INSULET CORP
Form 10-Q
August 05, 2009

Table of Contents

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

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

For the quarterly period ended June 30, 2009

OR

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

Commission File Number 001-33462
INSULET CORPORATION
(Exact name of Registrant as specified in its charter)

Delaware	**04-3523891**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)
9 Oak Park Drive **Bedford, Massachusetts**	**01730**
(Address of principal executive offices)	(Zip Code)

Registrant s telephone number, including area code: **(781) 457-5000**

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 þ No o

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

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

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

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

As of August 3, 2009, the registrant had 27,913,178 shares of common stock outstanding.

INSULET CORPORATION
TABLE OF CONTENTS

Table of Contents

PART I FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

INSULET CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)

	As of June 30, 2009	As of December 31, 2008 (Restated)
	(In thousands, except share data)	
ASSETS		
Current Assets		
Cash and cash equivalents	$ 52,362	$ 56,663
Accounts receivable, net	15,509	11,938
Inventories	10,409	16,870
Prepaid expenses and other current assets	2,100	3,028
Total current assets	80,380	88,499
Property and equipment, net	15,689	17,564
Other assets	3,244	2,170
Total assets	$ 99,313	$ 108,233
LIABILITIES AND STOCKHOLDERS EQUITY (DEFICIT)		
Current Liabilities		
Accounts payable	$ 5,580	$ 7,291
Accrued expenses	8,153	7,300
Deferred revenue	3,050	2,377
Total current liabilities	16,783	16,968
Long-term debt, net of current portion	83,079	60,172
Other long-term liabilities	2,922	2,987
Total liabilities	102,784	80,127
Stockholders Equity (Deficit)		
Preferred stock, $.001 par value: Authorized: 5,000,000 shares at June 30, 2009 and December 31, 2008. Issued and outstanding: zero shares at June 30, 2009 and December 31, 2008, respectively		
Common stock, $.001 par value: Authorized: 100,000,000 shares at June 30, 2009 and December 31, 2008 Issued and outstanding: 27,909,516 and 27,778,921 shares at June 30, 2009 and December 31, 2008, respectively	29	29
Additional paid-in capital	286,734	278,427
Accumulated deficit	(290,234)	(250,350)

Total stockholders equity (deficit)	(3,471)	28,106
Total liabilities and stockholders equity (deficit)	$ 99,313	$ 108,233

December 31, 2008 balances have been restated to reflect the retrospective adoption of FSP APB 14-1.

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

Table of Contents

INSULET CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008 (Restated)	2009	2008 (Restated)
	(In thousands, except share and per share data)			
Revenue	$ 14,617	$ 7,417	$ 27,086	$ 14,088
Cost of revenue	11,448	9,785	21,922	19,783
Gross profit (loss)	3,169	(2,368)	5,164	(5,695)
Operating expenses:				
Research and development	3,272	3,382	6,476	6,306
General and administrative	5,838	5,395	13,329	10,592
Sales and marketing	10,504	10,994	19,276	19,559
Total operating expenses	19,614	19,771	39,081	36,457
Operating loss	(16,445)	(22,139)	(33,917)	(42,152)
Interest income	81	360	182	1,073
Interest expense	(3,875)	(2,255)	(6,149)	(2,829)
Net interest expense	(3,794)	(1,895)	(5,967)	(1,756)
Net loss	(20,239)	(24,034)	(39,884)	(43,908)
Net loss per share basic and diluted	$ (0.73)	$ (0.87)	$ (1.43)	$ (1.60)
Weighted average number of shares used in calculating basic and diluted net loss per share	27,869,159	27,568,296	27,836,869	27,481,292

Results for the three and six months ended June 30, 2008 have been restated to reflect the retrospective adoption of FSP APB 14-1.

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

Table of Contents

INSULET CORPORATION
CONDENSED CONSOLIDATED STATEMENT OF CASH FLOWS
(Unaudited)

	Six Months Ended June 30,	
	2009	2008 (Restated)
	(In thousands)	
Cash flows from operating activities		
Net loss	$ (39,884)	$ (43,908)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation	2,631	2,884
Amortization of debt discount	2,672	757
Stock compensation expense	2,231	1,658
Provision for bad debts	1,670	1,122
Non cash interest expense	319	684
Changes in operating assets and liabilities:		
Accounts receivable	(5,241)	(6,099)
Inventory	6,461	(5,346)
Prepaids and other current assets	927	(1,357)
Accounts payable and accrued expenses	(857)	4,845
Other long term liabilities	(65)	2,217
Deferred revenue, short term	673	331
Net cash used in operating activities	(28,463)	(42,212)
Cash flows from investing activities		
Purchases of property and equipment	(756)	(7,824)
Net cash used in investing activities	(756)	(7,824)
Cash flows from financing activities		
Principal payments of long term loan		(5,454)
Proceeds from convertible note offering, net of financing expenses		81,615
Proceeds from issuance of facility agreement, net of financing expenses	24,513	
Redemption of long term loan		(22,719)
Proceeds from issuance of common stock, net of offering expenses	405	1,105
Proceeds from payment of subscription receivable		9
Net cash provided by financing activities	24,918	54,556
Net increase (decrease) in cash and cash equivalents	(4,301)	4,520
Cash and cash equivalents, beginning of period	56,663	94,588
Cash and cash equivalents, end of period	$ 52,362	$ 99,108

Supplemental disclosure of cash flow information

Cash paid for interest	$ 2,882	$ 1,746
Non-cash financing activities		
Allocation of fair value of warrants from net proceeds from issuance of facility agreement	$ 6,065	$

Results for the six months ended June 30, 2008 have been restated to reflect the retrospective adoption of FSP APB 14-1.

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

Table of Contents

INSULET CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Nature of Business

Insulet Corporation (the Company) is principally engaged in the development, manufacture and marketing of an insulin infusion system for people with insulin-dependent diabetes. The Company was incorporated in Delaware in 2000 and has its corporate headquarters in Bedford, Massachusetts. Since inception, the Company has devoted substantially all of its efforts to designing, developing, manufacturing and marketing the OmniPod Insulin Management System (OmniPod), which consists of the OmniPod disposable insulin infusion device and the handheld, wireless Personal Diabetes Manager (PDM). The Company commercially launched the OmniPod Insulin Management System in August 2005 after receiving FDA 510(k) approval in January 2005. The first commercial product was shipped in October 2005.

2. Summary of Significant Accounting Policies

Basis of Presentation

The unaudited condensed consolidated financial statements in this Quarterly Report on Form 10-Q have been prepared in accordance with accounting principles generally accepted 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, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2009, are not necessarily indicative of the results that may be expected for the full year ending December 31, 2009, or for any other subsequent interim period.

The condensed consolidated financial statements in this Quarterly Report on Form 10-Q should be read in conjunction with the Company s consolidated financial statements and notes thereto contained in the Company s Annual Report on Form 10-K for the year ended December 31, 2008.

Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expense during the reporting periods. The most significant estimates used in these financial statements include the valuation of inventories, accounts receivable, stock options and warrants, the lives of property and equipment, and warranty and doubtful account allowance reserve calculations. Actual results may differ from those estimates.

Principles of Consolidation

The consolidated financial statements in this Quarterly Report on Form 10-Q include the accounts of the Company and its wholly-owned subsidiary, Sub-Q Solutions, Inc. All material intercompany balances and transactions have been eliminated in consolidation. To date there has been minimal activity in Sub-Q Solutions, Inc.

Reclassifications

Certain previously reported amounts have been reclassified to conform to the current year presentation.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of amounts due from third-party payors, patients and third-party distributors. In estimating whether accounts receivable can be collected, the Company performs evaluations of third-party payors, patients and third-party distributors and continuously monitors collections and payments and estimates an allowance for doubtful accounts based on the aging of the underlying invoices, experience to date and any payor-specific collection issues that have been identified.

Inventories

Inventories are stated at the lower of cost or market, determined under the first-in, first-out (FIFO) method. Inventory has been recorded at cost at December 31, 2008 and June 30, 2009. Work in process is calculated based upon a build-up in the stage of completion using estimated labor inputs for each stage in production. Costs for PDMs and OmniPods include raw material, labor and manufacturing overhead. The Company evaluates inventory valuation

on a quarterly basis for obsolete or slow-moving items.

Table of Contents

Property and Equipment

Property and equipment is stated at cost and depreciated using the straight-line method over the estimated useful lives of the respective assets. Leasehold improvements are amortized over their useful life or the life of the lease, whichever is shorter. Assets capitalized under capital leases are amortized in accordance with the respective class of owned assets and the amortization is included with depreciation expense. Maintenance and repair costs are expensed as incurred.

Restructuring Expenses and Impairment of Assets

In connection with its efforts to pursue improved gross margins, leverage operational efficiencies and better pursue opportunities for low-cost supplier sourcing of asset costs, the Company periodically performs an evaluation of its manufacturing processes and reviews the carrying value of its property and equipment to assess the recoverability of these assets whenever events indicate that impairment may have occurred. As part of this assessment, the Company reviews the future undiscounted operating cash flows expected to be generated by those assets. If impairment is indicated through this review, the carrying amount of the asset would be reduced to its estimated fair value. This review of manufacturing processes and equipment can result in restructuring activity or an impairment of assets based on current net book value and potential future use of the assets.

The Company s restructuring expenses may also include workforce reduction and related costs for one-time termination benefits provided to employees who are involuntarily terminated under the terms of a one-time benefit arrangement. The Company records these one-time termination benefits upon incurring the liability provided that the employees are notified, the plan is approved by the appropriate level of management, the employees to be terminated and the expected completion date are identified, and the benefits the identified employees will be paid are established. Significant changes to the plan are not expected when the Company records the costs. In recording the workforce reduction and related costs, the Company estimates related costs such as taxes and outplacement services which may be provided under the plan. If changes in these estimated services occur, the Company may be required to record or reverse restructuring expenses associated with these workforce reduction and related costs.

Revenue Recognition

The Company generates nearly all of its revenue from sales of its OmniPod Insulin Management System to diabetes patients and third-party distributors who resell the product to diabetes patients. The initial sale to a new customer typically includes OmniPods and a Starter Kit, which is comprised of the PDM, two OmniPods, the OmniPod System User Guide and the OmniPod System Interactive Training CD. Subsequent sales to existing customers typically consist of additional OmniPods.

Revenue is recognized in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition in Financial Statements* (SAB 104), which requires that persuasive evidence of a sales arrangement exists, delivery of goods occurs through transfer of title and risk and rewards of ownership, the selling price is fixed or determinable and collectibility is reasonably assured. With respect to these criteria:

The evidence of an arrangement generally consists of a physician order form, a patient information form, and if applicable, third-party insurance approval for sales directly to patients or a purchase order for sales to a third-party distributor.

Transfer of title and risk and rewards of ownership are passed to the patient upon transfer to the third party carrier; transfer of title and risk and rewards of ownership are passed to the distributor typically upon their receipt of the products.

The selling prices for all sales are fixed and agreed with the patient or third-party distributor, and, if applicable, the patient s third-party insurance provider(s), prior to shipment and are based on established list prices or, in the case of certain third-party insurers, contractually agreed upon prices. Provisions for discounts and rebates to customers are established as a reduction to revenue in the same period the related sales are recorded.

The Company has considered the requirements of Emerging Issues Task Force 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21), when accounting for the OmniPods and Starter Kits. EITF 00-21 requires the Company to assess whether the different elements qualify for separate accounting. The Company recognizes revenue

for the initial shipment to a patient or other third party once all elements have been delivered.

The Company offers a 45-day right of return for its Starter Kits sales, and, in accordance with SFAS No. 48, *Revenue Recognition When the Right of Return Exists*, the Company defers revenue to reflect estimated sales returns in the same period that the related product sales are recorded. Returns are estimated through a comparison of the Company s historical return data to their related sales. Historical rates of return are adjusted for known or expected changes in the marketplace when appropriate. Historically, sales returns have amounted to approximately 3% of gross product sales.

When doubt exists about reasonable assuredness of collectibility from specific customers, the Company defers revenue from sales of products to those customers until payment is received.

In March 2008, the Company received a cash payment from Abbott Diabetes Care, Inc. (Abbott) for an agreement fee in connection with execution of the first amendment to the development and license agreement between the Company and Abbott. The Company recognizes revenue on the agreement fee from Abbott over the initial 5-year term of the agreement, and the non-current portion of the agreement fee is included in other long-term liabilities. Under the amended Abbott agreement, beginning July 1, 2008, Abbott agreed to pay an amount to the Company for services performed by Insulet in connection with each sale of a PDM that includes an Abbott Discrete Blood Glucose Monitor to a new customer. The Company typically recognizes the revenue related to this portion of the Abbott agreement at the time the revenue is recognized on the sale of the PDM to the patient. In the three and six

Table of Contents

months ended June 30, 2009, the Company recognized $1.0 million and $2.1 million of revenue related to the Abbott agreement, respectively. In the three and six months ended June 30, 2008, the Company recognized $0.1 million and $0.2 million of revenue related to the Abbott agreement, respectively. There was no impact to cost of revenue related to this agreement.

The Company had deferred revenue of $4.4 million and $4.0 million as of June 30, 2009 and December 31, 2008, respectively. The deferred revenue recorded as of June 30, 2009 was comprised of product-related revenue as well as the unrecognized portion of the agreement fee related to the Abbott agreement.

Concentration of Credit Risk

Financial instruments that subject the Company to credit risk primarily consist of cash, cash equivalents and accounts receivable. The Company maintains the majority of its cash with one accredited financial institution.

Although revenue is recognized from shipments directly to patients or third-party distributors, the majority of shipments are billed to third-party insurance payors. As of June 30, 2009, the two largest third-party payors each accounted for 4% of gross accounts receivable balances. As of December 31, 2008, the two largest third-party payors accounted for 7% and 4% of gross accounts receivable balances, respectively.

Income Taxes

The Company files federal and state tax returns. The Company has accumulated significant losses since its inception in 2000. Since the net operating losses may potentially be utilized in future years to reduce taxable income, all of the Company s tax years remain open to examination by the major taxing jurisdictions to which the Company is subject.

The Company recognizes estimated interest and penalties for uncertain tax positions in income tax expense. As of June 30, 2009, the Company had no interest and penalty accrual or expense.

Adoption of New Accounting Standards

In May 2008, the FASB issued Staff Position Accounting Principles Board 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP APB 14-1), which is effective for fiscal years beginning after December 15, 2008. FSP APB 14-1 clarifies that convertible debt instruments that may be settled in cash upon conversion should be separated between the liability and equity components in a manner that will reflect the entity s nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP APB 14-1 was applied retrospectively to all periods presented. The cumulative effect of the change in accounting principle on prior periods was recognized as of the beginning of the first period presented. The Company adopted the provisions of FSP APB 14-1 as of January 1, 2009 and has reclassified $26.9 million of its long-term debt to equity as of the issuance date of the convertible notes. During the three and six months ended June 30, 2009, the Company recorded $1.1 million and $2.1 million, respectively, of additional interest expense related to the provisions of FSP APB 14-1. During the three and six months ended June 30, 2008, the Company recorded $0.2 million of additional interest expense related to the provisions of FSP APB 14-1.

The Company adopted the provisions of SFAS No. 165, Subsequent Events (SFAS No. 165), as of June 30, 2009. SFAS No. 165 provides guidance to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 also requires entities to disclose the date through which subsequent events were evaluated as well as the rationale for why that date was selected. This disclosure should alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. SFAS No. 165 requires additional disclosures only, and therefore did not have an impact on the Company s financial position, results of operations, or cash flows. The Company has evaluated subsequent events through August 5, 2009, the date it has issued this Quarterly Report on Form 10-Q.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments.* FSP FAS 107-1 and APB 28-1 enhance consistency in financial reporting by increasing the frequency of fair value disclosures. FSP FAS 107-1 and APB 28-1 relate to fair value disclosures for any financial instruments that are not currently reflected on the balance sheet of companies at fair value. Prior to issuing this FSP, fair values for these assets and liabilities were disclosed only once a year. The FSP now requires these disclosures to be made on a quarterly basis, providing qualitative and quantitative information about fair value estimates for all those financial

instruments not measured on the balance sheet at fair value. FSP FAS 107-1 and APB 28-1 are effective for interim and annual periods ending after June 15, 2009. The Company adopted FSP FAS 107-1 and APB 28-1 in the three months ended June 30, 2009. The adoption of FSP FAS 107-1 and APB 28-1 did not have a material impact on its condensed consolidated financial statements.

In April 2009, FASB issued FSP No. 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments.* This FSP amends the other-than-temporary impairment guidance in U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of the other-than-temporary impairments on debt and equity securities in the financial statements. The FSP is effective for interim and annual reporting periods ending after June 15, 2009. The Company adopted FSP No. 115-2 and FAS 124-2 in the three months ended June 30, 2009. The adoption of FSP No. 115-2 and FAS 124-2 did not have a material impact on its condensed consolidated financial statements.

Table of Contents

Recent Accounting Pronouncements

In June 2009, the Financial Accounting Standards Board, or FASB, issued Statement No. 168, or SFAS No.168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*. SFAS No.168 will become the single source of authoritative nongovernmental U.S. generally accepted accounting principles, or GAAP, superseding existing FASB, American Institute of Certified Public Accountants, or AICPA, Emerging Issues Task Force, or EITF, and related accounting literature. SFAS No.168 reorganizes the thousands of GAAP pronouncements into roughly 90 accounting topics and displays them using a consistent structure. Also included is relevant Securities and Exchange Commission guidance organized using the same topical structure in separate sections. SFAS No.168 will be effective for financial statements issued for reporting periods that end after September 15, 2009. As a result, SFAS No.168 is effective for the Company in the three months ended September 30, 2009. This will have an impact on the Company s disclosures in the condensed consolidated financial statements since all future references to authoritative accounting literature will be references in accordance with SFAS No.168.

3. Facility Agreement and Common Stock Warrants

On March 13, 2009, the Company entered into a Facility Agreement with certain institutional accredited investors, pursuant to which the investors agreed to loan the Company up to $60 million, subject to the terms and conditions set forth in the Facility Agreement. Following the initial disbursement of $27.5 million on March 31, 2009, the Company may, but is not required to, draw down on the facility in $6.5 million increments at any time until November 2010 provided that the Company meets certain financial performance milestones. In connection with this Financing, the Company paid Deerfield Management Company, L.P., an affiliate of the lead lender, a one-time transaction fee of $1.2 million. Total financing costs, including the transaction fee, as of June 30, 2009, were $3.0 million and are being amortized as interest expense over the 42 months of the Facility Agreement.

Any amounts drawn under the Facility Agreement accrue interest at a rate of 9.75% per annum, and any undrawn amounts under the Facility Agreement accrue interest at a rate of 2.75% per annum. Accrued interest is payable quarterly in cash in arrears beginning on June 1, 2009. The Company has the right to prepay any amounts owed without penalty unless the prepayment is in connection with a major transaction. All principal amounts outstanding under the Facility Agreement are payable in September 2012.

Additionally, any amounts drawn under the Facility Agreement may become immediately due and payable upon (i) an event of default, as defined in the Facility Agreement, in which case the lenders would have the right to require the Company to re-pay 100% of the principal amount of the loan, plus any accrued and unpaid interest thereon, or (ii) the consummation of certain change of control transactions, in which case the lenders would have the right to require the Company to re-pay 106% of the outstanding principal amount of the loan, plus any accrued and unpaid interest thereon. The Facility Agreement also provides for higher interest rates to be paid by the Company in the event of default.

Because the consummation of certain change in control transactions would result in the payment of a premium on the outstanding principal, the premium feature is a derivative that is required to be bifurcated from the host debt instrument and recorded at fair value at each quarter end. Because an event of default results in a higher interest rate, the default interest is also a derivative. The default interest payment does not meet the criteria to be accounted for separately. Any changes in fair value of the premium feature will be recorded as interest expense and the difference between the face value of the outstanding principal on the Facility Agreement and the amount remaining after the bifurcation will be recorded as a discount to be amortized over the term of the Facility Agreement.

At June 30, 2009, the premium feature associated with the Facility Agreement had no value as the Company does not currently expect a change in control transaction to occur. The premium feature related to the Facility Agreement will be reassessed and marked-to-market through earnings on a quarterly basis.

At June 30, 2009, $20.8 million of the $27.5 million of outstanding debt related to the Facility Agreement is included in long-term debt in the condensed consolidated balance sheet, which reflects the net proceeds reduced by the $6.1 million fair value of the warrants and the $1.2 million transaction fee paid to Deerfield Management Company, L.P. The $7.3 million debt discount recorded upon the issuance of the debt is being recorded as interest expense over the 42 months of the loan. Approximately $1.3 million of interest expense was recorded in the three and six months ended June 30, 2009. Of the $1.3 million, approximately $0.7 million relates to cash interest and $0.6 million relates

to amortization of the debt discount and deferred financing costs.

Common Stock Warrants

On March 13, 2009, in connection with the execution of the Facility Agreement, the Company issued to the lenders fully exercisable warrants to purchase an aggregate of 3.75 million shares of common stock of the Company at an exercise price of $3.13 per share. Pursuant to the Facility Agreement, the Company has the right to request from the lenders one or more cash disbursements in the minimum amount of $6.5 million per disbursement. Each additional $6.5 million disbursement will be accompanied by the issuance to the lenders of warrants to purchase an aggregate of 0.3 million shares of common stock, at an exercise price equal to 120% of the average volume weighted average price of the Company s common stock on the fifteen consecutive trading days beginning with the date following receipt by the lenders of the disbursement request. If the Company, in its discretion, draws down the entire $60 million credit facility, the Company will have issued warrants to purchase a total of 5.25 million shares of its common stock.

If the Company issues or sells shares of its common stock (other than (i) pursuant to a registered public offering or shelf takedown, (ii) in a transaction that does not require shareholder approval, (iii) to partners in connection with a joint venture, distribution or other partnering arrangement in a transaction that does not require shareholder approval, (iv) upon the exercise of options granted to our

Table of Contents

employees, officers, directors and consultants, (v) of restricted stock to, or purchases of, our common stock under our employee stock purchase plan by employees, officers, directors or consultants or (vi) upon the exercise of the warrants) after March 13, 2009, the Company will issue concurrently therewith additional warrants to purchase such number of shares of common stock as will entitle the lenders to maintain the same beneficial ownership in the Company after the issuance as they had prior to such issuance, as adjusted on a pro rata basis for repayments of the outstanding principal amount under the loan, with such warrants being issued at an exercise price equal to the greater of $3.13 per share and the closing price of the common stock on the date immediately prior to the issuance.

All warrants issued under the Facility Agreement remain unexercised as of June 30, 2009, expire on March 13, 2015 and contain certain limitations that prevent the holder from acquiring shares upon exercise of a warrant that would result in the number of shares beneficially owned by it to exceed 9.98% of the total number of shares of Company common stock then issued and outstanding.

In addition, upon certain change of control transactions, or upon certain events of default (as defined in the warrant agreement), the holder has the right to net exercise the warrants for an amount of shares of Company common stock equal to the Black-Scholes value of the shares issuable under the warrants divided by 95% of the closing price of the common stock on the day immediately prior to the consummation of such change of control or event of default, as applicable. In certain circumstances where a warrant or portion of a warrant is not net exercised in connection with a change of control or event of default, the holder will be paid an amount in cash equal to the Black-Scholes value of such portion of the warrant not treated as a net exercise.

In accordance with EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially settled in, a Company s Own Stock* , the warrants issued in connection with the Facility Agreement qualify for permanent classification as equity and their relative fair value of $6.1 million on issuance date was recorded as additional paid in capital and debt discount and is being amortized as interest expense over the term of the Facility Agreement.

4. Convertible Notes and Repayment and Termination of Term Loan

In June 2008, the Company sold $85 million principal amount of 5.375% Convertible Senior Notes due June 15, 2013 (the 5.375% Notes) in a private placement to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. The interest rate on the notes is 5.375% per annum on the principal amount from June 16, 2008, payable semi-annually in arrears in cash on December 15 and June 15 of each year, beginning December 15, 2008. The 5.375% Notes are convertible into the Company s common stock at an initial conversion rate of 46.8467 shares of common stock per $1,000 principal amount of the 5.375% Notes, which is equivalent to a conversion price of approximately $21.35 per share, representing a conversion premium of 34% to the last reported sale price of the Company s common stock on the NASDAQ Global Market on June 10, 2008, subject to adjustment under certain circumstances, at any time beginning on March 15, 2013 or under certain other circumstances and prior to the close of business on the business day immediately preceding the final maturity date of the notes. The 5.375% Notes will be convertible for cash up to their principal amount and shares of the Company s common stock for the remainder of the conversion value in excess of the principal amount. The Company does not have the right to redeem any of the 5.375% Notes prior to maturity. If a fundamental change, as defined in the Indenture for the 5.375% Notes, occurs at any time prior to maturity, holders of the 5.375% Notes may require the Company to repurchase their notes in whole or in part for cash equal to 100% of the principal amount of the notes to be repurchased, plus accrued and unpaid interest, including any additional interest, to, but excluding, the date of repurchase.

If a holder elects to convert its 5.375% Notes upon the occurrence of a make-whole fundamental change, as defined in the Indenture for the 5.375% Notes, the holder may be entitled to receive an additional number of shares of common stock on the conversion date. These additional shares are intended to compensate the holders for the loss of the time value of the conversion option and are set forth in the Indenture to the 5.375% Notes. In no event will the number of shares issuable upon conversion of a note exceed 62.7746 per $1,000 principal amount (subject to adjustment as described in the Indenture for the 5.375% Notes).

The Company adopted the provisions of FSP APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement),* on January 1, 2009. FSP APB 14-1 clarifies that convertible debt instruments that may be settled in cash upon conversion should be separated between the liability

and equity components in a manner that will reflect the entity s nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP APB 14-1 was applied retrospectively to all periods presented. Accordingly, the Company recorded a debt discount of $26.9 million to equity to reflect the value of its nonconvertible debt borrowing rate of 14.5% per annum. This debt discount is being amortized as interest expense beginning June 15, 2008 over the 5 year life of the 5.375% Notes.

The Company incurred interest expense of approximately $2.2 million and $4.4 million for the three and six months ended June 30, 2009, respectively, related to the 5.375% Notes. Of the $2.2 million recorded in the three months ended June 30, 2009, approximately $1.1 million relates to additional interest expense recognized under the provisions of FSP APB 14-1. Of the $4.4 million recorded in the six months ended June 30, 2009, approximately $2.2 million relates to additional interest expense recognized under the provisions of FSP APB 14-1. The Company incurred deferred financing costs related to this offering of approximately $3.5 million, of which $1.1 million has been reclassified as an offset to the value of the amount allocated to equity. The remainder is recorded in the condensed consolidated balance sheet and is being amortized as a component of interest expense over the five year term of the 5.375% Notes.

At June 30, 2009, the outstanding amounts related to the 5.375% Notes of $62.3 million are included in long-term debt in the condensed consolidated balance sheet and reflect the debt discount of $22.7 million. At December 31, 2008, the outstanding amounts related to the 5.375% Notes of $60.2 million are included in long-term debt and have been retroactively restated as required by FSP APB 14-1 to reflect the debt discount of $24.8 million. The debt discount includes the equity allocation of $25.8 million ($26.9 million less the financing costs allocated to the equity of $1.1 million) offset by the accretion of the debt discount through interest expense from the issuance date in 2008 over the 5 year life of the notes. The Company recorded $1.1 million and $2.2 million

Table of Contents

of interest expense related to the debt discount in the three and six months ended June 30, 2009, respectively. At June 30, 2009, the 5.375% Notes have a remaining life of 4 years. The statement of operations for the 2008 periods subsequent to the debt issuance on June 15, 2008, has been retroactively restated to reflect the additional interest expense pursuant to FSP APB 14-1. The Company recorded $0.2 million of interest expense related to the debt discount in the three and six months ended June 30, 2008.

The Company received net proceeds of approximately $81.5 million from this offering. Approximately $23.2 million of the proceeds from this offering were used to repay and terminate the Company s outstanding term loan and the Company is using the remainder for general corporate purposes. On June 16, 2008, the Company repaid the entire outstanding principal balance, plus accrued and unpaid interest, under its existing term loan in the aggregate of approximately $21.8 million. Additionally, the Company paid a prepayment fee related to the term loan of approximately $0.4 million, a termination fee related to the term loan of $0.9 million, and incurred certain other expenses related to the repayment and termination of the term loan. The Company incurred interest expense related to the term loan of approximately $0.9 million and $1.5 million for the three and six months ended June 30, 2008, respectively. The term loan was subject to a loan origination fee of $0.9 million, which was recorded in the condensed consolidated balance sheet and was amortized as a component of interest expense over the term of the loan. The remaining balance of deferred financing costs of approximately $0.6 million was written off at the repayment and termination date. In connection with this term loan, the Company issued warrants to the lenders to purchase up to 247,252 shares of Series E preferred stock at a purchase price of $3.64 per share. The warrants automatically converted into warrants to purchase common stock on a 1-for-2.6267 basis at a purchase price of $9.56 per share at the closing of the Company s initial public offering in May 2007. The Company recorded the $0.8 million fair value of the warrants as a discount to the term loan. Upon repayment and termination of the term loan, the Company recognized approximately $0.5 million as interest expense for the unamortized balance of the warrants fair value. The difference between the amount paid, including the prepayment fee, and the carrying value of the term loan, including the remaining deferred financing costs and unamortized warrants to purchase common stock, was recognized as a $1.5 million loss from early extinguishment of the term loan.

5. Restructuring Expenses and Impairments of Assets

In December 2008, the Company recorded restructuring and impairment charges of $8.2 million for the impairment of certain manufacturing equipment no longer in use as well as workforce reduction and related costs. As part of the Company s strategic goal to pursue improved gross margins, leverage operational efficiencies and better pursue opportunities for low-cost supplier sourcing, the Company transitioned the manufacturing of completed OmniPods to Flextronics International Ltd., which is located in China. The Company determined that it would no longer use certain manufacturing equipment located in its Bedford facility. In addition, this transition resulted in a reduction in workforce of approximately 30 employees, mainly in the manufacturing and quality departments. As a result of these actions, the Company recorded $7.4 million as a non-cash charge related to impairments of assets and $0.8 million in workforce and related charges.

Employees terminated were mainly in the manufacturing and quality departments. In addition, certain members of senior management were terminated. This reduction was primarily in response to the successful transition of portions of the manufacturing process to Flextronics as well as on-going alignment of the Company s infrastructure.

During the third quarter of 2008, the Company successfully transitioned its production of completed OmniPods to the manufacturing line operated by Flextronics. Pursuant to the Company s agreement with Flextronics, Flextronics will supply, as a non-exclusive supplier, OmniPods at agreed upon prices per unit pursuant to a rolling 12-month forecast provided by the Company. The initial term of the agreement is three years from January 3, 2007, with automatic one-year renewals. The agreement may be terminated at any time by either party upon prior written notice given no less than a specified number of days prior to the date of termination. The Company continues to manufacture certain sub-assemblies and maintain packaging operations in its Bedford, Massachusetts facility.

The Company ceased to use certain assets in its Bedford facility in connection with the transition of manufacturing to Flextronics. The Company continued to evaluate Flextronics ability to manufacture completed OmniPods against the rolling forecast as well as anticipated capacity and demand throughout the fourth quarter of 2008. During the fourth quarter of 2008 the Company concluded that the capacity of the manufacturing line operated by Flextronics is

considered adequate to meet anticipated demand and quality standards in the future. As the Company determined that it would no longer use the Bedford equipment on December 1, 2008, the Company recorded an impairment charge for the remaining net book value of the assets of $7.4 million on that date. The equipment has no expected salvage value as it is highly customized equipment that can only be used for the manufacture of OmniPods.

At June 30, 2009 and December 31, 2008, the Company s accrued expense for restructuring was $0.3 million and $0.6 million, respectively, for final payments of severance and will be fully utilized in 2009.

The following is a summary of restructuring activity for the three and six months ended June 30, 2009. There was no restructuring activity in the three and six months ended June 30, 2008.

Table of Contents

	Three Months Ended June 30, 2009	Six Months Ended June 30, 2009
	Workforce and related	Workforce and related
	(In thousands)	
Balance at the beginning of year	$ 401	$ 612
Restructuring expense		
Payments	(139)	(350)
Balance at the end of the year	$ 262	$ 262

6. Net Loss Per Share

Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding for the period, excluding unvested restricted common shares. Diluted net loss per share is computed using the weighted average number of common shares outstanding and, when dilutive, potential common share equivalents from options and warrants (using the treasury-stock method), and potential common shares from convertible securities (using the if-converted method). Because the Company reported a net loss for the three and six months ended June 30, 2009 and 2008, all potential common shares have been excluded from the computation of the diluted net loss per share for all periods presented, as the effect would have been anti-dilutive. Such potentially dilutive common share equivalents consist of the following:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
Convertible notes	3,981,969	3,981,969	3,981,969	3,981,969
Unvested restricted common shares	3,108		3,108	
Outstanding options	3,547,547	2,863,384	3,547,547	2,863,384
Outstanding warrants	3,812,752	62,752	3,812,752	62,752
Total	11,345,376	6,908,105	11,345,376	6,908,105

7. Accounts Receivable

The components of accounts receivable are as follows:

	As of	
	June 30, 2009	December 31, 2008
	(In thousands)	
Trade receivables	$ 20,682	$ 15,738
Allowance for doubtful accounts	(5,173)	(3,800)
	$ 15,509	$ 11,938

8. Inventories

Inventories consist of the following:

	As of	
	June 30, 2009	December 31, 2008
	(In thousands)	
Raw materials	$ 3,300	$ 3,518
Work-in-process	717	997
Finished goods	6,392	12,355
	$ 10,409	$ 16,870

The Company is currently producing the OmniPod on a partially automated manufacturing line at a facility in China, operated by a subsidiary of Flextronics International Ltd. The Company also produces certain sub-assemblies for the OmniPod as well as maintains packaging operations in its facility in Bedford, Massachusetts. The Company purchases complete OmniPods from Flextronics, pursuant to its agreement with Flextronics entered into on January 3, 2007 and revised on October 4, 2007. The initial term of the agreement is three years from January 3, 2007, with automatic one-year renewals.

Inventories of finished goods were held at cost at June 30, 2009 and December 31, 2008. The Company s production process has a high degree of fixed costs and sales and production volumes may vary significantly from one period to another. Prior to June 30, 2008,

Table of Contents

sales and production volumes were not adequate to result in per-unit costs that were lower than the current market price for the OmniPod. During the third quarter of 2008, the Company began presenting its inventory of completed OmniPods at cost, as the cost to produce OmniPods was lower than the Company s selling price.

9. Product Warranty Costs

The Company provides a four-year warranty on its PDMs and replaces any OmniPods that do not function in accordance with product specifications. Warranty expense is estimated and recorded in the period that shipment occurs. The expense is based on the Company s historical experience and the estimated cost to service the claims. A reconciliation of the changes in the Company s product warranty liability follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2009	2008	2009	2008
	(In thousands)		(In thousands)	
Balance at the beginning of period	$ 2,672	$ 1,096	$ 2,268	$ 865
Warranty expense	793	1,053	1,936	1,769
Warranty claims settled	(856)	(649)	(1,595)	(1,134)
Balance at the end of the period	$ 2,609	$ 1,500	$ 2,609	$ 1,500
Composition of balance:				
Short-term	1,040	647	1,040	647
Long-term	1,569	853	1,569	853
Total warranty balance	$ 2,609	$ 1,500	$ 2,609	$ 1,500

10. Commitments and Contingencies

Operating Leases

The Company leases its facilities, which are accounted for as operating leases. The leases generally provide for a base rent plus real estate taxes and certain operating expenses related to the leases. In February 2008, the Company entered into a non-cancelable lease for additional office space in Bedford, Massachusetts. The lease expires in September 2010 and provides a renewal option of five years and escalating payments over the life of the lease. In March 2008, the Company extended the lease of its Bedford, Massachusetts headquarters facility containing research and development and manufacturing space. Following the extension, the lease expires in September 2014. The lease is non-cancelable and contains a five year renewal option and escalating payments over the life of the lease. The Company also leases warehouse facilities in Billerica, Massachusetts. This lease expires in December 2012.

The Company s operating lease agreements contain scheduled rent increases which are being amortized over the terms of the agreement using the straight-line method and are included in other liabilities in the accompanying balance sheet. The Company has considered FASB Technical Bulletin 88-1, *Issues Relating to Accounting for Leases*, and FASB Technical Bulletin 85-3, *Accounting for Operating Leases with Scheduled Rent Increases* , in accounting for these lease provisions.

Indemnifications

In the normal course of business, the Company enters into contracts and agreements that contain a variety of representations and warranties and provide for general indemnifications. The Company s exposure under these agreements is unknown because it involves claims that may be made against the Company in the future, but have not yet been made. To date, the Company has not paid any claims or been required to defend any action related to its indemnification obligations. However, the Company may record charges in the future as a result of these indemnification obligations.

In accordance with its bylaws, the Company has indemnification obligations to its officers and directors for certain events or occurrences, subject to certain limits, while they are serving at the Company s request in such capacity. There

have been no claims to date and the Company has a director and officer insurance policy that enables it to recover a portion of any amounts paid for future claims.

Table of Contents

11. Equity

Stock-Based Compensation Plans

Activity under the Company s stock option plans:

	Number of Options (#)	Weighted Average Exercise Price ($)	Aggregate Intrinsic Value ($)
Balance, December 31, 2008	2,933,832	$ 9.47	$6,080,097
Granted	978,000	6.43	
Exercised	(109,416)	2.44	$ 462,309(1)
Canceled	(254,869)	15.11	
Balance, June 30, 2009	3,547,547	$ 8.45	
Vested, June 30, 2009	1,579,149	6.85	$4,724,861(2)
Vested and expected to vest, June 30, 2009 (3)	2,878,926		

(1) The aggregate intrinsic value was calculated based on the positive difference between the fair market value of the Company s common stock as of the date of exercise and the exercise price of the underlying options.

(2) The aggregate intrinsic value was calculated based on the positive difference between the fair market value of the Company s common stock as of June 30, 2009, and the exercise price of

the underlying options.

(3) Represents the number of vested options as of June 30, 2009, plus the number of unvested options expected to vest as of June 30, 2009, based on the unvested options outstanding at June 30, 2009, adjusted for an estimated forfeiture rate of 16%.

As of June 30, 2009 and 2008, 22,367 and 5,995 shares were contingently issued under the employee stock purchase plan (ESPP), respectively. In the three and six months ended June 30, 2009 and 2008, the Company recorded no significant stock-based compensation charges related to the ESPP.

Employee stock-based compensation expense under SFAS 123R recognized in the three and six months ended June 30, 2009 was $1.0 million and $2.2 million, respectively. Employee stock-based compensation expense under SFAS 123R recognized in the three and six months ended June 30, 2008 was $1.0 million and $1.7 million, respectively.

12. Income Taxes

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes. The Company provided a valuation allowance for the full amount of its net deferred tax asset for all periods because realization of any future tax benefit cannot be determined as more likely than not, as the Company does not expect income in the near-term.

Table of Contents

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

You should read the following discussion of our financial condition and results of operations in conjunction with our condensed consolidated financial statements and the accompanying notes to those financial statements included in this Quarterly Report on Form 10-Q. This Quarterly Report on Form 10-Q contains forward-looking statements. These forward-looking statements are based on our current expectations and beliefs concerning future developments and their potential effects on us. There can be no assurance that future developments affecting us will be those that we have anticipated. These forward-looking statements involve a number of risks, uncertainties (some of which are beyond our control) or other assumptions that may cause actual results or performance to be materially different from those expressed or implied by these forward-looking statements. These risks and uncertainties include, but are not limited to: our historical operating losses; our dependence on the OmniPod System; our ability to achieve and maintain market acceptance of the OmniPod System; our ability to increase customer orders and manufacturing volume; adverse changes in general economic conditions; our ability to raise additional funds in the future; our ability to anticipate and effectively manage risks associated with doing business internationally, particularly in China; our dependence on third-party suppliers; our ability to obtain favorable reimbursement from third-party payors for the OmniPod System and potential adverse changes in reimbursement rates or policies relating to the OmniPod; potential adverse effects resulting from competition; technological innovations adversely affecting our business; potential termination of our license to incorporate a blood glucose meter into the OmniPod System; our ability to protect our intellectual property and other proprietary rights; conflicts with the intellectual property of third parties; adverse regulatory or legal actions relating to the OmniPod System; the potential violation of federal or state laws prohibiting kickbacks and false and fraudulent claims or adverse affects of challenges to or investigations into our practices under these laws; product liability lawsuits that may be brought against us; unfavorable results of clinical studies relating to the OmniPod System or the products of our competitors; our ability to attract and retain key personnel; our ability to manage our growth; our ability to maintain compliance with the restrictions and related to our indebtedness; our ability to successfully maintain effective internal controls; the volatility of the price of our common stock; and other risks and uncertainties described in our Annual Report on Form 10-K for the year ended December 31, 2008, which was filed with the Securities and Exchange Commission on March 16, 2009 as updated by Part II, Item 1A., Risk Factors of this Quarterly Report on Form 10-Q. Should one or more of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, actual results may vary in material respects from those projected in these forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements.

Overview

We are a medical device company that develops, manufactures and markets an insulin infusion system for people with insulin-dependent diabetes. Our proprietary OmniPod Insulin Management System consists of our disposable OmniPod insulin infusion device and our handheld, wireless Personal Diabetes Manager.

The U.S. Food and Drug Administration, or FDA, approved the OmniPod System in January 2005 and we began commercial sale of the OmniPod System in the United States in October 2005. We have progressively expanded our marketing and sales efforts from an initial focus in the Eastern United States, to having availability of the OmniPod System in the entire United States. We focus our sales towards key diabetes practitioners, academic centers and clinics specializing in the treatment of diabetic patients.

We believe a key contributing factor to the overall attractiveness of the OmniPod System is the disposable OmniPod insulin infusion device. Each OmniPod is worn for up to three days before it is replaced, so in order to manufacture sufficient volumes of the OmniPod and achieve a low per unit production cost, we have designed the OmniPod to be manufactured through a highly automated process.

During 2008, construction was completed on a partially automated manufacturing line at a facility in China operated by a subsidiary of Flextronics International Ltd. We purchase complete OmniPods pursuant to our agreement with Flextronics entered into on January 3, 2007 and revised on October 4, 2007. Under the agreement, Flextronics has agreed to supply us, as a non-exclusive supplier, with OmniPods at agreed upon prices per unit pursuant to a rolling 12-month forecast that we provide to Flextronics. The initial term of the agreement is three years from January 3, 2007, with automatic one-year renewals. The agreement may be terminated at any time by either party

upon prior written notice given no less than a specified number of days prior to the date of termination. The specified number of days is intended to provide the parties with sufficient time to make alternative arrangements in the event of termination. By purchasing OmniPods manufactured by Flextronics in China, we were able to substantially increase production volumes for the OmniPod and reduce our per unit production cost. We also produce certain sub-assemblies for the OmniPod as well as maintain packaging operations at our facility in Bedford, Massachusetts.

Our OmniPod manufacturing capacity as of June 30, 2009 was in excess of 250,000 OmniPods per month. By increasing production volumes of the OmniPod, we have been able to reduce our per-unit raw material costs and improve absorption of manufacturing overhead costs. This, as well as the installation of automated manufacturing equipment, collaboration with contract manufacturers and reduction of cost of supplies of raw materials and sub-assemblies, is important as we strive to achieve profitability.

Our sales and marketing effort is focused on generating demand and acceptance of the OmniPod System among healthcare professionals, people with insulin-dependent diabetes, third-party payors and third-party distributors. Our marketing strategy is to build awareness for the benefits of the OmniPod System through a wide range of education programs, patient demonstration programs, support materials and events at the national, regional and local levels. In addition, we are using third-party distributors to improve our access to managed care and government reimbursement programs, expand our commercial presence and provide access to additional potential patients.

As a medical device company, reimbursement from third-party payors is an important element of our success. If patients are not adequately reimbursed for the costs of using the OmniPod System, it will be much more difficult for us to penetrate the market. We

Table of Contents

continue to negotiate contracts establishing reimbursement for the OmniPod System with national and regional third-party payors, and we believe that substantially all of the units sold have been reimbursed by third-party payors, subject to applicable deductible and co-payment amounts. As we expand our sales and marketing coverage area and increase our manufacturing capacity, we will need to maintain and expand available reimbursement for the OmniPod System.

Our continued growth is dependent on our ability to generate interest in our products through sales and marketing activities. We also depend on our ability to effectively and correctly evaluate the extent of patients reimbursement coverage under applicable reimbursement programs in order to convert customer inquiries into shipments and revenue.

Since our inception in 2000, we have incurred losses every quarter. In the three and six months ended June 30, 2009, we incurred net losses of $20.2 million and $39.9 million, respectively. As of June 30, 2009, we had an accumulated deficit of $290.2 million. We have financed our operations through the private placement of debt and equity securities, public offerings of our common stock as well as a private placement of our convertible debt. As of June 30, 2009, we had $85 million of convertible debt outstanding and $27.5 million of outstanding debt relating to a Facility Agreement entered into March 13, 2009. Under the Facility Agreement, we have the ability to borrow up to a total of $60 million upon meeting certain financial performance milestones. Since inception, we have received aggregate net proceeds of $351.9 million from the issuance of redeemable convertible preferred stock, common stock and debt.

Our long-term financial objective is to achieve and sustain profitable growth. Our efforts for the remainder of 2009 will be focused primarily on continuing to reduce our per-unit production costs through higher production volumes and planned cost reduction initiatives, expanding sales to domestic and international markets and reducing our spending on manufacturing overhead and operating expenses. The continued expansion of our manufacturing capacity will help us to achieve lower material costs due to volume purchase discounts and improved absorption of manufacturing overhead costs, reducing our cost of revenue as a percentage of revenue. Achieving these objectives is expected to require additional investments in certain personnel and initiatives to allow for us to increase our market penetration in the United States market and enter certain international markets. We believe that we will continue to incur net losses in the near term in order to achieve these objectives, particularly in light of the recession in the United States and the slowdown of economic growth in the rest of the world which is creating a challenging near term business environment. However, we believe that the accomplishment of our near term objectives will have a positive impact on our financial condition in the future.

Facility Agreement and Common Stock Warrants

On March 13, 2009, we entered into a Facility Agreement with certain institutional accredited investors, pursuant to which the investors agreed to loan us up to $60 million, subject to the terms and conditions set forth in the Facility Agreement. Following the initial disbursement of $27.5 million on March 31, 2009, we may, but are not required to, draw down on the facility in $6.5 million increments at any time until November 2010 provided that we meet certain financial performance milestones. In connection with this financing, we paid Deerfield Management Company, L.P., an affiliate of the lead lender, a one-time transaction fee of $1.2 million. Total financing costs, including the transaction fee, as of June 30, 2009, were $3.0 million and are being amortized as interest expense over the 42 months of the Facility Agreement.

Any amounts drawn under the Facility Agreement accrue interest at a rate of 9.75% per annum, and any undrawn amounts under the Facility Agreement accrue interest at a rate of 2.75% per annum. Accrued interest is payable quarterly in cash in arrears beginning on June 1, 2009. We have the right to prepay any amounts owed without penalty unless the prepayment is in connection with a major transaction. All principal amounts outstanding under the Facility Agreement are payable in September 2012.

Additionally, any amounts drawn under the Facility Agreement may become immediately due and payable upon (i) an event of default, as defined in the Facility Agreement, in which case the lenders would have the right to require us to re-pay 100% of the principal amount of the loan, plus any accrued and unpaid interest thereon, or (ii) the consummation of certain change of control transactions, in which case the lenders would have the right to require us to re-pay 106% of the outstanding principal amount of the loan, plus any accrued and unpaid interest thereon. The

Facility Agreement also provides for higher interest rates to be paid by us in the event of default.

Because the consummation of certain change in control transactions would result in the payment of a premium of the outstanding principal, the premium feature is a derivative that is required to be bifurcated from the host debt instrument and recorded at fair value at each quarter end. Because an event of default results in a higher interest rate, the default interest is also a derivative. The default interest payment does not meet the criteria to be accounted for separately. Any changes in fair value of the premium feature will be recorded as interest expense and the difference between the face value of the outstanding principal on the Facility Agreement and the amount remaining after the bifurcation will be recorded as a discount to be amortized over the term of the Facility Agreement.

At June 30, 2009, the premium feature associated with the Facility Agreement had no value as we do not currently expect a change in control transaction to occur. The embedded derivatives related to the Facility Agreement will be reassessed and marked-to-market through earnings on a quarterly basis.

At June 30, 2009, of the $27.5 million of outstanding debt related to the Facility Agreement, $20.8 million is included in long-term debt in the condensed consolidated balance sheet, which reflects the net proceeds reduced by the fair value of the warrants of $6.1 million and the $1.2 million transaction fee paid to Deerfield Management Company, L.P. The $7.3 million debt discount is being recorded as interest expense over the 42 months of the loan. Approximately $1.3 million of interest expense was recorded in the three and six months ended June 30, 2009. Of the $1.3 million, approximately $0.7 million relates to cash interest and $0.6 million relates to amortization of the debt discount and deferred financing costs.

Table of Contents

On March 13, 2009, in connection with the execution of the Facility Agreement, we issued to the lenders fully exercisable warrants to purchase an aggregate of 3.75 million shares of common stock at an exercise price of $3.13 per share. Each additional $6.5 million disbursement will be accompanied by the issuance to the lenders of warrants to purchase an aggregate of 0.3 million shares of common stock, at an exercise price equal to 120% of the average volume weighted average price of our common stock on the fifteen consecutive trading days beginning with the date following receipt by the lenders of the disbursement request. If we, in our discretion, draw down the entire $60 million credit facility, we will have issued warrants to purchase a total of 5.25 million shares of our common stock.

If we issue or sell shares of our common stock (other than (i) pursuant to a registered public offering or shelf takedown, (ii) in a transaction that does not require shareholder approval, (iii) to partners in connection with a joint venture, distribution or other partnering arrangement in a transaction that does not require shareholder approval, (iv) upon the exercise of options granted to our employees, officers, directors and consultants, (v) of restricted stock to, or purchases of, our common stock under our employee stock purchase plan by employees, officers, directors or consultants or (vi) upon the exercise of the warrants) after March 13, 2009, we will issue concurrently therewith additional warrants to purchase such number of shares of common stock as will entitle the lenders to maintain the same beneficial ownership in us after the issuance as they had prior to such issuance, as adjusted on a pro rata basis for repayments of the outstanding principal amount under the loan, with such warrants being issued at an exercise price equal to the greater of $3.13 per share and the closing price of the common stock on the date immediately prior to the issuance.

All warrants issued under the Facility Agreement remain unexercised as of June 30, 2009, expire on March 13, 2015 and contain certain limitations that prevent the holder from acquiring shares upon exercise of a warrant that would result in the number of shares beneficially owned by it to exceed 9.98% of the total number of shares of our common stock then issued and outstanding.

In addition, upon certain change of control transactions, or upon certain events of default (as defined in the warrant agreement), the holder has the right to net exercise the warrants for an amount of shares of our common stock equal to the Black-Scholes value of the shares issuable under the warrants divided by 95% of the closing price of the common stock on the day immediately prior to the consummation of such change of control or event of default, as applicable. In certain circumstances where a warrant or portion of a warrant is not net exercised in connection with a change of control or event of default, the holder will be paid an amount in cash equal to the Black-Scholes value of such portion of the warrant not treated as a net exercise.

In accordance with EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock,* the warrants issued in connection with the Facility Agreement qualify for permanent classification as equity and their relative fair value of $6.1 million on issuance date was recorded as additional paid in capital and debt discount to be amortized as interest expense over the term of the Facility Agreement.

Convertible Notes and Repayment and Termination of Term Loan

In June 2008, we sold $85 million principal amount of 5.375% Convertible Senior Notes due June 15, 2013 (the 5.375% Notes) in a private placement to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. The interest rate on the notes is 5.375% per annum on the principal amount from June 16, 2008, payable semi-annually in arrears in cash on December 15 and June 15 of each year, beginning December 15, 2008. The 5.375% Notes are convertible into our common stock at an initial conversion rate of 46.8467 shares of common stock per $1,000 principal amount of the 5.375% Notes, which is equivalent to a conversion price of approximately $21.35 per share, representing a conversion premium of 34% to the last reported sale price of our common stock on the NASDAQ Global Market on June 10, 2008, subject to adjustment under certain circumstances, at any time beginning on March 15, 2013 or under certain other circumstances and prior to the close of business on the business day immediately preceding the final maturity date of the notes. The 5.375% Notes will be convertible for cash up to their principal amount and shares of our common stock for the remainder of the conversion value in excess of the principal amount. We do not have the right to redeem any of the 5.375% Notes prior to maturity. If a fundamental change, as defined in the Indenture for the 5.375% Notes, occurs at any time prior to maturity, holders of the 5.375% Notes may require us to repurchase their notes in whole or in part for cash equal to 100% of the principal amount of

the notes to be repurchased, plus accrued and unpaid interest, including any additional interest, to, but excluding, the date of repurchase.

If a holder elects to convert its 5.375% Notes upon the occurrence of a make-whole fundamental change, as defined in the Indenture for the 5.375% Notes, the holder may be entitled to receive an additional number of shares of common stock on the conversion date. These additional shares are intended to compensate the holders for the loss of the time value of the conversion option and are set forth in the Indenture to the 5.375% Notes. In no event will the number of shares issuable upon conversion of a note exceed 62.7746 per $1,000 principal amount (subject to adjustment as described in the Indenture for the 5.375% Notes).

We adopted the provisions of FSP APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement),* on January 1, 2009. FSP APB 14-1 clarifies that convertible debt instruments that may be settled in cash upon conversion should be separated between the liability and equity components in a manner that will reflect the entity s nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP APB 14-1 was applied retrospectively to all periods presented. Accordingly, we recorded a debt discount of $26.9 million to equity to reflect the value of our nonconvertible debt borrowing rate of 14.5% per annum. This debt discount is being amortized as interest expense beginning June 15, 2008 over the 5 year life of the 5.375% Notes.

We incurred interest expense of approximately $2.2 million and $4.4 million for the three and six months ended June 30, 2009, related to the 5.375% Notes. Of the $2.2 million recorded in the three months ended June 30, 2009, approximately $1.1 million relates to additional interest expense recognized under the provisions of FSP APB 14-1. Of the $4.4 million recorded in the six months ended June 30, 2009, approximately $2.2 million relates to additional interest expense recognized under the provisions of FSP APB 14-1.

Table of Contents

We incurred deferred financing costs related to this offering of approximately $3.5 million, of which $1.1 million has been reclassified as an offset to the value of the amount allocated to equity. The remainder is recorded in the condensed consolidated balance sheet and is being amortized as a component of interest expense over the five year term of the 5.375% Notes.

At June 30, 2009, the outstanding amounts related to the 5.375% Notes of $62.3 million are included in long-term debt in the condensed consolidated balance sheet and reflect the debt discount of $22.7 million. At December 31, 2008, the outstanding amounts related to the 5.375% Notes of $60.2 million are included in long-term debt and have been retroactively restated as required by FSP APB 14-1 to reflect the debt discount of $24.8 million. The debt discount includes the equity allocation of $25.8 million (which represents $26.9 million less the $1.1 million of allocated financing costs) offset by the accretion of the debt discount through interest expense from the issuance date in 2008 over the 5 year life of the notes. We recorded $1.1 million and $2.2 million of interest expense related to the debt discount in the three and six months ended June 30, 2009, respectively. At June 30, 2009, the 5.375% Notes have a remaining life of 4 years. The statement of operations for the 2008 periods subsequent to the debt issuance on June 15, 2008, has been retroactively restated to reflect the additional interest expense pursuant to FSP APB 14-1. We recorded $0.2 million of interest expense related to the debt discount in the three and six months ended June 30, 2008.

We received net proceeds of approximately $81.5 million from this offering. Approximately $23.2 million of the proceeds from this offering were used to repay and terminate our outstanding term loan, and we are using the remainder for general corporate purposes. On June 16, 2008, we repaid the entire outstanding principal balance, plus accrued and unpaid interest, under our existing term loan in the aggregate of approximately $21.8 million. Additionally, we paid a prepayment fee related to the term loan of approximately $0.4 million, a termination fee related to the term loan of $0.9 million, and incurred certain other expenses related to the repayment and termination of the term loan. We incurred interest expense related to the term loan of approximately $0.9 million and $1.5 million for the three and six months ended June 30, 2008, respectively. The term loan was subject to a loan origination fee of $0.9 million, which was recorded in the condensed consolidated balance sheet and was amortized as a component of interest expense over the term of the loan. The remaining balance of deferred financing costs of approximately $0.6 million was written off at the repayment and termination date. In connection with this term loan, we issued warrants to the lenders to purchase up to 247,252 shares of Series E preferred stock at a purchase price of $3.64 per share. The warrants automatically converted into warrants to purchase common stock on a 1-for-2.6267 basis at a purchase price of $9.56 per share at the closing of our initial public offering in May 2007. We recorded the $0.8 million fair value of the warrants as a discount to the term loan. Upon repayment and termination of the term loan, we recognized approximately $0.5 million as interest expense for the unamortized balance of the warrants fair value. The difference between the amount paid, including the prepayment fee, and the carrying value of the term loan, including the remaining deferred financing costs and unamortized warrants to purchase common stock, was recognized as a $1.5 million loss from early extinguishment of the term loan.

Financial Operations Overview

Revenue. Revenue is recognized in accordance with Securities and Exchange Staff Accounting Bulletin No. 104 (SAB 104) and Statement of Financial Accounting Standards No. 48, *Revenue Recognition when the Right of Return Exists* (SFAS 48). We derive nearly all of our revenue from the sale of the OmniPod System directly to patients and third-party distributors who resell the product to diabetes patients. The OmniPod System is comprised of two devices: the OmniPod, a disposable insulin infusion device that the patient wears for up to three days and then replaces; and the Personal Diabetes Manager (PDM), a handheld device much like a personal digital assistant that wirelessly programs the OmniPod with insulin delivery instructions, assists the patient with diabetes management and incorporates a blood glucose meter. Revenue is derived from the sale to new customers or third-party distributors of OmniPods and Starter Kits, which include the PDM, two OmniPods, the OmniPod System User Guide and OmniPod System Interactive Training CD, and from the subsequent sales of additional OmniPods to existing customers. Customers generally order a three-month supply of OmniPods. For the three and six months ended June 30, 2009, and for preceding periods, materially all of our revenue was derived from sales within the United States.

In March 2008, we received a cash payment from Abbott Diabetes Care, Inc. (Abbott) for an agreement fee in connection with execution of the first amendment to the development and license agreement with Abbott. We are

recognizing the payment as revenue over the 5 year term of the agreement. Under the amended Abbott agreement, beginning July 1, 2008, Abbott agreed to pay us an amount for services performed by us in connection with each sale of a PDM that includes an Abbott Discrete Blood Glucose Monitor to a new customer. We typically recognize the revenue related to this portion of the Abbott agreement at the time the revenue is recognized on the sale of the PDM to the patient. In the three and six months ended June 30, 2009, we recognized $1.0 million and $2.1 million of revenue related to the Abbott agreement, respectively. In the three and six months ended June 30, 2008, we recognized $0.1 million and $0.2 million of revenue related to the Abbott agreement, respectively. There was no impact to cost of revenue related to this agreement.

As of June 30, 2009 and December 31, 2008, we had deferred revenue of $4.4 million and $4.0 million, respectively, which includes product-related revenue as well as the unrecognized portion of the agreement fee related to the Abbott agreement.

Cost of revenue. Cost of revenue consists primarily of raw materials, labor, warranty and overhead costs related to the OmniPod System. Cost of revenue also includes depreciation, freight and packaging costs. For the remainder of 2009, we expect the cost of revenue to decrease as a percentage of revenue due to expected reductions in per-unit raw materials costs associated with planned cost reduction initiatives and volume purchase discounts, increases in our OmniPod manufacturing capacity as the supply of complete OmniPods and subassemblies from Flextronics increases and reduction in our scrap and other period expenses. The increase in our OmniPod production volume is expected to reduce the per-unit cost of manufacturing the OmniPods by allowing us to spread our fixed and semi-fixed overhead costs over a greater number of units. However, if sales volumes do not continue to increase, then the average cost of revenue per OmniPod may not decrease.

Table of Contents

Research and development. Research and development expenses consist primarily of personnel costs within our product development, regulatory and clinical functions, as well as the costs of market studies and product development projects. We expense all research and development costs as incurred. For the remainder of 2009, we expect overall research and development spending to be in line with current levels in order to support our current research and development efforts, which are focused primarily on increased functionality, improved design for ease of use and reduction of production cost, as well as developing a new OmniPod System that incorporates continuous glucose monitoring technology.

Sales and marketing. Sales and marketing expenses consist primarily of personnel costs within our sales, marketing, reimbursement support, customer support and training functions, sales commissions paid to our sales representatives and costs associated with participation in medical conferences, physician symposia and promotional activities, including distribution of units used in our demonstration kit programs. For the remainder of 2009, we expect sales and marketing expenses to decrease as a percentage of sales as we believe we have aligned our sales and marketing efforts with our current business needs.

General and administrative. General and administrative expenses consist primarily of salaries and other related costs for personnel serving the executive, finance, information technology and human resource functions, as well as legal fees, accounting fees, insurance costs, bad debt expenses, shipping, handling and facilities-related costs. For the remainder of 2009, we expect general and administrative expenses to continue to decrease slightly from current levels.

Results of Operations

The following table presents certain statement of operations information for the three and six months ended June 30, 2009 and 2008:

	Three Months Ended June 30,			Six Months Ended June 30,		
	2009	2008 (Restated)	% Change	2009	2008 (Restated)	% Change
	(In thousands) (Unaudited)					
Revenue	$ 14,617	$ 7,417	97%	$ 27,086	$ 14,088	92%
Cost of revenue	11,448	9,785	17%	21,922	19,783	11%
Gross profit (loss)	3,169	(2,368)	234%	5,164	(5,695)	191%
Operating expenses:						
Research and development	3,272	3,382	3%	6,476	6,306	3%
General and administrative	5,838	5,395	8%	13,329	10,592	26%
Sales and marketing	10,504	10,994	4%	19,276	19,559	1%
Total operating expenses	19,614	19,771	1%	39,081	36,457	7%
Operating loss	(16,445)	(22,139)	26%	(33,917)	(42,152)	20%
Other expense, net	(3,794)	(1,895)	100%	(5,967)	(1,756)	240%
Net loss	$ (20,239)	$ (24,034)	16%	$ (39,884)	$ (43,908)	9%

Comparison of the Three and Six Months Ended June 30, 2009 and 2008

Revenue

Our total revenue was $14.6 million and $27.1 million for the three and six months ended June 30, 2009, respectively, compared to $7.4 million and $14.1 million for the same periods in 2008. The increase in revenue is primarily due to an increased number of patients using the OmniPod System and an increase in sales to distributors. In addition to the increase in the number of reorders from our growing patient base, the increase in patients also resulted in additional revenue related to the Abbott agreement of $1.0 million and $2.1 million in the three and six months ended June 30, 2009, respectively, compared to $0.1 million and $0.2 million in the same periods in 2008. We expect our revenue to continue to increase in 2009 as we continue to add new patients and generate an increased number of reorders based on our expanding patient base. In addition, we will continue to recognize additional revenue related to the Abbott agreement.

Cost of Revenue

Cost of revenue was $11.5 million and $21.9 million for the three and six months ended June 30, 2009, compared to $9.8 million and $19.8 million for the same periods in 2008. The increase is due to significantly increased sales volume offset by efficiencies resulting from increased manufacturing capacity, cost reduction initiatives, lower depreciation and increased utilization of Flextronics as the sole manufacturer of complete OmniPods. Cost of revenue in the three and six months ended June 30, 2008, includes adjustment of inventory to lower of cost or market. The per-unit cost to manufacture the OmniPod decreased in the three and six months ended June 30, 2009, compared to the same periods in 2008, resulting in a significant improvement of our gross margin.

Table of Contents

Research and Development

Research and development expenses decreased $0.1 million, or 3%, to $3.3 million for the three months ended June 30, 2009 compared to $3.4 million for the same period in 2008. Research and development expenses increased $0.2 million, or 3%, to $6.5 million for the six months ended June 30, 2009 compared to $6.3 million for the same period in 2008. For the three months ended June 30, 2009, the slight decrease in research and development expenses was primarily attributable to a decrease of $0.1 million in employee related expenses including stock-based compensation and a decrease of $0.1 million in clinical trial expenses, offset by an increase of $0.2 million in manufacturing product expense and an increase of $0.1 million in travel related expenses. For the six months ended June 30, 2009, the slight increase in research and development expenses was primarily attributable to an increase of $0.3 million in employee related expenses including stock-based compensation, an increase of $0.3 million in samples, tools and supplies and an increase of $0.2 million in travel related expenses offset primarily by a decrease of $0.5 million in outside services and temporary help.

General and Administrative

General and administrative expenses increased $0.4 million, or 8%, to $5.8 million for the three months ended June 30, 2009, compared to $5.4 million for the same period in 2008. General and administrative expenses increased $2.7 million, or 26%, to $13.3 million for the six months ended June 30, 2009, compared to $10.6 million for the same period in 2008. For the three months ended June 30, 2009, the increase in general and administrative expenses was primarily due to an increase of $0.4 million in employee compensation and benefit costs, including stock-based compensation, associated with the hiring of additional employees. For the six months ended June 30, 2009, the increase in general and administrative expenses was primarily due to an increase of $0.5 million in allowances and write-offs for doubtful trade accounts receivables, $0.8 million increase in employee compensation and benefit costs, including stock-based compensation, associated with the hiring of additional employees, $0.5 million in consulting-related fees, $0.3 million in other licensing fees and $0.3 million in depreciation expense.

Sales and Marketing

Sales and marketing expenses decreased $0.5 million, or 4%, to $10.5 million for the three months ended June 30, 2009, compared to $11.0 million for the same period in 2008. Sales and marketing expenses decreased $0.3 million, or 1%, to $19.3 million for the six months ended June 30, 2009, compared to $19.6 million for the same period in 2008. For the three months ended June 30, 2009, the decrease in sales and marketing expenses was primarily due to a decrease of $0.9 million in samples and Patient Demonstration Kits and a $0.2 million decrease in convention and printing fees. These decreases were offset by an increase of $0.5 million in employee compensation and benefit costs resulting from the hiring of additional employees in our sales and marketing areas throughout 2008 and higher commissions and related taxes earned in connection with higher sales volumes and $0.3 million in outside consulting services, which include our external trainers. For the six months ended June 30, 2009, the decrease in sales and marketing expenses was primarily due to a decrease of $2.2 million in samples and Patient Demonstration Kits. The decrease was offset by an increase of $1.4 million in employee compensation and benefit costs resulting from the hiring of additional employees in our sales and marketing areas throughout 2008 and higher commissions and related taxes earned in connection with higher sales volumes and $0.6 million in outside consulting services, which include our external trainers.

Other Income (Expense)

Net interest expense was $3.8 million for the three months ended June 30, 2009, compared to $1.9 million for the same period in 2008. Net interest expense was $6.0 million for the six months ended June 30, 2009, compared to $1.8 million for the same period in 2008. For the three months ended June 30, 2009, the increase in interest expense was caused by the interest expense on the 5.375% Notes issued in June 2008, which were outstanding for only a portion of the three and six months ended June 30, 2008. In addition, we adopted FSP APB 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP APB 14-1) as of January 1, 2009 and reclassified $26.9 million of our long-term debt to equity as of the issuance date of the notes. During the three and six months ended June 30, 2009, we recorded interest expense related to both the cash interest on the 5.375% Notes as well as the provisions of FSP APB 14-1 of $2.2 million and $4.4 million, respectively. In addition, in the three and six months ended June 30, 2009, we recorded approximately $1.3 million of

interest expense related to the Facility Agreement we entered into in March 2009. Net interest expense in the three and six months ended June 30, 2008, included $1.5 million related to the repayment and termination of our term loan. We anticipate interest expense to remain consistent with current levels throughout the remainder of 2009.

Liquidity and Capital Resources

We commenced operations in 2000 and to date we have financed our operations primarily through private placement of common and preferred stock, secured indebtedness, public offerings of our common stock and issuance of convertible debt. As of June 30, 2009, we had $52.4 million in cash and cash equivalents. We believe that our current cash and cash equivalents, together with the cash expected to be generated from product sales and our borrowing capacity, will be sufficient to meet our projected operating and debt service requirements for at least the next twelve months.

Financial Resources

On March 13, 2009, we entered into a Facility Agreement with certain institutional accredited investors, pursuant to which the investors agreed to loan us up to $60 million, subject to the terms and conditions set forth in the Facility Agreement. Following the initial disbursement of $27.5 million on March 31, 2009, we may, but are not required to, draw down on the facility in $6.5 million increments at any time until November 2010 provided that we meet certain financial performance milestones. In connection with this

Table of Contents

financing, we paid Deerfield Management Company, L.P., an affiliate of the lead lender, a one-time transaction fee of $1.2 million. Total financing costs, including the transaction fee, as of June 30, 2009 were $3.0 million.

Any amounts drawn under the Facility Agreement accrue interest at a rate of 9.75% per annum, and any undrawn amounts under the Facility Agreement accrue interest at a rate of 2.75% per annum. Accrued interest is payable quarterly in cash in arrears beginning on June 1, 2009. We have the right to prepay any amounts owed without penalty unless the prepayment is in connection with a major transaction. All principal amounts outstanding under the Facility Agreement are payable in September 2012.

In connection with the Facility Agreement, we issued to the lenders warrants to purchase 3.75 million shares of common stock at an exercise price of $3.13 per share. Each additional $6.5 million disbursement will be accompanied by the issuance to the lenders of warrants to purchase an aggregate of 0.3 million shares of common stock, at an exercise price equal to 120% of the average volume weighted average price of our common stock on the fifteen consecutive trading days beginning with the date following receipt by the lenders of the disbursement request. At June 30, 2009, all warrants issued under the Facility Agreement remained unexercised.

In June 2008, we sold $85 million principal amount of 5.375% Convertible Senior Notes due June 15, 2013 (the 5.375% Notes) in a private placement to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. The interest rate on the notes is 5.375% per annum on the principal amount from June 16, 2008, payable semi-annually in arrears in cash on December 15 and June 15 of each year, beginning December 15, 2008. The 5.375% Notes are convertible into our common stock at an initial conversion rate of 46.8467 shares of common stock per $1,000 principal amount of the 5.375% Notes, which is equivalent to a conversion price of approximately $21.35 per share, representing a conversion premium of 34% to the last reported sale price of our common stock on the NASDAQ Global Market on June 10, 2008, per $1,000 principal amount of the 5.375% Notes, subject to adjustment under certain circumstances, at any time beginning on March 15, 2013 or under certain other circumstances and prior to the close of business on the business day immediately preceding the final maturity date of the notes. The 5.375% Notes will be convertible for cash up to their principal amount and shares of our common stock for the remainder of the conversion value in excess of the principal amount. We do not have the right to redeem any of the 5.375% Notes prior to maturity. If a fundamental change, as defined in the Indenture for the 5.375% Notes, occurs at any time prior to maturity, holders of the 5.375% Notes may require us to repurchase their notes in whole or in part for cash equal to 100% of the principal amount of the notes to be repurchased, plus accrued and unpaid interest, including any additional interest, to, but excluding, the date of repurchase.

We received net proceeds of approximately $81.5 million from this offering. On June 16, 2008, we used a portion of the net proceeds to repay the entire outstanding principal balance, plus accrued and unpaid interest, under our existing term loan in the aggregate of approximately $21.8 million in its entirety. Additionally, we paid a prepayment fee related to the term loan of approximately $0.4 million, a termination fee related to the term loan of $0.9 million, and incurred certain other expenses related to the repayment and termination of the term loan.

Operating Activities

The following table sets forth the amounts of cash used in operating activities and net loss for each of the periods indicated:

	Six Months Ended June 30,	
	2009	**2008**
	(In thousands)	
Cash used in operating activities	$(28,463)	$(42,212)
Net loss	$(39,884)	$(43,908)

For each of the periods above, the net cash used in operating activities was attributable primarily to the growth of our operations after adjustment for non-cash charges, such as depreciation, amortization of the debt discount and stock-based compensation expense as well as changes to working capital. Significant uses of cash from operations include an increase in accounts receivable and decreases in accounts payable and accruals. The increase in accounts receivable is primarily attributable to our increased sales, and to some extent increased aging of receivable balances. Accounts receivables are shown net of increased allowances for doubtful accounts in the consolidated balance sheets.

Cash used in operating activities is partly offset by decreases in inventory and other assets and an increase in deferred revenue.

Investing Activities

The following table sets forth the amounts of cash used in investing activities and cash provided by financing activities for each of the periods indicated:

	Six Months Ended June 30,	
	2009	**2008**
	(In thousands)	
Cash used in investing activities	$ (756)	$ (7,824)
Cash provided by financing activities	$24,918	$54,556

Cash used in investing activities in both periods was primarily for the purchase of fixed assets for use in the development and manufacturing of the OmniPod System. Our cash used in investing activities has decreased significantly in the six months ended June 30, 2009, compared to the six months ended June 30, 2008 as we completed building the majority of our manufacturing equipment in 2008. Capital expenditures are expected to remain at lower levels in 2009 compared to 2008. Cash provided by financing activities in

Table of Contents

the six months ended June 30, 2009, mainly consisted of the net proceeds from the Facility Agreement entered into on March 13, 2009. Cash provided by financing activities in the six months ended June 30, 2008, mainly consisted of the net proceeds from the 5.375% Convertible Notes issued in June 2008, offset by the redemption of the existing term loan.

Lease Obligations

We lease our facilities, which are accounted for as operating leases. The lease of our facilities in Bedford and Billerica, Massachusetts, generally provides for a base rent plus real estate taxes and certain operating expenses related to the lease. All operating leases contain renewal options and escalating payments over the life of the lease. As of June 30, 2009, we had an outstanding letter of credit which totaled $0.2 million to cover our security deposits for lease obligations. This letter of credit will expire on October 30, 2009.

Off-Balance Sheet Arrangements

As of June 30, 2009, we did not have any off-balance sheet financing arrangements.

Critical Accounting Policies and Estimates

Our financial statements are based on the selection and application of generally accepted accounting principles, which require us to make estimates and assumptions about future events that affect the amounts reported in our financial statements and the accompanying notes. Future events and their effects cannot be determined with certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates, and any such differences may be material to our financial statements. We believe that the policies set forth below may involve a higher degree of judgment and complexity in their application than our other accounting policies and represent the critical accounting policies and estimates used in the preparation of our financial statements. If different assumptions or conditions were to prevail, the results could be materially different from our reported results.

Revenue Recognition

We generate most of our revenue from sales of our OmniPod Insulin Management System to diabetes patients or third-party distributors who resell the product to diabetes patients. The initial sale to a new customer or a third-party distributor typically includes OmniPods and a Starter Kit, which include the PDM, two OmniPods, the OmniPod System User Guide and the OmniPod System Interactive Training CD. Subsequent sales to existing customers typically consist of additional OmniPods.

Revenue is recognized in accordance with Staff Accounting Bulletin No. 104, *Revenue Recognition in Financial Statements* (SAB 104), which requires that persuasive evidence of a sales arrangement exists, delivery of goods occurs through transfer of title and risk and rewards of ownership, the selling price is fixed or determinable and collectibility is reasonably assured. With respect to these criteria:

The evidence of an arrangement generally consists of a physician order form, a patient information form, and if applicable, third-party insurance approval for sales directly to patients or a purchase order for sales to a third-party distributor.

Transfer of title and risk and rewards of ownership are passed to the patient upon transfer to the third party carrier; transfer of title and risk and rewards of ownership are passed to the distributor typically upon their receipt of the products.

The selling prices for all sales are fixed and agreed with the patient or third-party distributor, and, if applicable, the patient s third-party insurance provider(s) prior to shipment and are based on established list prices or, in the case of certain third-party insurers, contractually agreed upon prices. Provisions for discounts and rebates to customers are established as a reduction to revenue in the same period the related sales are recorded.

We have considered the requirements of Emerging Issues Task Force 00-21, *Revenue Arrangements with Multiple Deliverables* (EITF 00-21), when accounting for the OmniPods and Starter Kits. EITF 00-21 requires us to assess whether the different elements qualify for separate accounting. We recognize revenue for the initial shipment to a patient or other third party once all elements have been delivered.

We offer a 45-day right of return for its Starter Kits sales, and in accordance with SFAS No. 48, *Revenue Recognition When the Right of Return Exists*, we defer revenue to reflect estimated sales returns in the same period

that the related product sales are recorded. Returns are estimated through a comparison of historical return data to their related sales. Historical rates of return are adjusted for known or expected changes in the marketplace when appropriate. Historically, sales returns have amounted to approximately 3% of gross product sales.

When doubt exists about reasonable assuredness of collectibility from specific customers, we defer revenue from sales of products to those customers until payment is received.

In March 2008, we received a cash payment from Abbott Diabetes Care, Inc. (Abbott) for an agreement fee in connection with execution of the first amendment to the development and license agreement between us and Abbott. We recognize the agreement fee received from Abbott over the 5-year term of the agreement, and the non-current portion of the agreement fee is included in other long-term liabilities. Under the amended Abbott agreement, beginning July 1, 2008, Abbott agreed to pay us an amount for services

Table of Contents

performed by us in connection with each sale of a PDM that includes an Abbott Discrete Blood Glucose Monitor to a new customer. We typically recognize the revenue related to this portion of the Abbott agreement at the time the revenue is recognized on the sale of the PDM to the patient. In the three and six months ended June 30, 2009, the Company recognized $1.0 million and $2.1 million of revenue related to the Abbott agreement, respectively. In the three and six months ended June 30, 2008, the Company recognized $0.1 million and $0.2 million of revenue related to the Abbott agreement, respectively. There was no impact to cost of revenue related to this agreement.

Restructuring Expense and Impairment of Assets

As part of our efforts to pursue improved gross margins, leverage operational efficiencies and better pursue opportunities for low-cost supplier sourcing of asset costs, we periodically perform an evaluation of our manufacturing processes and review the carrying value of our property and equipment to assess the recoverability of these assets whenever events indicate that impairment may have occurred. As part of this assessment, we review the planned use of the assets as well as the future undiscounted operating cash flows expected to be generated by those assets. If impairment is indicated through this review, the carrying amount of the asset would be reduced to its estimated fair value. This review of manufacturing processes and equipment can result in restructuring activity or an impairment of assets based on current net book value and potential future use of the assets.

Our restructuring expenses may also include workforce reduction and related costs for one-time termination benefits provided to employees who are involuntarily terminated under the terms of a one-time benefit arrangement. We record these one-time termination benefits upon incurring the liability provided that the employees are notified, the plan is approved by the appropriate level of management, the employees to be terminated and the expected completion date are identified and the benefits the identified employees will be paid are established. Significant changes to the plan are not expected when we record the costs. In recording the workforce reduction and related costs, we estimate related costs such as taxes and outplacement services which may be provided under the plan. If changes in these estimated services occur, we may be required to record or reverse restructuring expenses associated with these workforce reduction and related costs.

Asset Valuation

Asset valuation includes assessing the recorded value of certain assets, including accounts receivable, inventory and fixed assets. We use a variety of factors to assess valuation, depending upon the asset. Actual results may differ materially from our estimates. Fixed property and equipment is stated at cost and depreciated using the straight-line method over the estimated useful lives of the respective assets. Leasehold improvements are amortized over their useful life or the life of the lease, whichever is shorter. We review long-lived assets, including property and equipment and intangibles, for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. We also review assets under construction to ensure certainty of their future installation and integration into the manufacturing process. An impairment loss would be recognized when estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition is less than its carrying amount. Impairment, if any, is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value. We consider various valuation factors, principally discounted cash flows, to assess the fair values of long-lived assets.

Income Taxes

We file federal and state tax returns. We have accumulated significant losses since our inception in 2000. Since the net operating losses may potentially be utilized in future years to reduce taxable income, all of our tax years remain open to examination by the major taxing jurisdictions to which we are subject.

We recognize estimated interest and penalties for uncertain tax positions in income tax expense. As of June 30, 2009, we had no interest and penalty accrual or expense.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of amounts due from third-party payors, patients and third-party distributors. In estimating whether accounts receivable can be collected, we perform evaluations of customers and continuously monitor collections and payments and estimates an allowance for doubtful accounts based on the aging of the underlying invoices, experience to date and any payor-specific collection issues that have been identified.

Adoption of New Accounting Standards

In May 2008, the FASB issued Staff Position Accounting Principles Board 14-1, *Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement)* (FSP APB 14-1), which is effective for fiscal years beginning after December 15, 2008. FSP APB 14-1 clarifies that convertible debt instruments that may be settled in cash upon conversion should be separated between the liability and equity components in a manner that will reflect the entity s nonconvertible debt borrowing rate when interest cost is recognized in subsequent periods. FSP APB 14-1 should be applied retrospectively to all periods presented. The cumulative effect of the change in accounting principle on prior periods was recognized as of the beginning of the first period presented. We adopted the provisions of FSP APB 14-1 as of January 1, 2009 and reclassified $26.9 million of our long-term debt to equity as of the issuance date of the convertible notes. During the three and six months ended June 30, 2009, we recorded $1.1 million and $2.1 million, respectively, of additional interest expense related to the provisions of FSP APB 14-1. During the three and six months ended June 30, 2008, we recorded $0.2 million of additional interest expense related to the provisions of FSP

Table of Contents

APB 14-1.

We adopted the provisions of SFAS No. 165, Subsequent Events (SFAS No. 165), as of June 30, 2009. SFAS No. 165 provides guidance to establish general standards of accounting for and disclosures of events that occur after the balance sheet date but before financial statements are issued or are available to be issued. SFAS No. 165 also requires entities to disclose the date through which subsequent events were evaluated as well as the rationale for why that date was selected. This disclosure should alert all users of financial statements that an entity has not evaluated subsequent events after that date in the set of financial statements being presented. SFAS No. 165 requires additional disclosures only, and therefore did not have an impact on our financial position, results of operations, or cash flows. We have evaluated subsequent events through August 5, 2009, the date we have issued this Quarterly Report on Form 10-Q.

In April 2009, the FASB issued FSP FAS 107-1 and APB 28-1, *Interim Disclosures about Fair Value of Financial Instruments.* FSP FAS 107-1 and APB 28-1 enhance consistency in financial reporting by increasing the frequency of fair value disclosures. FSP FAS 107-1 and APB 28-1 relate to fair value disclosures for any financial instruments that are not currently reflected on the balance sheet of companies at fair value. Prior to issuing this FSP, fair values for these assets and liabilities were disclosed only once a year. The FSP now requires these disclosures to be made on a quarterly basis, providing qualitative and quantitative information about fair value estimates for all those financial instruments not measured on the balance sheet at fair value. FSP FAS 107-1 and APB 28-1 are effective for interim and annual periods ending after June 15, 2009. We adopted FSP FAS 107-1 and APB 28-1 in the three months ended June 30, 2009. The adoption of FSP FAS 107-1 and APB 28-1 did not have a material impact on our condensed consolidated financial statements.

In April 2009, FASB issued FSP No. 115-2 and FAS 124-2, *Recognition and Presentation of Other-Than-Temporary Impairments.* This FSP amends the other-than-temporary impairment guidance in U.S. GAAP for debt securities to make the guidance more operational and to improve the presentation and disclosure of the other-than-temporary impairments on debt and equity securities in the financial statements. The FSP is effective for interim and annual reporting periods ending after June 15, 2009. We adopted FSP No. 115-2 and FAS 124-2 in the three months ended June 30, 2009. The adoption of FSP No. 115-2 and FAS 124-2 did not have a material impact on our condensed consolidated financial statements.

Recent Accounting Pronouncement

In June 2009, the Financial Accounting Standards Board, or FASB, issued Statement No. 168, or SFAS No.168, *The FASB Accounting Standards Codification and the Hierarchy of Generally Accepted Accounting Principles*. SFAS No.168 will become the single source of authoritative nongovernmental U.S. generally accepted accounting principles, or GAAP, superseding existing FASB, American Institute of Certified Public Accountants, or AICPA, Emerging Issues Task Force, or EITF, and related accounting literature. SFAS No.168 reorganizes the thousands of GAAP pronouncements into roughly 90 accounting topics and displays them using a consistent structure. Also included is relevant Securities and Exchange Commission guidance organized using the same topical structure in separate sections. SFAS No.168 will be effective for financial statements issued for reporting periods that end after September 15, 2009. As a result, SFAS No.168 is effective for us in the three months ended September 30, 2009. This will have an impact on our disclosures in the condensed consolidated financial statements since all future references to authoritative accounting literature will be references in accordance with SFAS No.168.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

We do not use derivative financial instruments in our investment portfolio and have no foreign exchange contracts. Our financial instruments consist of cash, cash equivalents, short-term investments, accounts receivable, accounts payable, accrued expenses and long-term obligations. We consider investments that, when purchased, have a remaining maturity of 90 days or less to be cash equivalents. The primary objectives of our investment strategy are to preserve principal, maintain proper liquidity to meet operating needs and maximize yields. To minimize our exposure to an adverse shift in interest rates, we invest mainly in cash equivalents and short-term investments and maintain an average maturity of six months or less. We do not believe that a 10% change in interest rates would have a material impact on the fair value of our investment portfolio or our interest income.

As of June 30, 2009, we had outstanding debt recorded at $62.3 million related to our 5.375% Notes and $20.8 million related to our Facility Agreement. As the interest rates on the 5.375% Notes and the Facility Agreement are fixed, changes in interest rates do not affect the value of our debt.

Item 4. Controls and Procedures

Disclosure Controls and Procedures

As of June 30, 2009, our management conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended) under the supervision and with the participation of our chief executive officer and chief financial officer. In designing and evaluating our disclosure controls and procedures, we and our management recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily was required to apply its judgment in evaluating and implementing possible controls and procedures. Based upon that evaluation, our chief executive officer and chief financial officer have concluded that they believe that, as of the end of the period covered by this Quarterly Report on Form 10-Q, our disclosure controls and procedures were effective at the reasonable assurance

Table of Contents

level.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the three months ended June 30, 2009 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

None.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. Risk Factors in our Annual Report on Form 10-K for the year ended December 31, 2008, which could materially affect our business, financial condition or future results. These risks are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results. There have been no material changes in our risk factors from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2008.

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

None.

Item 3. Defaults Upon Senior Securities

None.

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

None.

Item 5. Other Information

None.

Item 6. Exhibits

Exhibit Number	Description of Document
31.1	Certification of Duane DeSisto, President and Chief Executive Officer, pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Brian Roberts, Chief Financial Officer, pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Duane DeSisto, President and Chief Executive Officer, and Brian Roberts, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Table of Contents

SIGNATURES

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

	INSULET CORPORATION (Registrant)
Date: August 5, 2009	/s/ Duane DeSisto Duane DeSisto President and Chief Executive Officer (Principal Executive Officer)
Date: August 5, 2009	/s/ Brian Roberts Brian Roberts Chief Financial Officer (Principal Financial and Accounting Officer)

Table of Contents

EXHIBIT INDEX

Exhibit Number	Description of Document
31.1	Certification of Duane DeSisto, President and Chief Executive Officer, pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Brian Roberts, Chief Financial Officer, pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of Duane DeSisto, President and Chief Executive Officer, and Brian Roberts, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.