INSULET CORP
Form 10-Q/A
June 10, 2011

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UNITED STATES SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
Form 10-Q/A
Amendment No. 1

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

For the quarterly period ended March 31, 2011

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 No.)
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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes 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 May 4, 2011, the registrant had 45,964,642 shares of common stock outstanding.

EXPLANATORY NOTE

Insulet Corporation is filing this Amendment No. 1 to its Quarterly Report on Form 10-Q (the Amended 10-Q) for the quarterly period ended March 31, 2011, which was originally filed with the Securities and Exchange Commission on May 10, 2011 (the Original 10-Q), solely to correct a typographical error in the certification filed as Exhibit 32.1, which inadvertently caused such certification to refer to a previously filed quarterly report on Form 10-Q.

No other changes have been made to the Original 10-Q. This Amended 10-Q speaks as of the original filing date of the Original 10-Q and does not reflect any events that occurred at a date subsequent to the filing of the Original 10-Q or modify or update the disclosures contained in the Original 10-Q in any way. The information in this Amended 10-Q does not reflect events or changes in circumstances occurring after May 10, 2011.

INSULET CORPORATION

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PART I FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

INSULET CORPORATION
CONSOLIDATED BALANCE SHEETS

	As of March 31, 2011	As of December 31, 2010
	(Unaudited)	
	(In thousands, except share data)	
ASSETS		
Current Assets		
Cash and cash equivalents	$ 104,488	$ 113,274
Accounts receivable, net	15,009	16,841
Inventories	12,199	11,430
Prepaid expenses and other current assets	1,841	912
Total current assets	133,537	142,457
Property and equipment, net	14,256	12,522
Other assets	1,133	1,254
Total assets	$ 148,926	$ 156,233
LIABILITIES AND STOCKHOLDERS EQUITY		
Current Liabilities		
Accounts payable	$ 6,213	$ 4,895
Accrued expenses	8,742	9,808
Deferred revenue	1,842	4,247
Total current liabilities	16,797	18,950
Long-term debt	70,857	69,433
Other long-term liabilities	1,492	1,619
Total liabilities	89,146	90,002
Stockholders Equity		
Preferred stock, $.001 par value: Authorized: 5,000,000 shares at March 31, 2011 and December 31, 2010. Issued and outstanding: zero shares at March 31, 2011 and December 31, 2010		
Common stock, $.001 par value: Authorized: 100,000,000 shares at March 31, 2011 and December 31, 2010. Issued and outstanding: 45,829,569 and 45,440,839 shares at March 31, 2011 and December 31, 2010, respectively	46	45
Additional paid-in capital	453,435	450,039
Accumulated deficit	(393,701)	(383,853)
Total stockholders equity	59,780	66,231

Total liabilities and stockholders equity	$	148,926	$	156,233

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

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INSULET CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended March 31,	
	2011	2010
	(Unaudited) (In thousands, except share and per share	
Revenue	$ 28,258	$ 20,807
Cost of revenue	14,725	12,422
Gross profit	13,533	8,385
Operating expenses:		
Research and development	4,589	3,847
General and administrative	7,211	6,959
Sales and marketing	9,006	8,309
Total operating expenses	20,806	19,115
Operating loss	(7,273)	(10,730)
Interest income	37	24
Interest expense	(2,612)	(3,785)
Other expense, net	(2,575)	(3,761)
Net loss	$ (9,848)	$ (14,491)
Net loss per share basic and diluted	$ (0.22)	$ (0.38)
Weighted average number of shares used in calculating basic and diluted net loss per share	45,583,242	37,888,258

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

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INSULET CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS

	Three Months Ended March 31, 2011	2010
	(Unaudited) (In thousands)	
Cash flows from operating activities		
Net loss	$ (9,848)	$ (14,491)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation	1,163	1,438
Amortization of debt discount	1,424	1,789
Stock-based compensation expense	1,961	1,311
Provision for bad debts	367	1,083
Non cash interest expense	121	217
Changes in operating assets and liabilities:		
Accounts receivable	1,465	(1,327)
Inventories	(770)	3,486
Prepaid expenses and other current assets	(930)	(769)
Accounts payable and accrued expenses	(287)	(2,437)
Deferred revenue	(2,405)	557
Other long term liabilities	(127)	(35)
Net cash used in operating activities	(7,866)	(9,178)
Cash flows from investing activities		
Purchases of property and equipment	(2,897)	(1,090)
Net cash used in investing activities	(2,897)	(1,090)
Cash flows from financing activities		
Proceeds from issuance of common stock, net of offering expenses	1,977	610
Net cash provided by financing activities	1,977	610
Net decrease in cash and cash equivalents	(8,786)	(9,658)
Cash and cash equivalents, beginning of period	113,274	127,996
Cash and cash equivalents, end of period	$ 104,488	$ 118,338
Supplemental disclosure of cash flow information		
Cash paid for interest	$	$ 681
Non-cash financing activities		
Unissued restricted stock units	$ (538)	$

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

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INSULET CORPORATION
NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

1. Nature of the 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.

In January 2010, the Company entered into a five year distribution agreement with Ypsomed Distribution AG, or Ypsomed, to become the exclusive distributor of the OmniPod System in eleven countries. Through the Company s partnership with Ypsomed, the OmniPod System is now available in seven markets, namely Germany, the United Kingdom, France, the Netherlands, Sweden, Norway, and Switzerland. The Company expects that Ypsomed will begin distribution of the OmniPod System, subject to approved reimbursement, in the other markets under the agreement in the last half of 2011 or 2012. In February 2011, the Company entered into a distribution agreement with GlaxoSmithKline Inc., or GSK, to become the exclusive distributor of the OmniPod System in Canada. The Company expects that GSK will begin distributing the OmniPod System, subject to approved reimbursement, in the second quarter of 2011.

2. Summary of Significant Accounting Policies

Basis of Presentation

The unaudited consolidated financial statements in this Quarterly Report on Form 10-Q have been prepared in accordance with GAAP for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, these unaudited consolidated financial statements 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 month period ended March 31, 2011, are not necessarily indicative of the results that may be expected for the full year ending December 31, 2011, or for any other subsequent interim period.

The unaudited 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, 2010.

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 and equity instruments, the lives of property and equipment, as well as warranty reserves and allowance for doubtful accounts calculations. Actual results may differ from those estimates.

Principles of Consolidation

The unaudited consolidated financial statements in this Quarterly Report on Form 10-Q include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany balances and transactions have been eliminated in consolidation.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of amounts due from third-party payors, patients and third-party distributors. The allowance for doubtful accounts is recorded in the period in which revenue is recorded or at the time potential collection risk is identified. The Company estimates its allowance based on historical experience, assessment of specific risk, discussions with individual customers and various assumptions and estimates that are believed to be reasonable under the circumstances.

Inventories

Inventories are held at the lower of cost or market, determined under the first-in, first-out (FIFO) method. Inventory has been recorded at cost as of March 31, 2011 and December 31, 2010. 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 periodically reviews inventories for potential impairment based on quantities on hand and expectations of future use.

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.

Warranty

The Company provides a four year warranty on its PDMs and may replace any OmniPods that do not function in accordance with product specifications. The Company estimates its warranty reserves at the time the product is shipped based on historical experience and the estimated cost to service the claims. Cost to service the claims reflects the current product cost, which has been decreasing over time. As these estimates are based on historical experience, and the Company continues to introduce new versions of existing products, the Company also considers the anticipated performance of the product over its warranty period in estimating warranty reserves.

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 or third-party distributor typically includes OmniPods and a Starter Kit, which includes the PDM, the OmniPod System User Guide and the OmniPod System Interactive Training CD. Subsequent sales to existing customers typically consist of additional OmniPods.

Revenue recognition 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 collectability 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 or third-party distributor upon shipment 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 assesses whether 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 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. When doubt exists about reasonable assuredness of collectability 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 five 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 in connection with each sale of a PDM that includes an Abbott Discrete Blood Glucose Monitor to certain customers. In July 2010, the Company entered into a second amendment to the development and license agreement with Abbott. Under the terms of the second amendment, Abbott agreed to pay certain amounts to the Company for services performed in connection with each sale of a PDM that includes an Abbott Discrete Blood

Glucose Monitor to customers in certain additional territories. The Company recognizes revenue related to this portion of the Abbott agreement at the time it meets the criteria for revenue recognition, typically at the time the revenue is recognized on the sale of the PDM to the patient. In the three month periods ended March 31, 2011 and 2010, the Company recognized revenue related to the amended Abbott agreement of $1.2 million and $1.1 million, respectively. There was no impact to cost of revenue related to this agreement.

The Company had deferred revenue of $2.3 million and $4.8 million as of March 31, 2011 and December 31, 2010, respectively. The deferred revenue recorded as of March 31, 2011 was comprised of product-related revenue as well as the non-amortized 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 two accredited financial institutions. Although revenue is recognized from shipments directly to patients or third-party distributors, the majority of shipments are billed to third-party insurance payors. There were no third-party payors that accounted for more than 10% of gross accounts receivable as of March 31, 2011 or December 31, 2010.

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Segment Reporting

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated on a regular basis by the chief operating decision-maker, or decision-making group, in deciding how to allocate resources to an individual segment and in assessing performance of the segment. In light of the Company s current product offering, and other considerations, management has determined that the primary form of internal reporting is aligned with the offering of the OmniPod System. Therefore, the Company believes that it operates in one segment.

Income Taxes

FASB Accounting Standard Codification, or ASC 740-10, *Income Taxes*, clarifies the accounting for uncertainty in income taxes recognized in an entity s financial statements. FASB ASC 740-10 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In addition, FASB ASC 740-10 provides guidance on derecogniton, classification, interest and penalties, accounting in interim periods, and disclosure and transition.

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 (subject to any applicable limitations), 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 March 31, 2011, interest and penalties are immaterial to the consolidated financial statements.

Stock-Based Compensation

The Company accounts for stock-based compensation under the provisions of FASB ASC 718-10, *Compensation Stock Compensation.* FASB ASC 718-10 requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values.

Nonpublic companies that used the minimum value method for either recognition or pro forma disclosures were required to apply the fair value method under FASB ASC 718-10 using the prospective-transition method. As such, the Company will continue to apply the minimum value method in future periods to equity awards outstanding that were originally measured using the minimum value method.

The Company uses the Black-Scholes option pricing model to determine the weighted average fair value of options granted. The Company recognizes the compensation expense of share-based awards on a straight-line basis over the vesting period of the award.

The determination of the fair value of share-based payment awards utilizing the Black-Scholes model is affected by the stock price and a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. The expected life of the awards is estimated based on the SEC Shortcut Approach as defined in SAB 107*,* which is the midpoint between the vesting date and the end of the contractual term. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of the awards. The dividend yield assumption is based on company history and expectation of paying no dividends. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Stock-based compensation expense recognized in the financial statements is based on awards that are ultimately expected to vest. The Company evaluates the assumptions used to value the awards on a quarterly basis and if factors change and different assumptions are utilized, stock-based compensation expense may differ significantly from what has been recorded in the past. If there are any modifications or cancellations of the underlying unvested securities, the Company may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense.

Prior to April 1, 2006, the exercise prices for options granted were set by the Company s board of directors based upon guidance set forth by the American Institute of Certified Public Accountants. The board considered a number of factors in determining the option price, including the following factors: (1) prices for the Company s preferred stock, which the Company had sold to outside investors in arm s-length transactions, and the rights, preferences and privileges of the Company s preferred stock and common stock in the Series A through Series E financings, (2) obtaining FDA 510(k) clearance, (3) launching the OmniPod System and (4) achievement of budgeted revenue and results.

The Company retrospectively estimated the fair value of its common stock based upon several factors, including the following factors: (1) operating and financial performance, (2) progress and milestones attained in the business, (3) past sales of convertible preferred stock, (4) the results of the retrospective independent valuations and (5) the expected valuation obtained in an initial public offering. The Company believes this to have been a reasonable methodology based on the factors above and based on several arm s-length transactions involving the Company s stock supportive of the results produced by this valuation methodology.

See Note 9 for a summary of the stock option activity under our stock-based employee compensation plan.

3. Long Term Debt

Convertible Notes

In June 2008, the Company sold $85.0 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. 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 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 over the five year term of the 5.375% Notes.

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 as other assets in the consolidated balance sheet and is being amortized as a component of interest expense over the five year term of the 5.375% Notes. The Company incurred interest expense related to the 5.375% Notes of approximately $2.7 million for the three months ended March 31, 2011, of which approximately $1.6 million relates to amortization of the debt discount and deferred financing costs and $1.1 million relates to cash interest. For the three months ended March 31, 2010, the Company incurred interest expense related to the 5.375% Notes of approximately $2.5 million, of which approximately $1.4 million relates to amortization of the debt discount and deferred financing costs and $1.1 million relates to cash interest.

As of March 31, 2011, the outstanding amounts related to the 5.375% Notes of $70.9 million are included in long-term debt in the consolidated balance sheet and reflect the debt discount of $14.1 million. As of December 31, 2010, the outstanding amounts related to the 5.375% Notes of $69.4 million are included in long-term debt and reflect the debt discount of $15.6 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 over the five year term of the notes. The Company recorded $1.4 million and $1.2 million of interest expense related to the debt discount in the three months ended March 31, 2011 and 2010, respectively. As of March 31, 2011, the 5.375% Notes have a remaining term of 2.25 years.

The Company received net proceeds of approximately $81.5 million from this offering. Approximately $23.2 million of the proceeds from this offering was used to repay and terminate the Company s then-existing term loan, including outstanding principal and accrued and unpaid interest of $21.8 million, a prepayment fee related to the term loan of approximately $0.4 million and a termination fee of $0.9 million. 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. As of March 31, 2011, warrants to purchase 62,752 shares of common stock remain outstanding and exercisable at a price of $9.56 per share and expire on December 27, 2013.

Facility Agreement and Common Stock Warrants

In March 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. Total financing costs, including the transaction fee, were $3.0 million and were amortized as interest expense over the 42 months of the Facility Agreement.

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. The warrants qualified for permanent treatment as equity, and their relative fair value of $6.1 million on the issuance date was recorded as additional paid-in capital and debt discount. The debt discount was amortized as non-cash interest expense over the term of the loan.

In September 2009, the Company entered into an Amendment to the Facility Agreement whereby the Company repaid the $27.5 million originally drawn and promptly drew down the remaining $32.5 million available under the Facility Agreement. The annual interest rate was 8.5%, payable quarterly in arrears. In connection with the Amendment to the Facility Agreement, the Company entered into a Securities Purchase Agreement with the lenders whereby the Company sold 2,855,659 shares of its common stock to the lenders at $9.63 per share, a $1.9 million discount based on the closing price of the Company s common stock of $10.28 on that date. The Company recorded the $1.9 million as a debt discount which was amortized as interest expense over the remaining term of the loan. The Company received aggregate proceeds of $27.5 million in connection with the sale of its shares. All principal amounts outstanding under the Facility Agreement were payable in September 2012.

In June 2010, the Company entered into a Second Amendment to its Facility Agreement whereby the Company paid a $0.5 million amendment fee in exchange for the reduction of the prepayment penalties and the modification of certain other terms of the Agreement. The fee was recorded as additional debt discount and was amortized as interest expense over the remaining term of the loan.

In December 2010, the Company paid $33.3 million to the lenders, of which $32.5 million related to principal and $0.8 million related to interest and prepayment fees, to extinguish this debt. The Company recorded a non-cash interest charge of $7.0 million in the fourth quarter of 2010 related to the write-off of the remaining debt discounts and financing costs included in other assets which were being amortized to interest expense over the term of the debt.

In the three months ended March 31, 2010, the Company recorded cash interest related to the Facility Agreement of approximately $0.7 million and non-cash interest of approximately $0.6 million. Non-cash interest in the three months ended March 31, 2010 consists of amortization of the debt discount from the issuance of warrants and transaction fee in March 2009, amortization of the discount on the shares sold in connection with the amendment in September 2009, and amortization of the issuance costs associated with the debt. No interest related to the Facility Agreement was recorded in the three months ended March 31, 2011 as the debt was repaid in December 2010.

As of March 31, 2011, all warrants to acquire 3.75 million shares of the Company s common stock issued in connection with the Facility Agreement were exercised.

4. 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 months ended March 31, 2011 and 2010, 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 March 31,	
	2011	**2010**
Convertible notes	3,981,969	3,981,969
Unvested restricted common shares		1,776
Unvested restricted stock units	591,677	305,999
Outstanding options	3,087,641	3,505,216
Outstanding warrants	62,752	3,812,752
Total	7,724,039	11,607,712

5. Accounts Receivable

The components of accounts receivable are as follows:

	As of	
	March 31, 2011	**December 31, 2010**
	(In thousands)	
Trade receivables	$ 20,336	$ 22,273
Allowance for doubtful accounts	(5,327)	(5,432)
	$ 15,009	$ 16,841

6. Inventories

Inventories consist of the following:

	As of March 31, 2011	As of December 31, 2010
	(In thousands)	
Raw materials	$ 2,304	$ 1,892
Work-in-process	1,254	2,378
Finished goods	8,641	7,160
	$ 12,199	$ 11,430

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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., or Flextronics. The Company produces certain sub-assemblies for the OmniPod and maintains packaging operations in its facility in Bedford, Massachusetts. The Company purchases complete OmniPods from Flextronics. Inventories of finished goods were held at cost at March 31, 2011 and December 31, 2010.

7. Product Warranty Costs

The Company provides a four year warranty on its PDMs and may replace 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 is as follows:

	Three Months Ended March 31,	
	2011	2010
	(In thousands)	
Balance at the beginning of period	$ 1,873	$ 1,820
Warranty expense	724	320
Warranty claims settled	(761)	(392)
Balance at the end of the period	$ 1,836	$ 1,748
Composition of balance:		
Short-term	$ 848	$ 770
Long-term	988	978
Total warranty balance	$ 1,836	$ 1,748

8. 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 2008, the Company extended the lease of its Bedford, Massachusetts headquarters facility containing research and development and manufacturing space, and in 2010 the Company extended the lease of its additional office space in Bedford, Massachusetts. Following the extension, the leases expire in September 2014. The leases contain 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 consolidated balance sheet.

Legal Proceedings

In August 2010, Becton, Dickinson and Company, or BD, filed a lawsuit in the United States District Court in the State of New Jersey against the Company alleging that the OmniPod System infringes three of its patents. BD seeks a declaration that the Company has infringed its patents, equitable relief, including an injunction that would enjoin the Company from infringing these patents, and an unspecified award for monetary damages. The Company believes that the OmniPod System does not infringe these patents. The Company expects that this litigation will not have a material adverse impact on its financial position or results of operations. The Company believes it has meritorious defenses to this lawsuit; however, litigation is inherently uncertain and there can be no assurance as to the ultimate outcome or effect of this action. The Company does not believe it has any financial exposure at March 31, 2011.

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.

9. Equity

In October 2009, in a public offering, the Company issued and sold 6,900,000 shares of its common stock at a price to the public of $10.25 per share. In connection with the offering, the Company received total gross proceeds of $70.7 million, or approximately $66.1 million in net proceeds after deducting underwriting discounts and offering expenses.

In December 2010, in a public offering, the Company issued and sold 3,450,000 shares of its common stock at a price of $13.27 per share. In connection with the offering, the Company received total gross proceeds of $47.8 million, or approximately $45.4 million in net proceeds after deducting underwriting discounts and offering expenses.

The Company grants share-based awards to employees in the form of options to purchase the Company s common stock, the ability to purchase stock at a discounted price under the employee stock purchase plan and restricted stock units. Stock-based compensation expense related to share-based awards recognized in the quarters ended March 31, 2011 and 2010 was $2.0 million and $1.3 million, respectively, and was calculated based on awards ultimately expected to vest. At March 31, 2011, the amount of stock-based compensation capitalized as part of inventory was not material. At March 31, 2011, the Company had $19.1 million of total unrecognized compensation expense related to stock options and restricted stock units.

Stock Options

The following summarizes the activity under the Company s stock option plans:

	Number of Options(#)	Weighted Average Exercise Price($)	Aggregate Intrinsic Value($) (in thousands)
Balance, December 31, 2010	3,018,469	$ 8.74	
Granted	424,000	16.65	
Exercised	(330,689)	7.43	$ 3,667(1)
Canceled	(24,139)	12.30	
Balance, March 31, 2011	3,087,641	$ 9.94	$ 33,200
Vested, March 31, 2011	1,684,936	$ 8.20	$ 21,110(2)
Vested and expected to vest, March 31, 2011 (3)	2,572,061		$ 28,525(2)

(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 March 31, 2011, and the exercise price of the underlying options.

(3) Represents the number of vested options as of March 31, 2011, plus the number of unvested options expected to vest as of March 31, 2011, based on the unvested options outstanding as of March 31, 2011, adjusted for the estimated forfeiture rate of 16%.

At the time of grant, options granted under the Company s 2000 Stock Option and Incentive Plan (the 2000 Plan) are typically immediately exercisable, but subject to restrictions. Therefore, under the 2000 Plan, the number of options exercisable is greater than the number of options vested until all options are fully vested. At March 31, 2011 there were 3,087,641 options outstanding with a weighted average exercise price of $9.94 per share and a weighted average remaining contractual life of 7.1 years. At March 31, 2011 there were 1,687,813 options exercisable with a weighted average exercise price of $8.21 per share and a weighted average remaining contractual life of 5.7 years.

Employee stock-based compensation expense related to stock options recognized in the three months ended March 31, 2011 and 2010 was $1.1 million and $1.2 million, respectively, and was based on awards ultimately expected to vest. At March 31, 2011, the Company had $10.1 million of total unrecognized compensation expense related to stock options that will be recognized over a weighted average period of 1.4 years.

Employee Stock Purchase Plan

As of March 31, 2011 and 2010, no shares were contingently issued under the employee stock purchase plan (ESPP). In the three months ended March 31, 2011 and 2010, the Company recorded no significant stock-based compensation charges related to the ESPP.

Restricted Stock Units

In the three months ended March 31, 2011, the Company awarded 339,500 restricted stock units to certain employees. The restricted stock units were granted under the Company s 2007 Stock Option and Incentive Plan (the 2007 Plan) and vest annually over three years from the grant date. The restricted stock units granted have a weighted average fair value of $17.00 per share based on the closing price of the Company s common stock on the date of grant. The restricted stock units granted were valued at approximately $5.8 million at their grant date, and the Company is recognizing the compensation expense over the three year vesting period. Approximately $0.9 million and $0.1 million of stock-based compensation expense related to the vesting of restricted stock units was recognized in the three mont