QUIDEL CORP /DE/
Form 10-Q
October 28, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 0-10961

QUIDEL CORPORATION
(Exact name of registrant as specified in its charter)

Delaware	94-2573850
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

12544 High Bluff Drive, Suite 200, San Diego, California 92130
(Address of principal executive offices, including zip code)
(858) 552-1100
(Registrant's telephone number, including area code)
Not Applicable
(Former name, former address and former fiscal year, if changed since last report)

Indicate by check mark whether the Registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the Registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No ¨
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨
Indicate by check mark whether the Registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See 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 x	Accelerated filer ¨
Non-accelerated filer (Do not check if a smaller reporting company) ¨	Smaller reporting company ¨

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

As of October 21, 2016, 32,643,557 shares of the registrant's common stock were outstanding.

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PART I FINANCIAL INFORMATION

ITEM 1. Financial Statements

QUIDEL CORPORATION
CONSOLIDATED BALANCE SHEETS
(in thousands, except par value; unaudited)

	September 30, 2016	December 31, 2015
ASSETS		
Current assets:		
Cash and cash equivalents	$153,363	$191,471
Accounts receivable, net	26,191	18,398
Inventories	23,364	26,388
Restricted cash	—	63
Prepaid expenses and other current assets	5,617	4,344
Total current assets	208,535	240,664
Property, plant and equipment, net	50,204	52,547
Goodwill	83,864	80,730
Intangible assets, net	28,616	31,833
Deferred tax asset—non-current	4,746	—
Other non-current assets	532	731
Total assets	$376,497	$406,505
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$11,296	$8,675
Accrued payroll and related expenses	7,907	9,627
Current portion of lease obligation	624	585
Current portion of contingent consideration (see Note 9)	630	1,286
Deferred grant revenue	—	3,658
Other current liabilities	4,891	6,999
Total current liabilities	25,348	30,830
Long-term debt	142,986	143,297
Lease obligation, net of current portion	3,560	4,032
Contingent consideration—non-current (see Note 9)	4,445	4,230
Deferred tax liability—non-current	55	1,970
Income taxes payable	985	910
Deferred rent	2,054	2,296
Other non-current liabilities	317	264
Commitments and contingencies (see Note 9)		
Stockholders' equity:		
Preferred stock, $.001 par value per share; 5,000 shares authorized; none issued or outstanding at September 30, 2016 and December 31, 2015	—	—
Common stock, $.001 par value per share; 97,500 shares authorized; 32,644 and 33,323 shares issued and outstanding at September 30, 2016 and December 31, 2015, respectively	33	33
Additional paid-in capital	199,049	209,121
Accumulated other comprehensive loss	(30)	(31)
(Accumulated deficit) retained earnings	(2,305)	9,553
Total stockholders' equity	196,747	218,676
Total liabilities and stockholders' equity	$376,497	$406,505

See accompanying notes.

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QUIDEL CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data; unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Total revenues	$49,341	$46,812	$138,795	$143,717
Costs and expenses				
Cost of sales (excludes amortization of intangible assets of $1,590, $1,590, $4,770 and $4,751, respectively)	17,728	16,961	54,295	53,566
Research and development	8,801	8,419	31,164	25,575
Sales and marketing	11,853	12,112	36,376	35,823
General and administrative	6,561	5,889	20,532	22,039
Amortization of intangible assets from acquired businesses and technology	2,273	2,219	6,782	6,638
Total costs and expenses	47,216	45,600	149,149	143,641
Operating income (loss)	2,125	1,212	(10,354)	76
Interest expense, net	(3,006)	(3,090)	(8,619)	(9,046)
Loss before taxes	(881)	(1,878)	(18,973)	(8,970)
Benefit for income taxes	(309)	(1,116)	(7,115)	(3,268)
Net loss	$(572)	$(762)	$(11,858)	$(5,702)
Basic and diluted loss per share	$(0.02)	$(0.02)	$(0.36)	$(0.17)
Shares used in basic and diluted per share calculation	32,673	33,683	32,645	34,313

See accompanying notes.

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QUIDEL CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(in thousands; unaudited)

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Net loss	$(572)	$(762)	$(11,858)	$(5,702)
Other comprehensive (loss) income, net of tax				
Changes in cumulative translation adjustment	3	(8)	1	6
Comprehensive loss	$(569)	$(770)	$(11,857)	$(5,696)

See accompanying notes.

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QUIDEL CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands; unaudited)

	Nine months ended September 30,	
	2016	2015
OPERATING ACTIVITIES:		
Net loss	$(11,858)	$(5,702)
Adjustments to reconcile net loss to net cash (used for) provided by operating activities:		
Depreciation, amortization and other	17,597	17,537
Stock-based compensation expense	5,820	5,713
Amortization of debt discount and deferred issuance costs	4,266	4,232
Change in deferred tax assets and liabilities	(7,375)	(6,368)
Change in fair value of acquisition contingencies	(589)	—
Gain on extinguishment of Convertible Senior Notes	(421)	—
Changes in assets and liabilities:		
Accounts receivable	(7,464)	3,441
Inventories	3,544	186
Income taxes receivable	(248)	234
Prepaid expenses and other current and non-current assets	(1,047)	(305)
Restricted cash	63	1,317
Accounts payable	984	(1,947)
Accrued payroll and related expenses	(1,867)	772
Income taxes payable	(12)	729
Deferred grant revenue	(3,658)	(813)
Other current and non-current liabilities	(2,541)	1,226
Net cash (used for) provided by operating activities:	(4,806)	20,252
INVESTING ACTIVITIES:		
Acquisitions of property, equipment and intangibles	(7,860)	(12,003)
Acquisition of Immutopics, net of cash acquired	(5,061)	—
Net cash used for investing activities:	(12,921)	(12,003)
FINANCING ACTIVITIES:		
Payments on lease obligation	(433)	(375)
Repurchases of common stock	(20,096)	(27,617)
Repurchases of Convertible Senior Notes	(4,459)	—
Proceeds from issuance of common stock	4,821	2,152
Payments of debt issuance costs	—	(365)
Payments on acquisition contingencies	(207)	(129)
Payment for acquisition holdback	—	(229)
Net cash used for financing activities:	(20,374)	(26,563)
Effect of exchange rates on cash	(7)	(21)
Net decrease in cash and cash equivalents	(38,108)	(18,335)
Cash and cash equivalents, beginning of period	191,471	200,895
Cash and cash equivalents, end of period	$153,363	$182,560

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	Nine months ended September 30,	
	2016	2015
SUPPLEMENTAL DISCLOSURES OF CASH FLOW INFORMATION:		
Cash paid for interest	$3,331	$3,744
Cash paid for income taxes	$459	$1,920
NON-CASH INVESTING ACTIVITIES:		
Purchase of property, equipment and intangibles by incurring current liabilities	$1,866	$1,433
NON-CASH FINANCING ACTIVITIES:		
Reduction of other current liabilities upon issuance of restricted share units	$539	$408

See accompanying notes.

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Quidel Corporation
Notes to Consolidated Financial Statements
(Unaudited)

Note 1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited consolidated financial statements of Quidel Corporation and its subsidiaries (the "Company") have been prepared in accordance with generally accepted accounting principles in the United States ("GAAP") for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments considered necessary for a fair presentation (consisting of normal recurring accruals) have been included.

The information at September 30, 2016, and for the three and nine months ended September 30, 2016 and 2015, is unaudited. For further information, refer to the Company's consolidated financial statements and notes thereto for the year ended December 31, 2015 included in the Company's 2015 Annual Report on Form 10-K. Operating results for any quarter are historically seasonal in nature and are not necessarily indicative of the results expected for the full year.

For 2016 and 2015, the Company's fiscal year will end or has ended on January 1, 2017 and January 3, 2016, respectively. For 2016 and 2015, the Company's third quarter ended on October 2, 2016 and September 27, 2015, respectively. For ease of reference, the calendar quarter end dates are used herein. The three and nine month periods ended September 30, 2016 and 2015 each included 13 and 39 weeks, respectively.

Comprehensive Loss

Comprehensive loss includes foreign currency translation adjustments excluded from the Company's Consolidated Statements of Operations.

Use of Estimates

The preparation of financial statements requires the Company to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses, and related disclosure of contingent assets and liabilities. On an on-going basis, management evaluates its estimates, including those related to revenue recognition, customer programs and incentives, bad debts, inventories, intangible assets, software development costs, stock-based compensation, contingencies and litigation, contingent consideration, the fair value of the debt component of convertible debt instruments and income taxes. Management bases its estimates on historical experience and on various other assumptions that it believes are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates.

Revenue Recognition

The Company records revenues primarily from product sales. These revenues are recorded net of rebates and other discounts that are estimated at the time of sale, and are largely driven by various customer program offerings, including special pricing agreements, promotions and other volume-based incentives. Revenue from product sales are recorded upon passage of title and risk of loss to the customer. Passage of title to the product and recognition of revenue occurs upon delivery to the customer when sales terms are free on board ("FOB") destination and at the time of shipment when the sales terms are FOB shipping point and there is no right of return.

A portion of product sales includes revenues for diagnostic kits, which are utilized on leased instrument systems under the Company's "reagent rental" program. The reagent rental program provides customers the right to use the instruments at no separate cost to the customer in consideration for a multi-year agreement to purchase annual minimum amounts of consumables ("reagents" or "diagnostic kits"). When an instrument is placed with a customer under a reagent rental agreement, the Company retains title to the equipment and it remains capitalized on the Company's Consolidated Balance Sheets as property and equipment. The instrument is depreciated on a straight-line basis over the life of the instrument. Depreciation expense is recorded in cost of sales included in the Consolidated Statements of Operations. The reagent rental agreements represent one unit of accounting as the instrument and consumables (reagents) are interdependent in producing a diagnostic result and neither has a stand-alone value with respect to these agreements.

No revenue is recognized at the time of instrument placement. All revenue is recognized when the title and risk of loss for the diagnostic kits have passed to the customer.

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Royalty income from the grant of license rights is recognized during the period in which the revenue is earned and the amount is determinable from the licensee.

The Company earns income from grants for research and commercialization activities. On November 6, 2012, the Company was awarded a milestone-based grant totaling up to $8.3 million from the Bill and Melinda Gates Foundation to develop, manufacture and validate a quantitative, low-cost, nucleic acid assay for HIV drug treatment monitoring on the integrated Savanna MDx platform for use in limited resource settings. Upon execution of the grant agreement, the Company received $2.6 million to fund subsequent research and development activities and received milestone payments totaling $2.5 million in 2013. On September 10, 2014, the Company entered into an amended grant agreement with the Bill and Melinda Gates Foundation for additional funding of up to $12.6 million in order to accelerate the development of the Savanna MDx platform in the developing world. Upon execution of the amended grant agreement, the Company received $10.6 million in cash. The Company received payments of $2.4 million in April 2015 and $2.8 million in July 2016 based on milestone achievements for both the original and the amended grant agreements. Under the original and amended grant agreements, the Company recognizes grant revenue on the basis of the lesser of the amount recognized on a proportional performance basis or the amount of cash payments that are non-refundable as of the end of each reporting period. The Company recognized grant revenue of $3.8 million and $0.8 million for the three months ended September 30, 2016 and 2015, respectively, and recognized $6.5 million and $3.2 million for the nine months ended September 30, 2016 and 2015, respectively. Cash payments received are restricted as to use until expenditures contemplated in the grant are incurred or committed. As of September 30, 2016, all payment related milestones have been achieved and all of the grant revenue of $20.9 million has been recorded.

Fair Value Measurements

The Company uses the fair value hierarchy established in ASC Topic 820, Fair Value Measurements and Disclosures, that requires the valuation of assets and liabilities subject to fair value measurements using a three tiered approach and fair value measurement be classified and disclosed by the Company in one of the following three categories:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities;

Level 2: Quoted prices for similar assets and liabilities in active markets, quoted prices in markets that are not active, or inputs which are observable, either directly or indirectly, for substantially the full term of the asset or liability;

Level 3: Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable (i.e. supported by little or no market activity).

The carrying amounts of the Company’s financial instruments, including cash, receivables, accounts payable, and accrued liabilities approximate their fair values due to their short-term nature.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board (“FASB”) issued guidance codified in Accounting Standards Update (“ASU”) 2014-09, Revenue from Contracts with Customers, which amends the guidance in former ASC 605, Revenue Recognition. This guidance is intended to improve and converge with international standards relating to the financial reporting requirements for revenue from contracts with customers. The standard’s core principle is that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. In doing so, companies will need to use more judgment and make more estimates than under current authoritative guidance. These may include identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The original guidance was effective for annual reporting periods beginning after December 15, 2016. However, in July 2015, the FASB deferred by one year the effective dates of the new revenue recognition standard for entities reporting under GAAP. As a result, the standard will be effective for public entities for annual reporting periods beginning after December 15, 2017, including interim periods therein. The Company is currently evaluating the impact of this guidance and expects to adopt the standard in the first quarter of 2018.

In August 2014, the FASB issued guidance codified in ASU 2014-15 (Subtopic 205-40), Presentation of Financial Statements - Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern. The guidance

requires management to evaluate whether there are conditions and events that raise substantial doubt about the entity's ability to continue as a going concern within one year after the financial statements are issued (or available to be issued when applicable). Management will be required to make this evaluation for both annual and interim reporting periods and will make certain disclosures if it concludes that substantial doubt exists or when its plans alleviate substantial doubt about the entity's

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ability to continue as a going concern. Substantial doubt exists when relevant conditions and events, considered in the aggregate, indicate that it is probable that the entity will be unable to meet its obligations as they become due within one year after the date that the financial statements are issued (or available to be issued). The term probable is used consistently with its use in ASC Topic 450, Contingencies. The guidance is effective for annual periods ending after December 15, 2016 and for interim reporting periods starting in the first quarter 2017, with early adoption permitted. The Company does not expect this guidance to have a significant impact on the consolidated financial statements and expects to adopt the standard for the annual reporting period ended December 31, 2016.

In February 2015, the FASB issued guidance codified in ASU 2015-02 (Topic 810), Consolidation - Amendments to the Consolidation Analysis. The guidance affects reporting entities that are required to evaluate whether they should consolidate certain legal entities. Specifically, the guidance amends (i) the identification of variable interests (fees paid to a decision maker or service provider), (ii) the variable interest entity (VIE) characteristics for a limited partnership or similar entity and (iii) the primary beneficiary determination. The guidance is effective for annual periods beginning after December 15, 2015 and for interim reporting periods starting in the first quarter 2016. The Company's adoption of this guidance in the first quarter of 2016 did not have a significant impact on the consolidated financial statements.

In July 2015, the FASB issued guidance codified in ASU 2015-11 (Topic 330), Simplifying the Measurement of Inventory. The guidance applies to inventory that is measured using first-in, first-out (“FIFO”) or average cost. Under the guidance, an entity should measure inventory that is within scope at the lower of cost and net realizable value, which is the estimated selling prices in the ordinary course of business, less reasonably predictable costs of completion, disposal and transportation. The guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years, with early adoption permitted as of the beginning of an interim or annual reporting period. The Company's adoption of this guidance in the first quarter of 2016 did not have a significant impact on the consolidated financial statements.

In February 2016, the FASB issued guidance codified in ASU 2016-02 (Topic 842), Leases. The guidance requires a lessee to recognize a lease liability for the obligation to make lease payments and a right-to-use asset representing the right to use the underlying asset for the lease term on the balance sheet. The guidance is effective for fiscal years beginning after December 15, 2018 including interim periods within those years, with early adoption permitted. The Company is currently evaluating the impact of this guidance and expects to adopt the standard in the first quarter of 2019.

In March 2016, the FASB issued guidance codified in ASU 2016-09 (Topic 718), Improvements to Employee Share Based Payments Accounting. Under the guidance, entities will no longer record excess tax benefits and certain tax deficiencies in additional paid-in capital (APIC). Instead, they will record all excess tax benefits and tax deficiencies as income tax expense or benefit in the income statement, and APIC pools will be eliminated. In addition, entities will recognize excess tax benefits regardless of whether the benefit reduces taxes payable in the current period. Under current guidance, excess tax benefits are not recognized until the deduction reduces taxes payable. Companies will apply this part of the guidance using a modified retrospective transition method and will record a cumulative-effect adjustment in retained earnings for excess tax benefits not previously recognized. The guidance also allows an employer to repurchase more of an employee’s shares for tax withholding purposes without triggering liability accounting. The guidance is effective for fiscal years beginning after December 15, 2016, including interim periods within those fiscal years. Early adoption is permitted, but all of the guidance must be adopted in the same period. The Company is currently evaluating the impact of this guidance and expects to adopt the standard in the first quarter of 2017.

Note 2. Computation of Loss Per Share

For the three and nine months ended September 30, 2016 and 2015, basic loss per share was computed by dividing net loss by the weighted-average number of common shares outstanding, including restricted stock units (RSUs) vested during the period. Diluted earnings per share (“EPS”) reflects the potential dilution that could occur if the earnings were divided by the weighted-average number of common shares and potentially dilutive common shares from outstanding stock options as well as unvested RSUs. Potential dilutive common shares were calculated using the treasury stock method and represent incremental shares issuable upon exercise of the Company’s outstanding stock options and

unvested RSUs.

As the effect would be anti-dilutive, 0.9 million and 0.8 million of outstanding stock options and RSUs were excluded from the computation of loss per share for the three and nine months ended September 30, 2016, respectively, and 0.9 million and 1.0 million of outstanding stock options and RSUs were excluded from the computation of loss per share for the three and nine months ended September 30, 2015, respectively.

Additionally, stock options are excluded from the calculation of diluted EPS when the combined exercise price, unrecognized stock-based compensation and expected tax benefits upon exercise are greater than the average market price for the Company’s common stock because their effect is anti-dilutive. Stock options totaling 1.9 million and 2.9 million for the

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three and nine months ended September 30, 2016, respectively, and 2.2 million and 1.8 million for the three and nine months ended September 30, 2015 were not included in the computation of diluted EPS because the exercise of such options would be anti-dilutive.

As discussed in Note 6, the Company issued its 3.25% Convertible Senior Notes due 2020 (“Convertible Senior Notes”) in December 2014. It is the Company’s intent and policy to settle conversions through combination settlement, which essentially involves repayment of an amount of cash equal to the “principal portion” and delivery of the “share amount” in excess of the conversion value over the principal portion in cash or shares of common stock (“conversion premium”). No conversion premium existed as of September 30, 2016 and 2015; therefore, there was no dilutive impact from the Convertible Senior Notes to diluted EPS during the three and nine months ended September 30, 2016 and 2015.

Note 3. Inventories

Inventories are stated at the lower of cost (first-in, first-out) or net realizable value. Inventories consisted of the following, net of reserves of $0.6 million and $0.7 million at September 30, 2016 and December 31, 2015, respectively (in thousands):

	September 30, 2016	December 31, 2015
Raw materials	$ 9,378	$ 10,289
Work-in-process (materials, labor and overhead)	8,591	7,441
Finished goods (materials, labor and overhead)	5,395	8,658
Total inventories	$ 23,364	$ 26,388

Note 4. Other Current Liabilities

Other current liabilities consist of the following (in thousands):

	September 30, 2016	December 31, 2015
Customer incentives	$ 2,173	$ 4,030
Accrued interest	1,586	202
Other	1,132	2,767
Total other current liabilities	$ 4,891	$ 6,999

Note 5. Income Taxes

The Company recognized an income tax benefit of $0.3 million and $1.1 million for the three months ended September 30, 2016 and 2015, respectively, which represents an effective tax rate of 35% and 59%, respectively. The effective tax rate was higher for the three months ended September 30, 2015 due to a year to date adjustment for the full year effective tax rate. The Company recognized an income tax benefit of $7.1 million and $3.3 million for the nine months ended September 30, 2016 and 2015, respectively, which represents an effective tax rate of 38% and 36%, respectively. For the nine months ended September 30, 2016, the effective tax rate benefit was higher as compared to the same period of 2015 due primarily to the federal research tax credit in 2016. There was no federal research tax credit for the nine months ended September 30, 2015 as the credit provisions of the United States tax code had expired at the end of 2014 and were not reinstated until December 2015.

The Company is subject to periodic audits by domestic and foreign tax authorities. Due to the carryforward of unutilized net operating loss and credit carryovers, the Company's federal tax years from 2009 and forward are subject to examination by the U.S. authorities. The Company's state and foreign tax years for 2001 and forward are subject to examination by applicable tax authorities. The Company believes that it has appropriate support for the income tax positions taken on its tax returns and that its accruals for tax liabilities are adequate for all open years based on an assessment of many factors, including past experience and interpretations of tax laws applied to the facts of each matter.

Note 6. Debt

3.25% Convertible Senior Notes due 2020

In December 2014, the Company issued $172.5 million aggregate principal amount of 3.25% Convertible Senior Notes due 2020. Debt issuance costs of approximately $5.1 million were primarily comprised of underwriters fees, legal, accounting

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and other professional fees of which $4.2 million were capitalized and are recorded as a reduction to long-term debt and are being amortized to interest expense over the six-year term of the Convertible Senior Notes. The remaining $0.9 million of debt issuance costs were allocated as a component of equity in additional paid-in capital. Deferred issuance costs related to the Convertible Senior Notes were $2.9 million and $3.5 million as of September 30, 2016 and December 31, 2015, respectively.

The Convertible Senior Notes will be convertible into cash, shares of common stock, or a combination of cash and shares of common stock based on an initial conversion rate, subject to adjustment, of 31.1891 shares per $1,000 principal amount of the Convertible Senior Notes (which represents an initial conversion price of approximately $32.06 per share) on the business day immediately preceding September 15, 2020. The conversion will occur in the following circumstances and to the following extent: (1) during any calendar quarter commencing after the calendar quarter ending on March 31, 2015, if the last reported sales price of the Company's common stock, for at least 20 trading days (whether or not consecutive) in the period of 30 consecutive trading days ending on the last trading day of the calendar quarter immediately preceding the calendar quarter in which the conversion occurs, is more than 130% of the conversion price of the notes in effect on each applicable trading day; (2) during the five consecutive business day period following any five consecutive trading day period in which the trading price per $1,000 principal amount of the Convertible Senior Note for each such trading day was less than 98% of the product of the last reported sale price of the Company's common stock and the conversion rate on each such day; or (3) upon the occurrence of specified events described in the indenture for the Convertible Senior Notes. On or after September 15, 2020 until the close of business on the second scheduled trading day immediately preceding the stated maturity date, holders may surrender their notes for conversion at any time, regardless of the foregoing circumstances.

It is the Company's intent and policy to settle conversions through combination settlement, which essentially involves repayment of an amount of cash equal to the "principal portion" and delivery of the "share amount" in excess of the principal portion in shares of common stock or cash. In general, for each $1,000 in principal, the "principal portion" of cash upon settlement is defined as the lesser of $1,000, or the conversion value during the 25-day observation period as described in the indenture for the Convertible Senior Notes. The conversion value is the sum of the daily conversion value which is the product of the effective conversion rate divided by 25 days and the daily volume weighted average price ("VWAP") of the Company's common stock. The "share amount" is the cumulative "daily share amount" during the observation period, which is calculated by dividing the daily VWAP into the difference between the daily conversion value (i.e., conversion rate x daily VWAP) and $1,000.

The Company pays 3.25% interest per annum on the principal amount of the Convertible Senior Notes semi-annually in arrears in cash on June 15 and December 15 of each year. The Convertible Senior Notes mature on December 15, 2020. During the nine months ended September 30, 2016, the Company recorded total interest expense of $8.2 million related to the Convertible Senior Notes of which $4.1 million related to the amortization of the debt discount and issuance costs and $4.1 million related to the coupon due semi-annually. During the nine months ended September 30, 2015, the Company recorded total interest expense of $8.2 million related to the Convertible Senior Notes of which $4.0 million related to the amortization of the debt discount and issuance costs and $4.2 million related to the coupon due semi-annually.

If a fundamental change, as defined in the indenture for the Convertible Senior Notes, such as an acquisition, merger, or liquidation of the Company, occurs prior to the maturity date, subject to certain limitations, holders of the Convertible Senior Notes may require the Company to repurchase all or a portion of their Convertible Senior Notes for cash at a repurchase price equal to 100% of the principal amount of the Convertible Senior Notes to be repurchased, plus any accrued and unpaid interest to, but excluding, the repurchase date.

The Company accounts separately for the liability and equity components of the Convertible Senior Notes in accordance with authoritative guidance for convertible debt instruments that may be settled in cash upon conversion. The guidance requires the carrying amount of the liability component to be estimated by measuring the fair value of a similar liability that does not have an associated conversion feature. Because the Company had no outstanding non-convertible public debt, the Company determined that senior, unsecured corporate bonds traded on the market represent a similar liability to the Convertible Senior Notes without the conversion option. Based on market data available for publicly traded, senior, unsecured corporate bonds issued by companies in the same industry with similar

credit ratings and with similar maturity, the Company estimated the implied interest rate of its Convertible Senior Notes to be 6.9%, assuming no conversion option. Assumptions used in the estimate represent what market participants would use in pricing the liability component, which were defined as Level 2 observable inputs. The estimated implied interest rate was applied to the Convertible Senior Notes, which resulted in a fair value of the liability component of $141.9 million upon issuance, calculated as the present value of implied future payments based on the $172.5 million aggregate principal amount. The $30.7 million difference between the cash proceeds of $172.5 million and the estimated fair value of the liability component was recorded in additional paid-in capital, net of tax and issuance costs, as the Convertible Senior Notes were not considered redeemable.

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In the first quarter of 2016, the Company repurchased and retired $5.2 million in principal amount of the outstanding Convertible Senior Notes. The aggregate cash used for the transaction was $4.5 million. The repurchase resulted in a reduction in debt of $4.4 million and a reduction in additional paid-in capital of $0.5 million with a gain on extinguishment of Convertible Senior Notes of $0.4 million included in interest expense, net in the Consolidated Statements of Operations.

The following table summarizes information about the equity and liability components of the Convertible Senior Notes (dollars in thousands). The fair values of the respective notes outstanding were measured based on quoted market prices.

	September 30, 2016	December 31, 2015
Principal amount of Convertible Senior Notes outstanding	$167,314	$ 172,500
Unamortized discount of liability component	(21,413)	(25,703)
Unamortized debt issuance costs	(2,915)	(3,500)
Net carrying amount of liability component	142,986	143,297
Less: current portion	—	—
Long-term debt	$142,986	$ 143,297
Carrying value of equity component, net of issuance costs	$29,211	$ 29,758
Fair value of outstanding Convertible Senior Notes	$168,054	$ 170,120
Remaining amortization period of discount on the liability component	4.3 years	5.0 years

As a policy election under applicable guidance related to the calculation of diluted net EPS, the Company elected the combination settlement method as its stated settlement policy and applied the treasury stock method in the calculation of dilutive impact of the Convertible Senior Notes. The Convertible Senior Notes were not convertible as of September 30, 2016 and 2015; therefore there was no dilutive impact during the three months ended September 30, 2016 and 2015. If the Convertible Senior Notes were converted as of September 30, 2016, the if-converted value would not exceed the principal amount.

Line of Credit

On August 10, 2012, the Company entered into an amended and restated $140.0 million senior secured syndicated credit facility (the “Senior Credit Facility”) that matures on August 10, 2017. As part of this amendment, the Company incurred an additional $1.0 million in deferred financing costs related to the Senior Credit Facility. Deferred financing costs are amortized on a straight-line basis over the term of the Senior Credit Facility. As of September 30, 2016, the Company had deferred financing costs related to the Senior Credit Facility of $0.3 million included as a portion of prepaid expenses and other current assets. As of December 31, 2015, the Company had deferred financing costs related to the Senior Credit Facility of $0.2 million included as a portion of other non-current assets and $0.3 million included as a portion of prepaid expenses and other current assets. The Senior Credit Facility bears interest at either the London Interbank Offered Rate (“LIBOR”) or the base rate, plus, in each case, an applicable margin. The base rate is equal to the highest of (i) the lender’s prime rate, (ii) the federal funds rate plus one-half of one percent and (iii) LIBOR plus one percent. The applicable margin is generally determined in accordance with a performance pricing grid based on the Company’s leverage ratio and ranges from 1.25% to 2.50% for LIBOR rate loans and from 0.25% to 1.50% for base rate loans. The agreement governing the Senior Credit Facility includes certain customary covenants, including among others, limitations on: liens; mergers, consolidations and dispositions of assets; debt; dividends, stock redemptions and the redemption and/or prepayment of other debt; investments (including loans and advances) and acquisitions; and transactions with affiliates. The Company is also subject to financial covenants, which include (i) a funded debt to adjusted EBITDA ratio (as defined in the Senior Credit Facility, with adjusted EBITDA generally calculated as earnings before, among other adjustments, interest, taxes, depreciation, amortization, and stock-based compensation) not to exceed 3:1 as of the end of each fiscal quarter, and (ii) an interest coverage ratio of not less than 3:1 as of the end of each fiscal quarter. Funded debt is defined as outstanding borrowings on the Senior Credit Facility plus Convertible Senior Notes, less the Company’s domestic cash and cash equivalents in excess of $15.0 million. The Senior Credit Facility is secured by substantially all present and future assets and properties of the Company and is senior to the Convertible Senior Notes.

The Company's ability to borrow under the Senior Credit Facility fluctuates from time to time due to, among other factors, the Company's borrowings under the facility, its funded debt to adjusted EBITDA ratio and interest coverage ratio. As of December 31, 2015, the Company had no borrowings outstanding. Due to the limitations of the interest coverage ratio, the Company had no borrowing capacity under the Senior Credit Facility at September 30, 2016.

Note 7. Stockholders' Equity

Issuances and Repurchases of Common Stock

During the nine months ended September 30, 2016, 110,446 shares of common stock were issued in conjunction with the vesting and release of RSUs, 305,227 shares of common stock were issued due to the exercise of stock options and 82,682 shares of common stock were issued in connection with the Company's employee stock purchase plan (the "ESPP"), resulting in net proceeds to the Company of approximately $4.8 million. During the nine months ended September 30, 2016, 1,152,386 shares of outstanding common stock were repurchased under the Company's previously announced share repurchase program for approximately $19.6 million. Additionally, 25,699 shares of outstanding common stock were repurchased in connection with payment of minimum tax withholding obligations for certain employees relating to the lapse of restrictions on certain RSUs for approximately $0.4 million. As of September 30, 2016, there was $35.0 million available under the Company's share repurchase program.

Stock-Based Compensation

The compensation expense related to the Company's stock-based compensation plans included in the accompanying Consolidated Statements of Operations was as follows (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Cost of sales	$129	$113	$498	$454
Research and development	365	268	1,006	562
Sales and marketing	376	351	645	1,228
General and administrative	864	987	3,671	3,469
Total stock-based compensation expense	$1,734	$1,719	$5,820	$5,713

Total compensation expense recognized for the three and nine months ended September 30, 2016 includes $1.1 million and $3.5 million related to stock options and $0.6 million and $2.3 million related to RSUs, respectively. Total compensation expense recognized for the three and nine months ended September 30, 2015 includes $1.1 million and $3.5 million related to stock options and $0.6 million and $2.2 million related to RSUs, respectively. As of September 30, 2016, total unrecognized compensation expense related to non-vested stock options was $6.9 million, which is expected to be recognized over a weighted-average period of approximately 2.5 years. As of September 30, 2016, total unrecognized compensation expense related to non-vested RSUs was $3.5 million, which is expected to be recognized over a weighted-average period of approximately 2.6 years. Compensation expense capitalized to inventory and compensation expense related to the Company's ESPP were not material for the three and nine months ended September 30, 2016 or 2015.

The estimated fair value of each stock option was determined on the date of grant using the Black-Scholes option valuation model with the following weighted-average assumptions for the option grants.

	Nine months ended September 30,	
	2016	2015
Risk-free interest rate	1.47%	1.48%
Expected option life (in years)	6.59	6.23
Volatility rate	36 %	40 %
Dividend rate	— %	— %

The weighted-average fair value of stock options granted during the nine months ended September 30, 2016 and 2015 was $5.97 and $9.60, respectively. The Company granted 670,733 and 616,994 stock options during the nine months ended September 30, 2016 and 2015, respectively. The weighted-average fair value of RSUs granted during the nine months ended September 30, 2016 and 2015 was $16.06 and $23.47, respectively. The Company granted 182,425 and

146,164 shares of

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RSUs during the nine months ended September 30, 2016 and 2015, respectively. The fair value of RSUs is determined based on the closing market price of the Company's common stock on the grant date.

Note 8. Industry and Geographic Information

The Company operates in one reportable segment. Sales to customers outside the U.S. represented $23.1 million (17%) and $18.8 million (13%) of total revenue for the nine months ended September 30, 2016 and 2015, respectively. As of September 30, 2016 and December 31, 2015, balances due from foreign customers were $4.1 million and $5.6 million, respectively.

The Company had sales to individual customers in excess of 10% of total revenues, as follows:

	Nine months ended September 30,	
	2016	2015
Customer:		
A	16%	23%
B	14%	16%
C	13%	11%
	43%	50%

As of September 30, 2016 and December 31, 2015, accounts receivable from customers with balances due in excess of 10% of total accounts receivable totaled $18.5 million and $12.0 million, respectively.

Note 9. Commitments and Contingencies

Legal

The Company is involved in various claims and litigation matters from time to time in the ordinary course of business. Management believes that all such current legal actions, in the aggregate, will not have a material adverse effect on the Company. The Company also maintains insurance, including coverage for product liability claims, in amounts which management believes are appropriate given the nature of its business. No accrual has been recorded as of September 30, 2016 related to such matters as they are not probable and/or reasonably estimable. At December 31, 2015, the Company had $0.2 million accrued as a liability for various legal matters where the Company deemed the liability probable and estimable.

Licensing Arrangements

The Company has entered into various licensing and royalty agreements, which largely require payments by the Company based on specified product sales as well as the achievement of specified milestones. The Company had royalty and license expenses relating to those agreements of approximately $0.1 million for each of the three months ended September 30, 2016 and 2015. The Company had royalty and license expenses relating to those agreements of approximately $0.6 million and $0.5 million for the nine months ended September 30, 2016 and 2015, respectively.

Research and Development Agreements

The Company has entered into various research and development agreements that provide it with rights to develop, manufacture and market products using the intellectual property and technology of its collaborative partners. Under the terms of certain of these agreements, the Company is required to make periodic payments based on achievement of certain milestones or resource expenditures. These milestones generally include achievement of prototype assays, validation lots and clinical trials. At September 30, 2016 and December 31, 2015, total future commitments under the terms of these agreements are estimated at $2.8 million and $4.2 million, respectively. The commitments will fluctuate as the Company agrees to new phases of development under the existing arrangements.

Contingent Consideration

In conjunction with the acquisition of BioHelix Corporation ("BioHelix") in May 2013, the Company agreed to contingent consideration ranging from $5.0 million to $10.0 million upon achievement of certain revenue targets through May 2018. The fair value of the revenue royalty earn-out to be settled in cash is estimated using a discounted revenue model. Due to changes in the estimated payments and a shorter discounting period, the fair value of the

contingent consideration liabilities

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changed, resulting in a gain of $0.6 million recorded to cost of sales in the Consolidated Statements of Operations during the three and nine months ended September 30, 2016. There were no changes to the fair value of the contingent consideration for the three and nine months ended September 30, 2015. No payments related to the revenue royalty earn-out were disbursed during the three months ended September 30, 2016 and 2015. Payments of $0.2 million and $0.1 million related to the revenue royalty earn-out were disbursed during the nine months ended September 30, 2016 and 2015, respectively. As of September 30, 2016, the current portion of the contingent consideration is $0.6 million and the non-current portion of the contingent consideration is $4.1 million.

In August 2013, the Company acquired the assets of AnDiaTec GmbH & Co. KG (“AnDiaTec”), a privately-held, diagnostics company, based in Germany. The Company agreed to contingent consideration of up to €0.5 million ($0.6 million based on the September 30, 2016 currency conversion rate) upon achievement of certain revenue targets through 2018. As of September 30, 2016, the Company has included $0.1 million in the non-current portion of contingent consideration related to these revenue targets. In addition, the Company agreed to pay the founder of AnDiaTec contingent payments of up to €3.0 million ($3.4 million based on the September 30, 2016 currency conversion rate) upon achievement of certain research and development milestones, subject to continued employment. The Company paid $0.3 million for the achievement of agreed upon research and development milestones during the three months ended September 30, 2015 and none during the three months ended September 30, 2016. The Company paid $0.9 million and $1.2 million for the achievement of agreed upon research and development milestones during the nine months ended September 30, 2016 and 2015, respectively. These costs are recorded as compensation expense included in research and development expense in the Consolidated Statements of Operations. As of September 30, 2016, there are no remaining research and development milestones to be achieved.

The Company recorded contingent consideration of $0.4 million related to the acquisition of Immutopics, Inc. ("Immutopics") in March 2016 as discussed in Note 11.

Note 10. Fair Value Measurements

The following table presents the Company’s hierarchy for its assets and liabilities measured at fair value on a recurring basis as of the following periods (in thousands):

	September 30, 2016				December 31, 2015			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Assets:								
Cash equivalents	$133,450	$ —	$—	$133,450	$133,147	$ —	$—	$133,147
Total assets measured at fair value	$133,450	$ —	$—	$133,450	$133,147	$ —	$—	$133,147
Liabilities:								
Contingent consideration	—	—	5,075	5,075	—	—	5,516	5,516
Total liabilities measured at fair value	$—	$ —	$5,075	$5,075	$—	$ —	$5,516	$5,516

There were no transfers of assets or liabilities between Level 1, Level 2 and Level 3 categories of the fair value hierarchy during the three and nine month periods ended September 30, 2016 and the year ended December 31, 2015.

The Company used Level 1 inputs to determine the fair value of its cash equivalents, which primarily consist of funds held in government money market account and commercial paper. As such, the carrying value of cash equivalents approximates fair value. As of September 30, 2016 and December 31, 2015, the carrying value of cash equivalents was $133.5 million and $133.1 million, respectively.

The Company assesses the fair value of contingent consideration to be settled in cash related to acquisitions using a discounted revenue model. Significant assumptions used in the measurement include revenue projections and discount rates. This fair value measurement of contingent consideration is based on significant inputs not observed in the market and thus represent Level 3 measurements. In the first quarter of 2016, the Company recorded an additional contingent liability of $0.4 million for the acquisition of Immutopics (see Note 11). Due to changes in the estimated payments and a shorter discounting period related to the BioHelix contingent consideration, the fair value of the contingent consideration liabilities changed during the three and nine months ended September 30, 2016. These changes resulted in a $0.6 million gain recorded to cost of sales in the Consolidated Statements of Operations during the three and nine months ended September 30, 2016. There were no changes to the fair value of the contingent

consideration for the three and nine months ended September 30, 2015.

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Changes in estimated fair value of contingent consideration liabilities from December 31, 2015 through September 30, 2016 are as follows (in thousands):

	Contingent consideration liabilities (Level 3 measurement)
Balance at December 31, 2015	$ 5,516
Cash payments	(207)
Net gain recorded for fair value adjustments	(589)
Additional liability recorded for current period acquisition	353
Unrealized gain on foreign currency translation	2
Balance at September 30, 2016	$ 5,075

Note 11. Acquisition

On March 18, 2016, the Company acquired Immutopics, Inc., a privately-held, life science research company, based in San Clemente, California. The acquisition has been accounted for in conformity with ASC Topic 805, Business Combinations. Total consideration for the acquisition was $5.5 million, which included $5.1 million in initial cash payments and $0.4 million in fair value of contingent consideration based upon achievement of certain revenue targets through September 2024. The Immutopics portfolio of products will be included with the Company's MicroVue products that serve the bone health research community.

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ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

In this Quarterly Report, all references to "we," "our" and "us" refer to Quidel Corporation and its subsidiaries.

Future Uncertainties and Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of the federal securities laws that involve material risks, assumptions and uncertainties. Many possible events or factors could affect our future financial results and performance, such that our actual results and performance may differ materially from those that may be described or implied in the forward-looking statements. As such, no forward-looking statement can be guaranteed. Differences in actual results and performance may arise as a result of a number of factors including, without limitation, fluctuations in our operating results resulting from seasonality, the timing of the onset, length and severity of cold and flu seasons, government and media attention focused on influenza and the related potential impact on humans from novel influenza viruses, adverse changes in competitive conditions in domestic and international markets, changes in sales levels as it relates to the absorption of our fixed costs, lower than anticipated market penetration of our products, the reimbursement system currently in place and future changes to that system, changes in economic conditions in our domestic and international markets, the quantity of our product in our distributors' inventory or distribution channels, changes in the buying patterns of our distributors, and changes in the healthcare market and consolidation of our customer base; our development and protection of intellectual property; our development of new technologies, products and markets; our reliance on a limited number of key distributors; our reliance on sales of our influenza diagnostics tests; our ability to manage our growth strategy, including our ability to integrate companies or technologies we have acquired or may acquire; intellectual property risks, including but not limited to, infringement litigation; our debt service requirements; our inability to settle conversions of our Convertible Senior Notes in cash; the effect on our operating results from the trigger of the conditional conversion feature of our Convertible Senior Notes; limitations and covenants in our Senior Credit Facility; our need for additional funds to finance our operating needs; volatility and disruption in the global capital and credit markets; acceptance of our products among physicians and other healthcare providers; competition with other providers of diagnostic products; adverse actions or delays in new product reviews or related to currently-marketed products by the U.S. Food and Drug Administration (the "FDA"); changes in government policies; compliance with other government regulations, such as safe working conditions, manufacturing practices, environmental protection, fire hazard and disposal of hazardous substances; third-party reimbursement policies; our ability to meet demand for our products; interruptions in our supply of raw materials; product defects; business risks not covered by insurance and exposure to other litigation claims; interruption to our computer systems; competition for and loss of management and key personnel; international risks, including but not limited to, compliance with product registration requirements, exposure to currency exchange fluctuations and foreign currency exchange risk sharing arrangements, longer payment cycles, lower selling prices and greater difficulty in collecting accounts receivable, reduced protection of intellectual property rights, political and economic instability, taxes, and diversion of lower priced international products into U.S. markets; our significant debt service requirements; the possibility that we may incur additional indebtedness; dilution resulting from future sales of our equity; volatility in our stock price; provisions in our charter documents, Delaware law and the indenture governing our Convertible Senior Notes that might delay or impede stockholder actions with respect to business combinations or similar transactions; and our intention of not paying dividends. Forward-looking statements typically are identified by the use of terms such as "may," "will," "should," "might," "expect," "anticipate," "estimate," "plan," "goal," "project," "strategy," "future," and similar words, although some forward-looking statements are expressed differently. Forward-looking statements in this Quarterly Report include, among others, statements concerning: our outlook for the remainder of the 2016 fiscal year; projected capital expenditures for the remainder of the 2016 fiscal year and our source of funds for such expenditures; the sufficiency of our liquidity and capital resources; our strategy, goals and objectives; anticipated new product and development results; expected growth and the sources of that growth; the impact and timing of expected adoption of new accounting standards; that we will continue to make substantial expenditures for sales and marketing, manufacturing and research and development activities; that we may enter into additional foreign currency exchange risk sharing arrangements; our exposure to claims and litigation; expectations regarding grant revenues and expenditures in the remainder of 2016; and our intention to continue to evaluate technology and acquisition opportunities. The risks described under "Risk Factors" in Item 1A of this Quarterly Report

on Form 10-Q and our Annual Report on Form 10-K for the year ended December 31, 2015, and elsewhere herein and in reports and registration statements that we file with the Securities and Exchange Commission (the "SEC") from time to time, should be carefully considered. You are cautioned not to place undue reliance on these forward-looking statements, which reflect management's analysis only as of the date of this Quarterly Report.

The following should be read in conjunction with the Consolidated Financial Statements and Notes thereto beginning on page 3 of this Quarterly Report. Except as required by law, we undertake no obligation to publicly release the results of any revision or update of these forward-looking statements, whether as a result of new information, future events or otherwise.

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Overview

We have a leadership position in the development, manufacturing and marketing of rapid diagnostic testing solutions. These diagnostic testing solutions primarily include applications in infectious diseases, women's health and gastrointestinal diseases. We sell our products directly to end users and distributors, in each case, for professional use in physician offices, hospitals, clinical laboratories, reference laboratories, leading universities, retail clinics and wellness screening centers. We market our products in the United States through a network of national and regional distributors, and through a direct sales force. Internationally, we sell and market primarily through distributor arrangements.

Outlook

We continue to realize expansion of our Sofia footprint and molecular platforms. For the remainder of 2016, we will continue to focus on managing our business and delivering long-term sustainable growth through the creation of a broader-based diagnostic company serving our existing customers as well as targeting larger and faster growing markets. We will continue to invest in research and development, focused on expansion of our Sofia and molecular programs. In addition, we continue to invest in our commercial organization and related marketing programs, in support of recent product launches. We will also continue to evaluate opportunities to acquire new product lines, technologies and companies that would enable us to expand more quickly.

Three months ended September 30, 2016 compared to the three months ended September 30, 2015

Total Revenues

The following table compares total revenues for the three months ended September 30, 2016 and 2015 (in thousands, except percentages):

	For the three months ended September 30,		Increase (Decrease)	
	2016	2015	$	%
Infectious disease net product sales	$ 32,774	$ 33,393	$ (619)	(2)%
Women's health net product sales	10,164	9,478	686	7 %
Gastrointestinal disease net product sales	1,711	1,803	(92)	(5)%
Royalty, grant and other revenue	4,692	2,138	2,554	119 %
Total revenues	$ 49,341	$ 46,812	$ 2,529	5 %

For the three months ended September 30, 2016, total revenue increased to $49.3 million from $46.8 million in the prior period. The Company realized declines in the infectious disease category primarily due to lower Influenza product sales slightly offset with an increase in sales of Strep A products. The increase in the women's health category was driven by our Bone Health, Autoimmune/Complement and Thyretain product lines. The acquisition of Immutopics, Inc. ("Immutopics") contributed to the growth in our Bone Health product line. Royalty, license fees and grant revenue increased year over year due primarily to timing of grant revenues associated with the amended Bill and Melinda Gates Foundation grant and our Savanna MDx development program.

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Cost of Sales

Cost of sales was $17.7 million, or 36% of total revenues for the three months ended September 30, 2016 compared to $17.0 million, or 36% of total revenues for the three months ended September 30, 2015. Cost of sales as a percentage of revenue remained flat compared to the prior year.

Operating Expenses

The following table compares operating expenses for the three months ended September 30, 2016 and 2015 (in thousands, except percentages):

	For the three months ended September 30,								
	2016			2015			Increase (Decrease)		
	Operating expenses	As a % of total revenues		Operating expenses	As a % of total revenues		$	%	
Research and development	$8,801	18	%	$8,419	18	%	$ 382	5	%
Sales and marketing	$11,853	24	%	$12,112	26	%	$ (259)	(2)	%
General and administrative	$6,561	13	%	$5,889	13	%	$ 672	11	%
Amortization of intangible assets from acquired businesses and technology	$2,273	5	%	$2,219	5	%	$ 54	2	%

Research and Development Expense

Research and development expense for the three months ended September 30, 2016 increased from $8.4 million to $8.8 million due primarily to an increase in development spending for the next generation Sofia and the Savanna MDx platform and an increase in clinical trials spending for Solana products. These increases are offset by lower spending for the development of our Lyra products.

Research and development expenses include direct external costs, such as fees paid to consultants, and internal direct and indirect costs, such as compensation and other expenses for research and development personnel, supplies and materials, clinical trials and studies, facility costs and depreciation. Our research and development spending will continue to be centered around our immunoassay and molecular platforms.

Sales and Marketing Expense

Sales and marketing expense for the three months ended September 30, 2016 decreased from $12.1 million to $11.9 million compared with the prior year period. This decrease is due primarily to reduced personnel, travel and training costs slightly offset by additional investments in our Virena platform, which is our wireless cellular instrument management and surveillance system.

General and Administrative Expense

General and administrative expense for the three months ended September 30, 2016 increased from $5.9 million to $6.6 million compared with the prior period. The increase was due to the integration costs associated with the acquisition of Immutopics and professional services, partially offset by the suspension of the medical device excise tax. General and administrative expense primarily includes personnel costs, information technology, facilities and professional service fees.

Amortization of Intangible Assets from Acquired Businesses and Technology

Amortization of intangible assets from acquired businesses consists of customer relationships, purchased technology and patents and trademarks acquired in connection with our acquisitions of Diagnostic Hybrids, Inc., BioHelix, AnDiaTec, and Immutopics. Amortization of intangibles assets for the three months ended September 30, 2016 increased by $0.1 million to $2.3 million compared with the prior period primarily due to amortization of intangible assets acquired with the Immutopics acquisition in March 2016.

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Interest Expense, net

Interest expense primarily relates to accrued interest for the coupon and accretion of the discount on our $172.5 million 3.25% Convertible Senior Notes due 2020 (“Convertible Senior Notes”) issued in December 2014 and interest paid on our lease obligation associated with our San Diego McKellar facility. Interest expense was $3.0 million for each of the three months ended September 30, 2016 and 2015.

Income Taxes

Our effective tax rate for the three months ended September 30, 2016 and 2015 was 35% and 59%, respectively. We recognized an income tax benefit of $0.3 million and $1.1 million for the three months ended September 30, 2016 and 2015, respectively. The effective tax rate was higher for the three months ended September 30, 2015 due to a year to date adjustment for the full year effective tax rate.

Nine months ended September 30, 2016 compared to the nine months ended September 30, 2015

Total Revenues

The following table compares total revenues for the nine months ended September 30, 2016 and 2015 (in thousands, except percentages):

	For the nine months ended September 30,		Increase (Decrease)	
	2016	2015	$	%
Infectious disease net product sales	$93,357	$103,123	$ (9,766)	(9)%
Women’s health net product sales	29,975	27,876	2,099	8 %
Gastrointestinal disease net product sales	5,014	5,393	(379)	(7)%
Royalty, grant and other revenue	10,449	7,325	3,124	43 %
Total revenues	$138,795	$143,717	$ (4,922)	(3)%

For the nine months ended September 30, 2016, total revenue decreased to $138.8 million from $143.7 million in the prior year. The Company realized declines in the infectious disease category due to lower sales of Influenza and other Respiratory products slightly offset with an increase in sales of Strep A products. The increase in the women's health category was driven by our Bone Health, Autoimmune/Complement and Thyretain product lines. The acquisition of Immutopics contributed to the growth in our Bone Health product line. For the nine months ended September 30, 2016, royalty, grant and other revenue increased by $3.1 million due primarily to timing of grant revenues associated with the amended Bill and Melinda Gates Foundation grant and our Savanna MDx development program.

Cost of Sales

Cost of sales was $54.3 million, or 39% of total revenues for the nine months ended September 30, 2016 compared to $53.6 million, or 37% of total revenues for the nine months ended September 30, 2015. The increase in cost of sales as a percentage of total revenue was primarily driven by the unfavorable product mix, with lower Influenza product sales in the same period as compared to the prior year.

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Operating Expenses

The following table compares operating expenses for the nine months ended September 30, 2016 and 2015 (in thousands, except percentages):

	For the nine months ended September 30,								
	2016			2015			Increase (Decrease)		
	Operating expenses	As a % of total revenues		Operating expenses	As a % of total revenues		$	%	
Research and development	31,164	22	%	25,575	18	%	$ 5,589	22	%
Sales and marketing	36,376	26	%	35,823	25	%	$ 553	2	%
General and administrative	20,532	15	%	22,039	15	%	$ (1,507)	(7)	%
Amortization of intangible assets from acquired businesses and technology	6,782	5	%	6,638	5	%	$ 144	2	%

Research and Development Expense

Research and development expense for the nine months ended September 30, 2016 increased from $25.6 million to $31.2 million due primarily to an increase in development spending for the Savanna MDx platform and our next generation Sofia instrument and an increase in clinical trials spending for Solana products. These increases are offset by lower spending on development of our Lyra products.

Research and development expenses include direct external costs such as fees paid to consultants, and internal direct and indirect costs such as compensation and other expenses for research and development personnel, supplies and materials, clinical trials and studies, facility costs and depreciation.

Sales and Marketing Expense

Sales and marketing expense for the nine months ended September 30, 2016 increased $0.6 million to $36.4 million compared with the prior year period, due primarily to additional investment in our Virena platform. This increase was partially offset with reduced personnel, travel and training costs as well as lower stock-based compensation expense.

General and Administrative Expense

General and administrative expense for the nine months ended September 30, 2016 decreased from $22.0 million to $20.5 million compared with the prior year period. The decline was due primarily to business development expenditures in the prior year period that did not repeat for the nine months ended September 30, 2016, as well as the suspension of the medical device excise tax. These decreases were partially offset by increased integration costs associated with the acquisition of Immutopics and stock-based compensation expense. General and administrative expense primarily includes personnel costs, information technology, facilities and professional service fees.

Amortization of Intangible Assets from Acquired Businesses and Technology

Amortization of intangible assets from acquired businesses consists of customer relationships, purchased technology and patents and trademarks acquired in connection with our acquisitions of Diagnostic Hybrids, Inc., BioHelix, AnDiaTec, and Immutopics. Amortization of intangibles assets for the nine months ended September 30, 2016 increased by $0.1 million to $6.8 million as compared with the prior period primarily due to amortization of intangible assets acquired with the Immutopics acquisition in March 2016.

Interest Expense, net

Interest expense consists of fees paid to maintain our ability to borrow under the Senior Credit Facility, interest paid on our lease obligation for our San Diego McKellar facility and interest expense associated with our Convertible Senior Notes issued in December 2014. The decrease in interest expense of $0.4 million for the nine months ended September 30, 2016 was primarily due to a gain on extinguishment of debt related to the repurchase of $5.2 million in principal of our Convertible Senior Notes during the first quarter of 2016.

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Income Taxes

For the nine months ended September 30, 2016 and 2015, we recognized an income tax benefit of $7.1 million and $3.3 million, respectively. Our effective tax rates for the nine months ended September 30, 2016 and 2015 was 38% and 36%, respectively. For the nine months ended September 30, 2016, the effective tax rate was higher primarily due to the federal research tax credit in 2016. There was no federal research tax credit in the nine months ended September 30, 2015 as the credit provisions of the United States tax code had expired at the end of 2014 and were not reinstated until December 2015.

Liquidity and Capital Resources

As of September 30, 2016 and December 31, 2015, the principal sources of liquidity consisted of the following (in thousands):

	September 30, 2016	December 31, 2015
Cash and cash equivalents	$153,363	$191,471
Restricted cash	—	63
Cash, cash equivalents and restricted cash	$153,363	$191,534
Working capital including cash, cash equivalents and restricted cash	$183,187	$209,834

As of September 30, 2016, we had $153.4 million in cash and cash equivalents, a $38.1 million decrease from December 31, 2015. During the nine months ended September 30, 2016, we repurchased an aggregate of $24.6 million in common stock and Convertible Senior Notes and used $5.1 million to acquire Immutopics. Our cash requirements fluctuate as a result of numerous factors, such as the extent to which we generate cash from operations, progress in research and development projects, competition and technological developments and the time and expenditures required to obtain governmental approval of our products. In addition, we intend to continue to evaluate candidates for new product lines, company or technology acquisitions or technology licensing. If we decide to proceed with any such transactions, we may need to incur additional debt, or issue additional equity, to successfully complete the transactions.

Our primary source of liquidity, other than our holdings of cash and cash equivalents, has been cash flows from operations. Our ability to generate cash from operations provides us with the financial flexibility we need to meet operating, investing, and financing needs. We anticipate that our current cash and cash equivalents, together with cash provided by operating activities will be sufficient to fund our near term capital and operating needs for at least the next 12 months. Operating needs include the planned costs to operate our business, including amounts required to fund working capital and capital expenditures. Our primary short-term needs for capital, which are subject to change, include expenditures related to:

- support of commercialization efforts related to our current and future products, including support of our direct sales force and field support resources both in the United States and abroad;
- the continued advancement of research and development efforts;
- acquisitions of equipment and other fixed assets for use in our current and future manufacturing and research and development facilities;
- repurchases of our outstanding common stock or Convertible Senior Notes;
- potential strategic acquisitions and investments; and
- repayments of our lease obligation.

In December 2014, we issued Convertible Senior Notes in the aggregate principle amount of $172.5 million. The Convertible Senior Notes have a coupon rate of 3.25% and are due 2020. The Convertible Senior Notes were not convertible as of September 30, 2016. For detailed information of the terms of the Convertible Senior Notes, see Note 6 of the Notes to Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report under the heading “3.25% Convertible Senior Notes due 2020,” which is incorporated by reference herein.

On August 10, 2012, we entered into an amended and restated $140.0 million Senior Credit Facility that matures on August 10, 2017. As of September 30, 2016, the Company had no borrowings under the Senior Credit Facility and due

to the limitations of the interest coverage ratio, we had no borrowing capacity under the Senior Credit Facility. At the current time, we do not anticipate the need in the near term to utilize the Senior Credit Facility. For detailed information of the terms of the Senior Credit Facility see Note 6 of the Notes to Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report under the heading “Line of Credit,” which is incorporated by reference herein.

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As of September 30, 2016, we have $5.1 million in fair value of contingent considerations associated with prior acquisitions to be settled in future periods.

In January 2016, our board of directors authorized an amendment to replenish the amount available to repurchase up to an aggregate of $50.0 million in shares of common stock or Convertible Senior Notes under our share repurchase program. During the nine months ended September 30, 2016, we used $19.6 million to repurchase our outstanding shares under the share repurchase program and $4.5 million to repurchase $5.2 million in principal amount of our outstanding Convertible Senior Notes.

We received $2.4 million and $2.8 million during the year ended December 31, 2015 and nine months ended September 30, 2016, respectively, pursuant to the Bill and Melinda Gates Foundation grant agreement, which was restricted as to use until expenditures contemplated in the grant were incurred or committed. We recorded this restricted cash as a current asset as we anticipated making expenditures under the grant within one year. As of September 30, 2016, there was no restricted cash.

We expect our revenue and operating expenses will significantly impact our cash management decisions. Our future capital requirements and the adequacy of our available funds will depend on many factors, including:

- our ability to successfully realize revenue growth from our new technologies and create innovative products in our markets;
- leveraging our operating expenses to realize operating profits as we grow revenue;
- competing technological and market developments; and
- the need to enter into collaborations with other companies or acquire other companies or technologies to enhance or complement our product and service offerings.

Cash Flow Summary

	Nine months ended September 30,	
	2016	2015
Net cash (used for) provided by operating activities:	$(4,806)	$20,252
Net cash used for investing activities:	(12,921)	(12,003)
Net cash used for financing activities:	(20,374)	(26,563)
Effect of exchange rates on cash	(7)	(21)
Net decrease in cash and cash equivalents	$(38,108)	$(18,335)

Cash used by operating activities was $4.8 million during the nine months ended September 30, 2016. The major contributions to the use of cash during the nine months ended September 30, 2016 were a net loss of $11.9 million, a change in deferred tax assets and liabilities of $7.4 million and a net working capital use of $9.7 million. Offsetting this use of cash was the add back of non-cash items of $27.7 million associated with depreciation, amortization and stock-based compensation. For the nine months ended September 30, 2015, operating activities generated cash of $20.3 million. The add back of non-cash items was $27.5 million related to depreciation, amortization and stock based compensation. Working capital also had a cash contribution of $3.6 million. Offsetting these cash generating activities was a net loss of $5.7 million and a change in deferred tax assets and liabilities of $6.4 million.

Our investing activities used $12.9 million during the nine months ended September 30, 2016. We used $5.1 million for the acquisition of Immutopics as more fully described in Note 11 in the Notes to Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report. Our investing activities also used $7.9 million during the nine months ended September 30, 2016 primarily for the acquisition of production equipment, Sofia instruments available for lease and building improvements. For the nine months ended September 30, 2015, we spent $12.0 million on the acquisition of production equipment, Sofia instruments available for lease and building improvements.

We are planning approximately $4.5 million in capital expenditures for the remainder of 2016. The primary purpose for our capital expenditures is to acquire manufacturing and scientific equipment, to purchase or develop information

technology, and to implement facility improvements. We plan to fund these capital expenditures with the cash on our balance sheet.

Cash used by financing activities was $20.4 million during the nine months ended September 30, 2016, of which $20.1 million was used for repurchases of common stock primarily related to our share repurchase program, and $4.5 million was used for the repurchase of Convertible Senior Notes. These amounts were partially offset by proceeds from the issuance of

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common stock of $4.8 million. Cash used by financing activities was $26.6 million during the nine months ended September 30, 2015 due to $27.2 million used for repurchases of common stock primarily related to our share repurchase program. Additionally, we made payments of debt issuance costs of $0.4 million and payments on the lease obligation of $0.4 million. These amounts were partially offset by proceeds from issuance of common stock of $2.2 million.

Seasonality

Sales of our infectious disease products are subject to, and significantly affected by, the seasonal demands of the cold and flu seasons, prevalent during the fall and winter. As a result of these seasonal demands, we typically experience lower sales volume in the second and third quarters of the calendar year, and typically have higher sales in the first and fourth quarters of the calendar year. Historically, sales of our infectious disease products have varied from year to year based in large part on the severity, length and timing of the onset of the cold and flu season.

Off-Balance Sheet Arrangements

At September 30, 2016 and December 31, 2015, we did not have any relationships or other arrangements with unconsolidated entities or financial partners, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

Recent Accounting Pronouncements

Information about recently adopted and proposed accounting pronouncements is included in Note 1 of the Notes to Consolidated Financial Statements in Part I, Item 1 of this Quarterly Report under the heading “Recent Accounting Pronouncements” and is incorporated by reference herein.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the U.S. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, 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 customer programs and incentives, bad debts, inventories, intangible assets, software development costs, stock-based compensation, restructuring, contingencies and litigation, contingent consideration, the fair value of the debt component of the convertible debt instruments, and income taxes. We base our estimates on historical experience and on various other assumptions that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

A comprehensive discussion of our critical accounting policies and management estimates is included in Management’s Discussion and Analysis of Financial Condition and Results of Operations in our Annual Report on Form 10-K for the year ended December 31, 2015.

ITEM 3. Quantitative and Qualitative Disclosures About Market Risk

Interest Rate Risk

We had no borrowings outstanding under our Senior Credit Facility at September 30, 2016. If we had borrowings under the credit facility, the interest rate would have been 1.78% as of September 30, 2016.

We are not subject to interest rate risk on our Convertible Senior Notes as the notes have a fixed interest rate of 3.25%. For fixed rate debt, changes in interest rates will generally affect the fair value of the debt instrument, but not our earnings or cash flows. Under our current policies, we do not use interest rate derivative instruments to manage our exposure to changes in interest rates.

The Company’s current investment policy with respect to cash and cash equivalents focuses on maintaining acceptable levels of interest rate risk and liquidity. Although the Company continually evaluates the placement of investments, as of

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September 30, 2016, cash and cash equivalents were placed in government money market account, commercial paper or overnight funds that we believe are highly liquid and not subject to material market fluctuation risk.

Foreign Currency Exchange Risk

The majority of our international sales are negotiated for and paid in U.S. dollars. Nonetheless, these sales are subject to currency risks, since changes in the values of foreign currencies relative to the value of the U.S. dollar can render our products comparatively more expensive. These exchange rate fluctuations could negatively impact international sales of our products, as could changes in the general economic conditions in those markets. Continued change in the values of the Euro, the Japanese Yen and other foreign currencies against the U.S. Dollar could have an impact on our business, financial condition and results of operations. We do not currently hedge against exchange rate fluctuations, which means that we are fully exposed to exchange rate changes. In addition, we have agreements with a number of foreign vendors whereby we evenly share the foreign currency exchange fluctuation risk. We may, in the future, enter into similar such arrangements.

ITEM 4. Controls and Procedures

Evaluation of disclosure controls and procedures: We have performed an evaluation under the supervision and with the participation of our management, including our Chief Executive Officer (“CEO”) and Chief Financial Officer (“CFO”), of the effectiveness of our disclosure controls and procedures, as defined in Rule 13a-15(e) under the Securities Exchange Act of 1934 (the “Exchange Act”). Based on that evaluation, our CEO and CFO concluded that our disclosure controls and procedures were effective as of September 30, 2016 to ensure that information required to be disclosed by us in the reports filed or submitted by us under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms.

Changes in internal control over financial reporting: There was no change in our internal control over financial reporting during the quarter ended September 30, 2016 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. Legal Proceedings

The information set forth in the section entitled “Legal” under Note 9 of the Notes to the Consolidated Financial Statements, included in Part I, Item I of this Quarterly Report, is incorporated herein by reference.

ITEM 1A. Risk Factors

There has been no material change in our risk factors as previously disclosed in our Annual Report on Form 10-K for the fiscal year ended December 31, 2015. For a detailed description of our risk factors, refer to Item 1A, “Risk Factors” of our Annual Report on Form 10-K for the year ended December 31, 2015.

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ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds

Issuer Purchases of Equity Securities

The table below sets forth information regarding repurchases of our common stock by us during the three months ended September 30, 2016.

Period	Total number of shares purchased (1)	Average price paid per share	Total number of shares purchased as part of publicly announced plans or programs	Approximate dollar value of shares that may yet be purchased under the plans or programs (2)
July 4, 2016 - July 31, 2016	—	$ —	—	$ 35,006,981
August 1, 2016 - August 28, 2016	676	21.59	—	35,006,981
August 29, 2016 - October 2, 2016	91	21.07	—	35,006,981
Total	767	$ 21.53	—	$ 35,006,981

(1) We repurchased 767 shares of common stock from employees in connection with payment of minimum tax withholding obligations relating to the lapse of restrictions on certain RSUs during the three months ended September 30, 2016.

(2) On January 25, 2016, we announced that the Board of Directors authorized an amendment to the Company's previously announced stock repurchase program to (i) replenish the amount available for repurchase under the program back to the previously authorized repurchase amount of $50.0 million, (ii) approve the addition of repurchases of the Company's Convertible Senior Notes under the program and (iii) extend the expiration date of the program to January 25, 2018. Under the amended program, the Company may repurchase, in the aggregate, up to $50.0 million in shares of its common stock and/or its Convertible Senior Notes. The amounts provided in this column give effect to the repurchase of our Convertible Senior Notes that are in addition to the repurchases of our common stock shown in this table.

ITEM 3. Defaults Upon Senior Securities

None.

ITEM 4. Mine Safety Disclosures

Not applicable.

ITEM 5. Other Information

None.

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ITEM 6. Exhibits

Exhibit Number	
3.1	Restated Certificate of Incorporation of Quidel Corporation. (Incorporated by reference to Exhibit 3.1 to the Registrant's Form 8-K filed on February 27, 2015.)
3.2	Certificate of Amendment to the Restated Certificate of Incorporation of Quidel Corporation. (Incorporated by reference to Exhibit 3.1 to the Registrant's Form 8-K filed on May 6, 2015.)
3.3	Amended and Restated Bylaws of Quidel Corporation. (Incorporated by reference to Exhibit 3.1 to the Registrant's Form 8-K filed on May 21, 2012.)
4.1	Certificate of Designations of Series C Junior Participating Preferred Stock. (Incorporated by reference to Exhibit 4.1 to the Registrant's Form 10-Q for the quarter ended September 30, 2010.)
31.1*	Certification by Principal Executive Officer of Registrant pursuant to Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2*	Certification by Principal Financial Officer of Registrant pursuant to Rules 13a-14 and 15d-14, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1*	Certifications by Principal Executive Officer and Principal Financial Officer of Registrant pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS*	XBRL Instance Document
101.SCH*	XBRL Taxonomy Extension Schema Document
101.CAL*	XBRL Taxonomy Calculation Linkbase Document
101.DEF*	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*	XBRL Taxonomy Label Linkbase Document
101.PRE*	XBRL Taxonomy Presentation Linkbase Document

* Filed herewith.

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SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the Registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: October 27, 2016 QUIDEL CORPORATION

/s/ DOUGLAS C. BRYANT
Douglas C. Bryant
President and Chief Executive Officer
(Principal Executive Officer)

/s/ RANDALL J. STEWARD
Randall J. Steward
Chief Financial Officer
(Principal Financial Officer)

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