including resolutions of any related appeals or litigation processes, based on the technical merits. Income tax positions must meet a more-likely-than-not recognition threshold at the effective date to be recognized upon the adoption of FIN 48 and in subsequent periods. This interpretation also provides guidance on measurement, derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. FIN 48 is effective for fiscal years beginning after December 15, 2006. The Company adopted the provisions

**Table of Contents**

**ENDOLOGIX, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(in thousands, except share or performance unit and per share amounts)**

of FIN 48, on January 1, 2007. The Company did not recognize any additional liability for unrecognized tax benefit as a result of the implementation. The Company will recognize interest and penalties related to unrecognized tax benefits within the income tax expense line in the accompanying consolidated statement of operations. As of December 31, 2007, the Company has not recognized liabilities for penalty and interest as the Company does not have liability for unrecognized tax benefits.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159, or SFAS 159, The Fair Value Option for Financial Assets and Financial Liabilities Including an amendment of FASB Statement No. 115. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. Unrealized gains and losses on items for which the fair value option has been elected will be recognized in earnings at each subsequent reporting date. SFAS No. 159 is effective for the Company's fiscal year beginning January 1, 2008. The Company is currently evaluating the impact that the adoption of SFAS No. 159 will have on its consolidated financial statements.

In June 2007, the FASB's Emerging Issues Task Force reached a consensus on EITF Issue No. 07-3, Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities that would require nonrefundable advance payments made by the Company for future R&D activities to be capitalized and recognized as an expense as the goods or services are received by the Company. EITF Issue No. 07-3 is effective with respect to new arrangements entered into beginning January 1, 2008. The Company is currently evaluating the impacts and disclosures of this standard, but would not expect EITF Issue No. 07-3 to have a material impact on its consolidated financial statements.

In December 2007, the FASB's Emerging Issues Task Force issued EITF 07-01, Accounting for Collaborative Arrangements Related to the Development and Commercialization of Intellectual Property, or EITF 07-01. EITF-07-01 prescribes the accounting for collaborations. It requires certain transactions between collaborators to be recorded in the income statement on either a gross or net basis within expenses when certain characteristics exist in the collaboration relationship. EITF 07-01 is effective for all collaborations existing after January 1, 2008. The Company is evaluating the impact this standard will have on its financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 141(R), or SFAS 141(R), Business Combinations (revised 2007). SFAS 141(R) is a revision to previously existing guidance on accounting for business combinations. The statement retains the fundamental concept of the purchase method of accounting, and introduces new requirements for the recognition and measurement of assets acquired, liabilities assumed and noncontrolling interests. The statement is effective for fiscal years beginning after December 15, 2008. The Company does not expect adoption of this standard to have a material impact on its consolidated financial statements.

In December 2007, the FASB issued Statement of Financial Accounting Standards No. 160, or SFAS 160, Noncontrolling Interests in Consolidated Financial Statements. The Statement requires that noncontrolling interests be reported as stockholders equity. The Statement also establishes a single method of accounting for changes in a parent's ownership interest in a subsidiary as long as that ownership change does not result in deconsolidation. SFAS 160 is required to be applied prospectively in 2009, except for the presentation and disclosure requirements which are to be applied retrospectively. The statement is effective for fiscal years beginning after December 15, 2008. The Company is currently evaluating the impact of SFAS 160 and does not expect a material impact to its consolidated financial statements.

**2. License Agreements**

In June 1998, the Company signed a technology license agreement with Guidant granting Guidant the right to manufacture and distribute stent delivery products using the Company's Focus technology. Under the agreement, the Company was entitled to receive certain milestone payments based upon the transfer of the technology to Guidant, and royalty payments based upon the sale of products using the Focus technology. For the years ended December 31, 2007, 2006 and 2005, the Company recorded \$250, \$250, and \$250, respectively, in royalties under the agreement. At December 31, 2007 and 2006, \$182 and \$117, respectively, due under this agreement are included in other receivables

on the consolidated balance sheet. This royalty agreement expires in June of 2008, at which time Guidant will have a fully paid up license for the underlying technology.

In September 2006, the Company licensed to BioLucent, Inc., a privately held medical device company, rights under certain patents held by the Company. In September 2007, Hologic, Inc. purchased BioLucent, Inc. Pursuant to this acquisition, the Company had the option to continue the royalty arrangement or to receive a one-time cash payment in exchange for a fully-paid up license. The Company elected to receive the one-time payment of \$500. For the year ended December 31, 2007, the Company recorded \$504 in royalties under the agreement and all payments were received.

### **3. Restricted Cash Equivalents**

The Company has a \$475 line of credit with a bank in conjunction with a corporate credit card agreement. At December 31, 2007, the Company had pledged all of its cash equivalents held at the bank as collateral on the line of credit. Per the agreement, the Company must maintain a balance of at least \$500 in cash and cash equivalents with the bank.

F-12

---

**Table of Contents**

**ENDOLOGIX, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands, except share or performance unit and per share amounts)

**4. Marketable Securities Available-for-Sale**

The Company's investments in debt securities are diversified among high credit quality securities in accordance with the Company's investment policy. A major financial institution manages the Company's investment portfolio. Marketable Securities are classified as current or non-current depending on the security's maturity date. If the maturity date is less than one year from the balance sheet date, the security is classified as current. As of December 31, 2007, the Company was not invested in debt securities. All investment funds were held in liquid high yield money market funds. As of December 31, 2006, \$11,917 and \$1,500 of the Company's debt securities had original contractual maturities more than 90 days and less than one year and original contractual maturities between one to two years, respectively.

	<b>December 31, 2006</b>		
	<b>Cost</b>	<b>Gross Unrealized Holding Loss</b>	<b>Fair Value</b>
U.S. Treasury and other agencies debt securities	\$	\$	\$
Corporate debt securities	13,414	3	13,417
	\$ 13,414	\$ 3	\$ 13,417

**5. Receivables**

Receivables consist of the following at December 31, 2007 and 2006:

	<b>2007</b>	<b>2006</b>
Trade	\$ 4,527	\$ 2,763
Credit card rebate	43	
License	182	117
Interest	1	14
Other	8	67
Total other receivables	\$ 234	\$ 198

**6. Inventories**

Inventories consisted of the following:

	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>
Raw materials	\$ 2,760	\$ 2,325
Work in process	2,125	2,426
Finished goods	3,169	4,605
	\$ 8,054	\$ 9,356

**7. Property and Equipment**

Property and equipment consisted of the following:

	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>
Construction in progress	\$ 17	\$ 2,527
Leasehold improvements	2,032	1,982
Furniture and equipment	4,387	1,490
	6,436	5,999
Less accumulated depreciation and amortization	(2,665)	(1,483)
	\$ 3,771	\$ 4,516

F-13

---

**Table of Contents**

**ENDOLOGIX, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands, except share or performance unit and per share amounts)

**8. Intangibles**

Intangibles consisted of the following:

	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>
Developed technology	\$ 14,050	\$ 14,050
Accumulated amortization	(7,845)	(6,439)
	6,205	7,611
Trademarks and trade names	2,708	2,708
	\$ 8,913	\$ 10,319
Intangible assets, net		

**9. Line of Credit**

On February 21, 2007, the Company entered into a revolving credit facility, whereby it may borrow up to \$5.0 million. All outstanding amounts under the credit facility bear interest at a variable rate equal to the lender's prime rate plus 0.5%, which is payable on a monthly basis. The unused portion is subject to an unused revolving line facility fee, payable quarterly, in arrears, on a calendar year basis, in an amount equal to one quarter of one percent per annum of the average unused portion of the revolving line, as determined by the bank. The credit facility also contains customary covenants regarding operations of the Company's business and financial covenants relating to ratios of current assets to current liabilities and tangible net worth during any calendar quarter and is collateralized by the Company's assets with the exception of its intellectual property. All amounts owing under the credit facility will become due and payable on February 21, 2009.

As of December 31, 2007, the Company had no outstanding borrowings under the credit facility and is in compliance with all covenants.

**10. Accounts Payable and Accrued Expenses**

Accounts payable and accrued expenses consisted of the following:

	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>
Accounts payable	\$ 1,395	\$ 3,066
Customer Deposits	418	10
Accrued payroll and related expenses	2,071	1,526
Accrued clinical expenses	250	178
Accrued compensation	53	160
Other accrued expenses	72	69
	\$ 4,259	\$ 5,009

**11. Long Term Liabilities**

Long term liabilities consisted of the following:

	<b>December 31,</b>	
	<b>2007</b>	<b>2006</b>
Deferred tax	\$ 1,029	\$ 1,029
Deferred rent	80	143

\$ 1,109      \$ 1,172

F-14

---

**Table of Contents**

**ENDOLOGIX, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands, except share or performance unit and per share amounts)

**12. Commitments and Contingencies*****Sole-Source, Related-Party Supplier Agreement***

In February 1999, the Company entered into a supply agreement with Bard Peripheral Vascular Inc., a subsidiary of C.R. Bard, Inc for the supply of ePTFE. The supply agreement had an initial term through December 2007, at which time it automatically would renew on a year-by-year basis, unless either party were to give the other party notice of its intention not to renew within 30 days from the expiration date of the applicable renewal period. Under the terms of a third amendment to the supply agreement dated September 21, 2007, the minimum purchase requirement for the 2007 year was reduced from \$2,875 to \$2,200, the Company agreed to pay \$550 in consideration for the reduction, and both parties agreed to terminate the agreement on December 31, 2007. The \$550 paid to reduce the 2007 commitment was recorded as an operating expense in the quarter ended September 30, 2007.

During 2007, the Company purchased approximately \$2,200 of such materials, which fulfilled its 2007 purchase commitments. No future commitments exist under this agreement.

***Operating Leases***

The Company leases its administrative, research and manufacturing facilities and certain equipment under long-term, non-cancelable lease agreements that have been accounted for as operating leases. Certain of these leases include renewal options and require the Company to pay operating costs, including property taxes, insurance and maintenance as prescribed by the agreements.

Future minimum payments by year under non-cancelable operating leases with initial terms in excess of one year were as follows as of December 31, 2007:

Year Ending December 31,	
2008	344
2009	346
2010	87
Thereafter	
	\$ 777

Rental expense charged to operations for all operating leases during the years ended December 31, 2007, 2006 and 2005, was approximately \$329, \$336, and \$472, respectively.

***Employment Agreements and Retention Plan***

The Company has entered into employment agreements with its officers and key employees under which payment and benefits would become payable in the event of termination by the Company for any reason other than cause, or upon a change in control or corporate transaction, or by the key employee for good reason, as such terms are defined in the agreement. If due, the payment will generally be equal to six months of the key employee's then current salary for termination by the Company without cause or by the key employee for good reason, and generally be equal to twelve months of salary upon a change in control or corporate transaction.

**13. Stockholders' Equity*****Authorized Shares of Common Stock***

In October 2003, shareholders approved an increase in the number of authorized shares of common stock from 30,000,000 to 50,000,000. In May 2006, shareholders approved an amendment, which increased the number of authorized shares of common stock from 50,000,000 to 60,000,000.

**Table of Contents**

**ENDOLOGIX, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands, except share or performance unit and per share amounts)

***Sale of Common Stock***

In July 2005, the Company completed a private placement of 4,150,000 shares of its common stock at a purchase price of \$4.00 per share, which resulted in net proceeds of approximately \$15,450, after deducting the offering expenses.

In June 2006, the Company completed a registered direct public offering of 6,061,000 shares of its common stock at a purchase price of \$3.30 per share, which resulted in net proceeds of approximately \$18,750, after deducting the offering expenses.

***Treasury Stock***

In July 2002, the board of directors authorized a program for repurchases of the Company's outstanding common stock of up to \$1,500 under certain parameters. During the year ended December 31, 2003, the Company utilized \$456 to repurchase 268,000 shares of its common stock at a weighted average share price of \$1.71 per share. During the year ended December 31, 2002, the Company utilized \$205 to repurchase 227,000 shares of its common stock at a weighted average share price of \$.90 per share.

***Stock Option Plan***

Pursuant to the Company's 1996 Stock Option/Issuance Plan (the "1996 Plan") and the Company's 2006 Stock Incentive Plan (the "2006 Plan"), either incentive stock options or non-qualified options awards may be granted and under the 1997 Supplemental Stock Option Plan (the "1997 Plan" and together with the 1996 Plan and 2006 Plan, the

Plans), non-qualified option awards may be granted. Under the Plans, options are granted at a price not less than 100% for incentive stock options and 85% for non-qualified stock options of the value of the Company's common stock on the date of grant and are exercisable over a maximum term of ten years from the date of grant and generally vest over a four-year period. At December 31, 2007 and 2006, there were approximately 607,000 and 1,740,000 shares of common stock available for future stock option grants. The activity under the plans is summarized below:

	<b>2007</b>		<b>2006</b>		<b>2005</b>	
	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>	<b>Number of Shares</b>	<b>Weighted Average Exercise Price</b>
Outstanding						
Beginning of Year	3,396,929	\$ 4.38	2,678,201	\$ 4.53	1,793,363	\$ 3.85
Granted	1,556,500	4.08	1,309,300	3.77	1,201,800	5.50
Exercised	122,868	2.38	316,404	2.95	133,148	3.71
Forfeited	647,822	4.34	274,168	4.62	183,814	4.86
Expired	58,000	4.27				
Outstanding End of Year	4,124,739	\$ 4.34	3,396,929	\$ 4.38	2,678,201	\$ 4.53
Exercisable End of Year	2,059,617	\$ 4.56	1,579,764	\$ 4.53	1,302,155	\$ 3.94
Weighted Average Fair Value of Options Granted During Year		\$ 2.59		\$ 2.55		\$ 5.50

The total intrinsic value for options outstanding was approximately \$126, \$530 and \$6,358 as of December 31, 2007, 2006, and 2005, respectively. The total intrinsic value for options exercisable was approximately \$126, \$461, and \$3,873 as December 31, 2007, 2006, and 2005, respectively. The total intrinsic value of options exercised was approximately \$126, \$1,347, and \$358 in 2007, 2006, and 2005, respectively.

As of December 31, 2007, there was \$4,594 of total unrecognized compensation cost related to unvested options granted. This unrecognized compensation cost is expected to be recognized over a weighted average period of 2.3 years.

F-16

---

**Table of Contents**

**ENDOLOGIX, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands, except share or performance unit and per share amounts)

The following table summarizes information regarding stock options outstanding at December 31, 2007:

		Options Outstanding			Options Exercisable	
		Options	Weighted-Average Remaining Contractual Life	Weighted-Average Exercise Price	Options	Weighted-Average Exercise Price
Range of Exercise Prices		Outstanding	(Years)	Price	Exercisable	Price
\$0.77	3.00	252,720	6.5	\$ 2.36	132,720	\$ 1.90
3.07	3.40	560,850	8.4	3.39	317,093	3.40
3.42	3.90	544,500	7.9	3.63	186,355	3.61
3.92	4.26	548,499	7.9	4.02	261,167	3.93
4.29	4.44	741,000	9.3	4.32	9,375	4.44
4.45	4.88	371,729	7.7	4.58	242,563	4.57
4.94	5.68	441,900	4.2	5.19	372,963	5.17
5.81	8.75	663,541	7.0	6.09	537,381	6.11
0.77	8.75	4,124,739	7.6	\$ 4.34	2,059,617	\$ 4.56

The weighted-average grant-date fair value of options granted during 2007, 2006 and 2005 where the exercise price on the date of grant was equal to the stock price on that date, was \$2.59, \$2.55, and \$5.50, respectively.

***Stock Based Compensation***

As disclosed in Note 1 of Notes to Consolidated Financial Statements, effective January 1, 2006, the Company adopted Financial Accounting Standards Board Statement No. 123(R) Share Based Payment, or FAS 123R. FAS 123R establishes the accounting required for share based compensation, and requires companies to measure and recognize compensation expense for all share-based payments at the grant date based on the fair value of the award. This compensation expense shall be included in the statement of operations over the requisite service period. The provisions of FAS 123R apply to new stock options and stock options outstanding, but not yet vested on the effective date. For all unvested options outstanding as of January 1, 2006, compensation expense previously measured under Statement of Financial Accounting Standards No. 123, or FAS 123, Accounting for Stock-Based Compensation, but unrecognized, will be recognized using the straight-line method over the remaining vesting period. For share-based payments granted subsequent to January 1, 2006, compensation expense, based on the fair value on the date of grant, as defined by FAS 123R, will be recognized using the straight-line method from the date of grant over the service period of the employee receiving the award.

FAS 123R requires the estimation of forfeitures when recognizing compensation expense and that this estimate of forfeitures be adjusted over the requisite service period should actual forfeitures differ from such estimates. Changes in estimated forfeitures are recognized through a cumulative catch-up adjustment, which is recorded in the period of change and which impacts the amount of unamortized compensation expense to be recognized in future periods. Share-based compensation expense recognized in the Company's consolidated statements of operations in 2006 and 2007 includes (i) compensation expense for share-based payment awards granted prior to, but not vested as of December 31, 2005, based on the grant-date fair value estimated in accordance with the pro forma provisions of FAS 123 and (ii) compensation expense for the share-based payment awards granted subsequent to December 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of FAS 123R. As share-based compensation expense recognized in the consolidated statement of operations for the fiscal year 2006 and 2007 is based on awards ultimately expected to vest, it has been reduced for estimated forfeitures. In the Company's pro forma

information required by FAS 123 for the periods prior to fiscal year 2006, the Company accounted for forfeitures as they occurred.

The Company elected to adopt FAS 123R using the modified prospective application approach which requires the Company to value unvested stock options granted prior to its adoption of FAS 123R under the fair value method and expense these amounts in the statement of operations over the stock option's remaining vesting period. Prior periods are not required to be restated. Prior to the effective date of FAS 123R the Company applied the disclosure-only provisions of FAS 123. In accordance with the provisions of FAS 123, the Company applied Accounting Principles Board Opinion No. 25, or APB 25, Accounting for Stock Issued to Employees, and related interpretations in accounting for its stock option plans. Under the provisions of APB 25, the Company recognized compensation expense only to the extent that the exercise price of the Company's employee stock options was less than the market price of the underlying stock at date of grant.

F-17

---

**Table of Contents**

**ENDOLOGIX, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(in thousands, except share or performance unit and per share amounts)**

The Company uses the Black-Scholes option pricing model which requires extensive use of financial estimates and accounting judgment, including estimates of the expected period of time employees will retain their vested stock options before exercising them, the expected volatility of the Company's common stock over the expected term, and the number of shares that are expected to be forfeited before they are vested. Application of alternative assumptions could produce significantly different estimates of the fair value of the stock-based compensation and as a result, significantly different results recognized in the consolidated statements of operations.

The weighted average of the assumptions used to estimate the fair value of stock options granted using the Black-Scholes valuation method were as follows:

	2007	2006
Expected Life (in years) (1)	5.5	5.5
Expected Volatility (2)	71.2%	75.8%
Risk Free Interest Rate (3)	4.5%	4.9%
Dividend Yield (4)	0.0%	0.0%

1. Estimated based on historical experience.
2. Volatility based on historical experience over a period equivalent to the expected life in years.
3. Based on the US Treasury constant maturity interest rate with a term consistent with the expected life of the options granted.
4. The Company does not pay dividends on its common stock and the Company currently does not have any plans to pay or

declare any cash  
dividends.

Expense recorded pursuant to FAS 123R during was as follows:

	2007	2006
General and Administrative	\$ 894	\$ 767
Marketing and Sales	878	448
Research, Development, and Clinical	417	347
Cost of Sales	195	72
Total Stock Based Compensation	\$ 2,384	\$ 1,634

In addition, the Company has \$177 and \$130 of stock based compensation capitalized in inventory as of December 31, 2007, and 2006.

Expense related to non-employee stock options is being amortized over the vesting period, which is generally four years. During the years ended December 31, 2007, 2006, and 2005, \$42, \$(6), and \$31, respectively, was recorded as compensation expense for the change in the fair value of unvested non-employee option grants. During the years ended December 31, 2007, 2006 and 2005, the Company granted 10,000, 20,000, and -0- options, respectively, to non-employees. As of December 31, 2007, 2006 and 2005, a total of 187,000, 220,100, and 236,100 non-employee stock options, respectively, were outstanding. As of December 31, 2007, 2006, and 2005, a total of 168,667, 207,000, and 232,100, non-employee stock options, respectively, were fully vested.

#### ***Stock Purchase Plan***

Under the terms of the Company's 1996 Employee Stock Purchase Plan (the "Purchase Plan"), eligible employees can purchase common stock through payroll deductions at a price equal to the lower of 85% of the fair market value of the Company's common stock at the beginning or end of the applicable offering period. In 2006, an additional 250,000 shares of common stock were approved for issuance under the Purchase Plan. During 2007,

F-18

**Table of Contents**

**ENDOLOGIX, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
(in thousands, except share or performance unit and per share amounts)

2006, and 2005, a total of approximately 180,000, 77,000, and 34,000 shares of common stock, respectively, were purchased at an average price of \$2.74, \$4.11, and \$3.58, respectively.

**14. Income Taxes**

Income tax expense (benefit) consists of the following:

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Current			
Federal	\$	\$	\$
State	2	3	
Foreign		3	
	2	3	
Deferred			
Federal			
State			
Total tax expense (benefit)	\$ 2	\$ 3	\$

Income taxes for 2007, 2006 and 2005 differ from expected income taxes for those years computed by applying the U.S. federal statutory rate of 34% to income/(loss) before taxes for those years as follows:

	<b>2007</b>	<b>2006</b>	<b>2005</b>
Tax expense (benefit) at U.S. statutory rate	\$ (5,126)	\$ (5,965)	\$ (5,267)
State tax (benefit) net of federal benefit	(493)	(662)	(612)
Meals & Entertainment (50% addback)	114	76	51
Research & Development Credits	(201)	(39)	(357)
Stock based compensation	456	437	
Net change in valuation allowance	5,240	5,811	4,609
Other, net	12	345	1,576
	\$ 2	\$ 3	\$

Significant components of the Company's deferred tax assets and (liabilities) are as follows at December 31:

	<b>2007</b>	<b>2006</b>
Net operating loss carryforwards	\$ 36,257	\$ 32,783
Accrued expenses	181	140
Tax credits	6,232	5,734
License fees	61	73
Inventory	248	30
Capitalized research and development	401	613
Developed technology	(2,337)	(2,903)
Trademarks and tradenames	(1,029)	(1,029)
Deferred compensation	803	441
Other	746	164

Deferred tax assets	41,563	36,046
Valuation allowance	(42,592)	(37,075)
Net deferred tax liability	\$ (1,029)	\$ (1,029)

Based upon the Company's history of continuing operating losses, realization of its deferred tax assets does not meet the more likely than not criteria under SFAS No. 109. The Company recorded a valuation allowance of \$42.6 million. In determining the net asset subject to a valuation allowance, the Company exceeded a deferred tax liability related to its indefinite-lived other intangible assets that is not expected to reverse in the foreseeable future resulting in a net deferred tax liability of approximately \$1.0 million after application of the valuation allowance.

The valuation allowance increased by \$5,517, \$6,651, and \$3,815 in 2007, 2006 and 2005, respectively.

At December 31, 2007, the Company has net operating loss carryforwards for federal and state income tax purposes of approximately \$100,248 and \$60,261, respectively. The federal net operating loss carryforward will begin expiring in 2015. The state net operating loss began expiring in the current year. In addition, the Company has research and development and other tax credits for federal and state income tax purposes of approximately \$3,239, and \$2,882, respectively, which begin to expire in 2018. The state research and development credits do not expire for California purposes. In addition, the Company has approximately \$110 of California Manufacturers' Investment Credits, which begin to expire in 2010.

As a result of certain realization requirements of SFAS 123(R), the table of deferred tax assets and liabilities shown above does not include certain deferred tax assets at December 31, 2007 and 2006 that arose directly from (or the use of which was postponed by) tax deductions related to equity compensation in excess of compensation recognized for financial reporting. Those deferred tax assets include federal and state net operating losses. Equity will be increased by \$454 if and when such deferred tax assets are ultimately realized. The Company uses SFAS 109 ordering for purposes of determining when excess tax benefits have been realized.

Utilization of the NOL and R&D credit carryforwards may be subject to a substantial annual limitation due to ownership change limitations that may have occurred or that could occur in the future, as required by Section 382 of the Internal Revenue Code of 1986, as amended (the Code), as well as similar state and foreign provisions. These ownership changes may limit the amount of NOL and R&D credit carryforwards that can be utilized annually to offset future taxable income and tax, respectively. In general, an ownership change as defined by Section 382 of the Code results from a transaction or series of transactions over a three-year period resulting in an ownership

**Table of Contents**

**ENDOLOGIX, INC.  
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(in thousands, except share or performance unit and per share amounts)**

change of more than 50 percentage points of the outstanding stock of a company by certain stockholders or public groups. Since the Company's formation, the Company has raised capital through the issuance of capital stock on several occasions which, combined with the purchasing stockholders' subsequent disposition of those shares, may have resulted in such an ownership change, or could result in an ownership change in the future upon subsequent disposition.

The Company has not completed a study to assess whether an ownership change has occurred or whether there have been multiple ownership changes since the Company's formation due to the complexity and cost associated with such a study, and the fact that there may be additional such ownership changes in the future. If the Company has experienced an ownership change at any time since its formation, utilization of the NOL or R&D credit carryforwards would be subject to an annual limitation under Section 382 of the Code, which is determined by first multiplying the value of the Company's stock at the time of the ownership change by the applicable long-term, tax-exempt rate, and then could be subject to additional adjustments, as required. Any limitation may result in expiration of a portion of the NOL or R&D credit carryforwards before utilization. Further, until a study is completed and any limitation known, no amounts are being considered as an uncertain tax position or disclosed as an unrecognized tax benefit under FIN 48. Due to the existence of the valuation allowance, future changes in the Company's unrecognized tax benefits will not impact its effective tax rate. Any carryforwards that will expire prior to utilization as a result of such limitations will be removed from deferred tax assets with a corresponding reduction of the valuation allowance.

As of December 31, 2007, a portion of the federal and state valuation allowance includes tax benefits of stock option deductions that are also included in the Company's net operating loss carryforwards. At such time as the valuation allowance is reduced (if at all, subject to change in ownership limitations described above), the benefit will be first credited to income tax expense. Thereafter, the benefit will be credited to additional paid-in capital.

The results of operations for the years ended December 31, 2007, 2006 and 2005 include the net losses of the Company's wholly-owned German subsidiary of \$14, \$17, and \$24, respectively.

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes, on January 1, 2007. The Company did not recognize any additional liability for unrecognized tax benefit as a result of the implementation. As of December 31, 2007, the Company did not increase or decrease liability for unrecognized tax benefit related to tax positions in prior period nor did the company increase its liability for any tax positions in the current year. Furthermore, there were no adjustments to the liability or lapse of statute of limitation or settlements with taxing authorities.

The Company expects resolution of unrecognized tax benefits, if created, would occur while the full valuation allowance of deferred tax assets is maintained, therefore, the Company does not expect to have any unrecognized tax benefits that, if recognized, that would affect the effective tax rate.

The Company will recognize interest and penalty related to unrecognized tax benefits and penalties as income tax expense. As of December 31, 2007, the Company has not recognized liabilities for penalty and interest as the Company does not have liability for unrecognized tax benefits.

The Company is subject to taxation in the US and various states. The company's tax years for 2004, 2005, and 2006 are subject to examination by the taxing authorities. With few exceptions, the Company is no longer subject to U.S. federal, state, local or foreign examinations by taxing authorities for years before 2004.

**15. Employee Benefit Plan**

The Company provides a 401(k) Plan for all employees 21 years of age or older. Under the 401(k) Plan, eligible employees voluntarily contribute to the Plan up to 100% of their salary through payroll deductions. Employer contributions may be made by the Company at its discretion based upon matching employee contributions, within limits, and profit sharing provided for in the Plan. No employer contributions were made in 2007, 2006, or 2005.

**16. Legal Matters**

The Company is a party to ordinary disputes arising in the normal course of business, including an intellectual property infringement claim as well as claims with respect to its employment of former employees of its competitors.

Management is of the opinion that the outcome of these matters will not have a material adverse effect on the Company's consolidated financial position, results of operations or cash flow.

F-20

---

**Table of Contents**

(b) Financial Statement Schedule

**ENDOLOGIX, INC.**  
**SCHEDULE II VALUATION AND QUALIFYING ACCOUNTS**  
**Years Ended December 31, 2007, 2006 and 2005**

Column A	Column B	Column C	Column D	Column E
Description	Balance at Beginning of Period	Additions (Reductions) Charges to Costs and Expenses Charged to Other Accounts (In thousands)	Deductions(a)	Balance at End of Period
<b>Year ended December 31, 2007</b>				
Allowance for doubtful accounts	\$ 38	\$ 81	\$ (19)	\$ 100
Reserve for excess and obsolete inventories	\$ 79	\$ 777	\$ (196)	\$ 660
Income tax valuation allowance	\$ 37,075	\$ 5,517	\$	\$ 42,592
<b>Year ended December 31, 2006</b>				
Allowance for doubtful accounts	\$ 26	\$ 38	\$ (26)	\$ 38
Reserve for excess and obsolete inventories	\$ 426	\$ 488	\$ (835)	\$ 79
Income tax valuation allowance	\$ 30,424	\$ 6,651	\$	\$ 37,075
<b>Year ended December 31, 2005</b>				
Allowance for doubtful accounts	\$ 31	\$	\$ (5)	\$ 26
Reserve for excess and obsolete inventories	\$ 65	\$ 780	\$ (419)	\$ 426
Income tax valuation allowance	\$ 26,609	\$ 3,815	\$	\$ 30,424

(a) Deductions represent the actual write-off of accounts receivable balances or the disposal of inventory.

**Table of Contents**

**EXHIBIT INDEX**

<b>Exhibit Number</b>	<b>Description</b>
3.1	Amended and Restated Certificate of Incorporation (Incorporated by reference to Exhibit 4.1 to Endologix Registration Statement on Form S-8, filed with the SEC on August 7, 2006).
3.2	Amended and Restated Bylaws (Incorporated by reference to Exhibit 3.2 to Endologix Annual Report on Form 10-K filed with the SEC on March 29, 2001).
4.1	Specimen Certificate of Common Stock (Incorporated by reference to Exhibit 4.1 to Amendment No. 2 to Endologix Registration Statement on Form S-1, No. 333-04560, filed with the SEC on June 10, 1996).
10.1(2)	Employee Stock Purchase Plan and forms of agreement thereunder (Incorporated by reference to Exhibit 4.1 to Endologix Registration Statement on Form S-8, No. 333-114465, filed with the SEC on April 14, 2004).
10.2(2)	1997 Supplemental Stock Option Plan (Incorporated by reference to Exhibit 99.1 to Endologix Registration Statement on Form S-8, No. 333-42161, filed with the SEC on December 12, 1997).
10.3(1)	License Agreement by and between Endologix and Guidant dated June 19, 1998 (Incorporated by reference to Exhibit 10.24 to Endologix Quarterly Report on Form 10-Q, filed with the SEC on August 11, 1998).
10.4(2)	1996 Stock Option/Stock Issuance Plan (Incorporated by reference to Exhibit 4.1 to Endologix Registration Statement on Form S-8, No. 333-122491, filed with the SEC on February 2, 2005).
10.5(2)	1997 Stock Option Plan assumed by Endologix pursuant to its acquisition of Radiance Medical Systems, Inc. on January 14, 1999 (Incorporated by reference to Exhibit 99.2 to Endologix Registration Statement on Form S-8, No. 333-72531, filed with the SEC on February 17, 1999).
10.6(2)	2006 Stock Incentive Plan (Incorporated by reference to Exhibit 10.1 to Endologix Current Report on Form 8-K, filed with the SEC on May 26, 2006).
10.6.1(2)	Stock Option Agreement under 2006 Stock Incentive Plan (Incorporated by reference to Exhibit 10.1 to Endologix Quarterly Report on Form 10-Q, filed with the SEC on November 9, 2006).
10.6.2(1)	Restricted Stock Award Agreement under 2006 Stock Incentive Plan (Incorporated by reference to Exhibit 10.2 to Endologix Quarterly Report on Form 10-Q, filed with the SEC on November 9, 2006).
10.7(2)	2006 Employee Stock Purchase Plan (Incorporated by reference to Exhibit 10.2 to Endologix Current Report on Form 8-K, filed with the SEC on May 26, 2006).
10.9	Form of Indemnification Agreement entered into with Endologix officers and directors (Incorporated by reference to Exhibit 10.41 to Endologix Quarterly Report on Form 10-Q, filed with the SEC on November 13, 2002).

**Table of Contents**

<b>Exhibit Number</b>	<b>Description</b>
10.10(2)	Form of Employment Agreement with certain officers of Endologix (Incorporated by reference to Exhibit 10.42 to Endologix Annual Report on Form 10-K, filed with the SEC on March 27, 2003).
10.10.1	Schedule of officers of Endologix party to the Employment Agreement.
10.11	Standard Industrial/Commercial Single-Tenant Lease Net, dated November 2, 2004, by and between Endologix and Del Monico Investments, Inc. (Incorporated by reference to Exhibit 10.46 to Endologix Current Report on Form 8-K, filed with the SEC on November 24, 2004).
10.12	Stock Purchase Agreement, dated July 5, 2005, by and between Endologix and the investors named therein (Incorporated by reference to Exhibit 10.48 to Endologix Current Report on Form 8-K, filed with the SEC on July 8, 2005).
10.13	Loan and Security Agreement, dated as of February 21, 2007, by and between Endologix and Silicon Valley Bank (Incorporated by reference to Exhibit 10.13 to Endologix Quarterly Report on Form 10-Q, filed with the SEC on May 9, 2007).
14	Code of Ethics for Chief Executive Officer and Principal Financial Officers (Incorporated by reference to Exhibit 14 to Endologix Annual Report on Form 10-K filed with the SEC on March 26, 2004).
21.1	List of Subsidiaries.
23.1	Consent of Independent Registered Public Accounting Firm.
24.1	Power of Attorney (included on signature page hereto).
31.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934.
31.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(a)/15d-14(a) under the Securities Exchange Act of 1934.
32.1	Certification of Chief Executive Officer Pursuant to Rule 13a-14(b)/15d-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
32.2	Certification of Chief Financial Officer Pursuant to Rule 13a-14(b)/15d-14(b) under the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
(1)	Portions of this exhibit are omitted and were filed separately with the Securities and Exchange Commission

pursuant to  
Endologix  
application  
requesting  
confidential  
treatment under  
Rule 24b-2 of  
the Securities  
Exchange Act  
of 1934.

- (2) These exhibits  
are identified as  
management  
contracts or  
compensatory  
plans or  
arrangements of  
Endologix  
pursuant to  
Item 15(a)(3) of  
Form 10-K.