

InfuSystem Holdings, Inc  
Form 10-Q  
August 09, 2010  
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**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**  
**WASHINGTON, D.C. 20549**

**FORM 10-Q**

x **Quarterly Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the quarterly period ended June 30, 2010**

or

.. **Transition Report Pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934 for the transition period from \_\_\_\_\_ to \_\_\_\_\_**

Commission File Number: 000-51902

**INFUSYSTEM HOLDINGS, INC.**

(Exact name of registrant as specified in its charter)

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**Delaware**  
(State or Other Jurisdiction of

**20-3341405**  
(I.R.S. Employer

Incorporation or Organization)

Identification No.)

**31700 Research Park Drive**

**Madison Heights, Michigan 48071**

(Address of Principal Executive Offices including zip code)

**(248) 291-1210**

(Registrant's Telephone Number, Include Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports) and (2) has been subject to such filing requirements for the past 90 days. Yes  No

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

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

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer  (Do not check if a smaller reporting company)

Smaller reporting company

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

As of August 5, 2010, 19,874,039 shares of the registrant's common stock, par value \$0.0001 per share, were outstanding.

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**INFUSYSTEM HOLDINGS, INC. AND SUBSIDIARIES**

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**Table of Contents****Item 1. Financial Statements****INFUSYSTEM HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED BALANCE SHEETS**

<i>(in thousands, except share data)</i>	<b>June 30, 2010 (Unaudited)</b>	<b>December 31, 2009</b>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	\$ 3,016	\$ 7,750
Accounts receivable, less allowance for doubtful accounts of \$2,178 and \$1,842 at June 30, 2010 and December 31, 2009, respectively	7,459	5,517
Inventory	1,650	925
Prepaid expenses and other current assets	614	395
Deferred income taxes	255	125
 Total Current Assets	 12,994	 14,712
Property & equipment, net	16,994	13,499
Deferred debt issuance costs, net	804	781
Goodwill	64,068	56,580
Intangible assets, net	34,312	28,911
Other assets	286	207
 Total Assets	 \$ 129,458	 \$ 114,690
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current Liabilities:		
Accounts payable	\$ 1,893	\$ 1,306
Other current liabilities	2,207	1,573
Derivative liabilities	750	2,670
Current portion of long-term debt; December 31, 2009 includes \$4,928 payable to Kimberly-Clark (I-Flow)	5,011	5,501
 Total Current Liabilities	 9,861	 11,050
Long-term debt, net of current portion; December 31, 2009 includes \$16,757 payable to Kimberly-Clark (I-Flow)	29,235	18,640
Deferred income taxes	5,354	3,314
Other Liabilities	491	221
 Total Liabilities	 \$ 44,941	 \$ 33,225
Stockholders Equity		
Preferred stock, \$.0001 par value; authorized 1,000,000 shares; none issued		
Common stock, \$.0001 par value; authorized 200,000,000; shares; issued and outstanding 19,869,239 and 18,734,144, respectively	2	2
Additional paid-in capital	84,330	81,410
Retained earnings	185	53
 Total Stockholders Equity	 84,517	 81,465
 Total Liabilities and Stockholders Equity	 \$ 129,458	 \$ 114,690

See accompanying notes to consolidated financial statements.



**Table of Contents****INFUSYSTEM HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF OPERATIONS****(UNAUDITED)**

<i>(in thousands, except per share data)</i>	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>	<b>2010</b>	<b>2009</b>
Net revenues	\$ 10,487	\$ 9,173	\$ 21,421	\$ 18,400
Operating expenses:				
Cost of Revenues Product and supply costs	1,719	1,384	3,394	2,654
Cost of Revenues Pump depreciation and disposals	1,248	894	2,387	1,734
Provision for doubtful accounts	1,076	875	2,469	1,844
Amortization of intangibles	534	457	991	914
Selling and marketing	1,595	1,419	3,036	2,739
General and administrative	4,569	2,800	7,905	5,910
<b>Total Operating Expenses</b>	<b>10,741</b>	<b>7,829</b>	<b>20,182</b>	<b>15,795</b>
Operating (loss) income	(254)	1,344	1,239	2,605
Other (loss) income:				
(Loss) gain on derivatives	(71)	2,006	(460)	(636)
Interest expense	(1,366)	(851)	(2,172)	(1,837)
Gain on extinguishment of long-term debt	1,118		1,118	
<b>Total other (loss) income</b>	<b>(319)</b>	<b>1,155</b>	<b>(1,514)</b>	<b>(2,473)</b>
(Loss) income before income taxes	(573)	2,499	(275)	132
Income tax benefit	717	261	407	121
<b>Net income</b>	<b>\$ 144</b>	<b>\$ 2,760</b>	<b>\$ 132</b>	<b>\$ 253</b>
Net income per share:				
Basic	0.01	0.15	0.01	0.01
Diluted	0.01	0.15	0.01	0.01
Weighted average shares outstanding:				
Basic	19,798,719	18,566,748	19,353,638	18,549,389
Diluted	20,811,813	18,943,962	19,922,468	18,915,995

See accompanying notes to consolidated financial statements.

**Table of Contents****INFUSYSTEM HOLDINGS, INC. AND SUBSIDIARIES****CONSOLIDATED STATEMENTS OF CASH FLOWS****(UNAUDITED)**

(in thousands)	Six Months Ended June 30	
	2010	2009
<b>OPERATING ACTIVITIES</b>		
Net Income	\$ 132	\$ 253
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on derivative liabilities	460	636
Gain on extinguishment of long-term debt	(1,118)	
Provision for doubtful accounts	2,469	1,844
Depreciation and loss on disposal of pumps	2,559	2,093
Amortization of intangible assets	991	914
Amortization of deferred debt issuance costs	834	264
Stock-based compensation	997	545
Deferred income taxes	(814)	787
Changes in assets and liabilities, exclusive of effects of acquisitions:		
Increase in accounts receivable, net of provision	(2,682)	(2,653)
Increase in other current assets	(404)	(1,317)
Increase in other assets	(860)	(511)
Increase in accounts payable and other liabilities	1,165	657
Decrease in derivative liabilities from termination of interest rate swap	(365)	
<b>NET CASH PROVIDED BY OPERATING ACTIVITIES</b>	<b>3,364</b>	<b>3,512</b>
<b>INVESTING ACTIVITIES</b>		
Capital expenditures	(743)	(2,672)
Cash paid for acquisition, net of cash acquired	(16,418)	
Proceeds from sale of property		1
Other assets		(18)
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(17,161)</b>	<b>(2,689)</b>
<b>FINANCING ACTIVITIES</b>		
Principal payments on term loan	(20,568)	(6,929)
Cash proceeds from term loan	30,000	
Common stock repurchased to satisfy statutory withholding on Stock-based compensation	(38)	
Principal payments on capital lease obligation	(331)	(43)
<b>NET CASH PROVIDED BY (USED IN) FINANCING ACTIVITIES</b>	<b>9,063</b>	<b>(6,972)</b>
Net change in cash and cash equivalents	(4,734)	(6,149)
Cash and cash equivalents, beginning of period	7,750	11,513
Cash and cash equivalents, end of period	3,016	5,364
<b>SUPPLEMENTAL DISCLOSURES</b>		
Cash paid for interest (including swap payments)	\$ 1,226	\$ 1,533
Cash paid for income taxes	\$ 14	\$ 39
<b>NON-CASH TRANSACTIONS</b>		

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Additions to property (a)	\$ 111	\$ 1,002
Property acquired pursuant to a capital lease	\$ 1,372	
Origination of long term debt	\$ 750	
Current assets assumed in acquisition (b)	\$ 2,314	
Current liabilities assumed in acquisition (b)	\$ 438	
Deferred tax liability assumed in acquisition (b)	\$ 2,754	
Deferred tax asset assumed in acquisition (b)	\$ 30	

- (a) Amounts consist of current liabilities for net property that have not been included in investing activities. These amounts have not been paid for as of June 30, 2010 and 2009 but will be included as a cash outflow from investing activities for capital expenditures when paid.
- (b) See Note 3 - Acquisitions

See accompanying notes to consolidated financial statements.



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**INFUSYSTEM HOLDINGS, INC. AND SUBSIDIARIES**

**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**

**(UNAUDITED)**

**1. Basis of Presentation and Nature of Operations**

The information in this Quarterly Report on Form 10-Q includes the financial position of InfuSystem Holdings, Inc. and its consolidated subsidiaries (the Company) as of June 30, 2010 and December 31, 2009, the results of operations for the three and six months ended June 30, 2010 and 2009, and cash flows for the six months ended June 30, 2010 and 2009.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America (GAAP). All intercompany accounts and transactions have been eliminated. Results of operations for the three and six months ended June 30, 2010 are not necessarily indicative of the results for an entire year.

The Company is a provider of infusion services to oncologists and other outpatient treatment settings. The Company provides pole mounted and ambulatory pumps, supplies and related clinical, biomedical and billing services to practices and patients, nationwide. The Company's unique suite of services appeals to practices, patients and payors by improving access to clinically necessary medical equipment, while driving down costs and maximizing clinical outcomes.

On June 15, 2010, the Company entered into a stock purchase agreement with the shareholders of First Biomedical, Inc., (First Biomedical) a Kansas corporation, to acquire all of the issued and outstanding stock of First Biomedical and completed the acquisition. First Biomedical sells, rents, services and repairs new and pre-owned infusion pumps and other medical equipment. First Biomedical also sells a variety of primary and secondary tubing, cassettes, catheters and other disposable items that are utilized with infusion pumps. For more information, please refer to the Acquisition discussion included in Note 3.

To the Company's knowledge, it is the largest ambulatory infusion pump management service provider to oncology practices in the United States. The Company supplies electronic ambulatory infusion pumps and associated disposable supply kits to oncology practices, infusion clinics and hospital outpatient chemotherapy clinics. These pumps and supplies are utilized primarily by colorectal cancer patients who receive a standard of care treatment that utilizes continuous chemotherapy infusions delivered via electronic ambulatory infusion pumps. The Company obtains an assignment of insurance benefits from the patient, bills the insurance company or patient accordingly, and collects payment. The Company provides pump management services for the pumps and associated disposable supply kits to over 1,300 oncology practices in the United States. The Company retains title to the pumps during this process.

In addition, the Company sells or rents new and pre-owned pole mounted and ambulatory infusion pumps to, and provides biomedical recertification, maintenance and repair services for, oncology practices as well as other alternate site settings including home care and home infusion providers, skilled nursing facilities, pain centers and others. The company also provides these products and services to customers in the small-hospital market.

The Company purchases new and pre-owned pole mounted and ambulatory infusion pumps from a variety of sources on a non-exclusive basis. The Company repairs, refurbishes and provides biomedical certification for the devices as needed. The pumps are then available for sale, rental or to be used within the Company's ambulatory infusion pump management service.

The Company has one operating segment, representing the only reportable segment in accordance with Accounting Standard Codification (ASC) 280 (formerly Statement of Financial Accounting Standards (SFAS) No. 131, *Disclosures about Segments of an Enterprise and Related Information*).

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### **2. Summary of Significant Accounting Policies**

#### *Principles of Consolidation*

The consolidated financial statements include the accounts of the Company and all wholly owned organizations. All intercompany transactions and account balances have been eliminated in consolidation.

#### *Use of Estimates*

The preparation of financial statements in conformity with GAAP requires management to make estimates, assumptions and judgments that affect the amounts reported in the financial statements, including the notes thereto. The Company considers critical accounting policies to be those that require more significant judgments and estimates in the preparation of its consolidated financial statements, including the following: revenue recognition, which includes contractual allowances; accounts receivable and allowance for doubtful accounts; income taxes; and goodwill valuation. Management relies on historical experience and other assumptions believed to be reasonable in making its judgment and estimates. Actual results could differ materially from those estimates.

#### *Cash and Cash Equivalents*

The Company considers all highly liquid investments with original maturities of three months or less to be cash equivalents. The Company maintains its cash and cash equivalents primarily with a single financial institution and is fully insured with the Federal Deposit Insurance Corporation (FDIC) under the Transaction Account Guarantee Program (which has been extended until December 31, 2010).

#### *Accounts Receivable and Allowance for Doubtful Accounts*

Accounts receivable are reported at the estimated net realizable amounts from patients, third-party payors and other direct pay customers for goods provided and services rendered. The Company performs periodic analyses to assess the accounts receivable balances. It records an allowance for doubtful accounts based on the estimated collectability of the accounts such that the recorded amounts reflect estimated net realizable value. Upon determination that an account is uncollectible, the account is written-off and charged to the allowance.

Accounts receivable are reduced by an allowance for amounts that could become uncollectible in the future. The Company's estimate for its allowance for doubtful accounts is based upon management's assessment of historical and expected net collections by payor. Due to continuing changes in the health care industry and third-party reimbursement it is possible that management's estimates could change in the near term, which could have an impact on its financial position, results of operations, and cash flows.

#### *Inventory Supplies*

Our Inventory consists of infusion pumps and related parts and supplies and is stated at the lower of cost (determined on a first in, first out basis) or market. The Company records a period expense for inventory supplies obsolescence when incurred.

#### *Property and Equipment*

Property and equipment is stated at acquired cost and depreciated using the straight-line method over the estimated useful lives of the related assets, ranging from three to seven years. Rental equipment, consisting primarily of infusion pumps that the Company acquires from third-parties, is depreciated over five years. Leasehold improvements are amortized using the straight-line method over the life of the asset or the remaining term of the lease, whichever is shorter. Maintenance and minor repairs are charged to operations as incurred. When assets are sold, or otherwise disposed of, the cost and related accumulated depreciation are removed from the accounts and any gain or loss is recorded in the current period.

#### *Long-Lived Assets*

The Company accounts for the impairment and disposition of long-lived assets in accordance with ASC 360, (formerly SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets*). This standard

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addresses financial accounting and reporting for the impairment of long-lived assets and for the disposal of long-lived assets. In accordance with this standard, long-lived assets to be held are reviewed for events or changes in circumstances, which indicate that their carrying value may not be recoverable. If an impairment indicator exists, the Company assesses the asset (or asset group) for recoverability. Recoverability of these assets is determined based upon the expected undiscounted future net cash flows from the operations to which the assets relate, utilizing management's best estimates, appropriate assumptions and projections at the time. If the carrying value is determined not to be recoverable from future operating cash flows, the asset is deemed impaired and an impairment loss would be recognized to the extent the carrying value exceeded the estimated fair market value of the asset. The Company reviews the carrying value of long-lived assets if there is an indicator of impairment. The Company has determined that no impairment indicators existed as of June 30, 2010.

### *Goodwill Valuation*

Goodwill arising from business combinations represents the excess of the purchase price over the estimated fair value of the net assets of the businesses acquired.

In accordance with the provisions of ASC 350 (formerly SFAS No. 142, *Goodwill and Other Intangible Assets*), goodwill is tested annually for impairment or more frequently if circumstances indicate the possibility of impairment. Significant judgments required to estimate fair value include estimating future cash flows, and determining appropriate discount rates, growth rates and other assumptions. Changes in these estimates and assumptions could materially affect the determination of fair value which could trigger impairment. The Company performed the annual impairment test at October 31, 2009, and determined there was no impairment of goodwill. No events have occurred subsequent to October 31, 2009 that indicates impairment may have occurred.

### *Intangible Assets*

Intangible assets consist of trade names, physician and customer relationships, non-compete agreements and software. The trade names, physician and customer relationships and non-compete agreements arose from the acquisitions of InfuSystem and First Biomedical. Software is amortized on a straight-line basis over 3 years. The Company amortizes the value assigned to the physician and customer relationships on a straight-line basis over the period of expected benefit, which is 15 years. The acquired physician and customer relationship base represents a valuable asset of InfuSystem due to the expectation of future business opportunities to be leveraged from the existing relationship with each physician and customer. InfuSystem has long-standing relationships with numerous oncology clinics, physicians, home care and home infusion providers, skilled nursing facilities, pain centers and others. These relationships are expected, on average, to have a 15 year useful life, based on minimal attrition experienced to date by the Company and expectations of continued minimal attrition. Management tests non-amortizable intangible assets (trade names) for impairment in accordance with ASC 350 (formerly SFAS No. 142). The Company performed the annual impairment test at October 31, 2009, and determined there was no impairment. No events have occurred subsequent to October 31, 2009 that indicates impairment may have occurred.

### *Revenue Recognition*

The majority of the Company's revenue is rental revenue in the oncology market. Revenues are recognized predominantly under fee for service arrangements through equipment that the Company rents to patients. The Company recognizes revenue only when all of the following criteria are met: persuasive evidence of an arrangement exists; services have been rendered; the price to the customer is fixed or determinable; and collectability is reasonably assured. Persuasive evidence of an arrangement is determined to exist, and collectability is reasonably assured, when the Company receives a physician's written order and assignment of benefits, signed by the physician and patient, respectively, and the Company has verified actual pump usage and insurance coverage. The Company recognizes rental revenue from electronic infusion pumps as earned, normally on a month-to-month basis. Pump rentals are billed at the Company's established rates, which often differ from contractually allowable rates provided by third-party payors such as Medicare, Medicaid and commercial insurance carriers. All billings to third party payors are recorded net of provision for contractual adjustments to arrive at net revenues.

Due to the nature of the industry and the reimbursement environment in which the Company operates, certain estimates are required to record net revenues and accounts receivable at their net realizable values. Inherent in these estimates is the risk that they will have to be revised or updated as additional information becomes

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available. Specifically, the complexity of many third-party billing arrangements and the uncertainty of reimbursement amounts for certain services from certain payors may result in adjustments to amounts originally recorded. Due to continuing changes in the health care industry and third-party reimbursement, it is possible that management's estimates could change in the near term, which could have an impact on our results of operations and cash flows.

The Company's largest contracted payor is Medicare, which accounted for approximately 31% of its gross billings for the six months ended June 30, 2010. The Company has contracts with various individual Blue Cross/Blue Shield affiliates which in the aggregate accounted for approximately 23% of its gross billings for the six months ended June 30, 2010. No individual payor (other than Medicare and the Blue Cross/Blue Shield entities) accounts for greater than approximately 6% of the Company's gross billings.

The Company also recognizes revenue for selling, renting and servicing new and pre-owned infusion pumps and other medical equipment. Revenue is recognized when goods are provided or services are rendered.

### *Income Taxes*

The Company accounts for income taxes in accordance with ASC 740 (formerly SFAS No. 109, *Accounting for Income Taxes*), which requires that the Company recognize deferred tax liabilities and assets based on the differences between the financial statement carrying amounts and the tax basis of assets and liabilities, using enacted tax rates in effect in the years the differences are expected to reverse. Deferred income tax benefit (expense) results from the change in net deferred tax assets or deferred tax liabilities. A valuation allowance is recorded when, in the opinion of management, it is more likely than not that some or all of any deferred tax assets will not be realized. For more information, please refer to the *Income Taxes* discussion included in Note 8.

### *Share Based Payment*

ASC 718 (formerly SFAS No. 123(R), *Share-Based Payment*), requires all entities to recognize compensation expense in an amount equal to the fair value of share based payments made to employees, among other requirements. Under the fair value based method, compensation cost is measured at the grant date based on the fair value of the award and is recognized on a straight-line basis over the award vesting period. Accordingly, share based payments issued to officers and directors are measured at fair value and recognized as expense over the related vesting periods.

In 2007, the Company adopted the 2007 Stock Incentive Plan (the *Plan*) providing for the issuance of a maximum of 2,000,000 shares of common stock in connection with the grant of stock-based or stock-denominated awards. In addition, during the three and six months ended June 30, 2010, the Company made certain grants of restricted stock outside of the Plan.

During the three and six months ended June 30, 2010, the Company granted 3,425,000 restricted shares. Of the total shares granted, 1,425,000 entitle a holder to receive, at the end of a vesting period, a specified number of shares of the Company's common stock. The remaining 2,000,000 shares granted entitle the holder to receive common stock when the shares vest based upon certain market conditions tied to the Company's stock price, or certain performance conditions including a change in control.

Share based compensation expense recognized for the three and six months ended June 30, 2010 was \$897,000 and \$997,000, respectively, compared to \$268,000 and \$545,000 for each of the three and six months ended June 30, 2009, respectively.

### *Warrants and Derivative Financial Instruments*

On April 18, 2006, the Company consummated its initial public offering (*IPO*) of 16,666,667 units. Each unit consists of one share of common stock and two redeemable common stock purchase warrants. Each warrant entitles the holder to purchase from the Company one share of its common stock at an exercise price of \$5.00. On May 18, 2006, the Company sold an additional 208,584 units (the *Over allotment Units*) to FTN Midwest Securities Corp., the underwriter of its IPO (*FTN Midwest*), pursuant to a partial exercise by FTN Midwest of its over allotment option. The Warrant Agreement provides for the Company to register the shares underlying the warrants in the absence of the Company's ability to deliver registered shares to the warrant holders upon warrant exercise.

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In September 2000, the Emerging Issues Task Force issued ASC 815 (formerly EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in, a Company's Own Stock*), which requires freestanding derivative contracts that are settled in a company's own stock, including common stock warrants, to be designated as equity instruments, assets or liabilities. Under the provisions of this standard, a contract designated as an asset or a liability must be carried at its fair value on a company's balance sheet, with any changes in fair value recorded in the company's results of operations. A contract designated as an equity instrument must be included within equity, and no fair value adjustments are required from period to period.

On February 16, 2010 the Company announced an Offer to Exchange common stock for outstanding warrants. At the time, the Company had 35,108,219 outstanding warrants. The exchange offer expired on March 17, 2010. Holders of the Company's warrants had the option to exchange their warrants for either One (1) share of Common Stock for every thirty-five (35) Warrants tendered, or One (1) share of Common Stock for every twenty-five (25) Warrants tendered, provided the recipient agreed to be subject to a lock-up provision precluding transfer of the shares of Common Stock received for six months following the expiration of the Exchange Offer. Based on the final count, 25,635,723 Warrants were properly tendered; 24,766,700 were tendered for shares of Common Stock subject to a lock-up, and 869,023 were tendered for unrestricted shares of Common Stock. Under the terms of the Exchange Offer, the Company issued an aggregate 1,015,489 shares of Common Stock in exchange for the tendered Warrants. After the exchange, there are 8,329,638 publicly held warrants and 1,142,858 privately held warrants outstanding.

In accordance with ASC 815, the 8,329,638 remaining warrants issued in connection with the IPO and overallotment to purchase common stock must be settled in registered shares and are separately accounted for as liabilities as discussed in Note 6. The fair value of these warrants is shown on the Company's balance sheet and the unrealized changes in the value of these warrants are shown in the Company's statement of operations as (Loss) gain on derivatives. These warrants are freely traded on the Over the Counter Bulletin Board. Consequently, the fair value of these warrants is estimated as the market price of the warrant at each period end. To the extent the market price increases or decreases, the Company's warrant liabilities will also increase or decrease with a corresponding impact on the Company's results of operations within Loss on derivatives.

Sales of warrants that can be settled in unregistered shares of common stock, as discussed in Note 10, are treated as equity and included in additional paid in capital. The total warrants issued to date that can be settled in unregistered shares of common stock are 1,142,858 at an issue price of \$.70 per warrant or a total issue price of \$800,000.

ASC 815 (formerly SFAS No. 133, *Accounting for Derivative Instruments and Hedging Activities*), requires that an entity recognize all derivatives as either assets or liabilities in the statement of financial position and measure those instruments at fair value.

*Deferred Debt Issuance Costs*

Capitalized debt issuance costs as of June 30, 2010 relate solely to the Company's recently completed Bank of America credit facility, while as of December 31, 2009 they relate solely to the Company's term loan with Kimberly-Clark (formerly I-Flow). The Company classifies the costs related to the Bank of America credit facility as non-current assets and amortizes them using the interest method through the maturity date of June 2014. For a further discussion of the Company's deferred debt issuance costs, please see Note 7.

*Earnings Per Share*

Basic earnings per share are computed by dividing net income by the weighted average number of common shares outstanding during the period. Diluted earnings per share assumes the issuance of potentially dilutive shares of common stock during the period. The following table reconciles the numerators and denominators of the basic and diluted earnings per share computations:

	Three Months Ended		Six Months Ended	
	June 30,		June 30,	
	2010	2009	2010	2009
Numerator:				
Net income (in thousands)	\$ 144	\$ 2,760	\$ 132	\$ 253
Denominator:				
Weighted average common shares outstanding:				
Basic	19,798,719	18,566,748	19,353,638	18,549,389
Dilutive effect of nonvested awards	1,013,094	377,214	568,830	366,606

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Diluted	20,811,813	18,943,962	19,922,468	18,915,995
Net earnings per share:				
Basic	0.01	0.15	0.01	0.01
Diluted	0.01	0.15	0.01	0.01

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For the three and six months ended June 30, 2010 the following warrants and stock options were not included in the calculation because they would have an anti-dilutive effect: 8,329,638 outstanding warrants issued in connection with the IPO, 1,142,858 warrants issued privately and 100,479 vested stock options. For the three and six months ended June 30, 2009 the following warrants and stock options were not included in the calculation because they would have an anti-dilutive effect: 33,750,502 outstanding warrants issued in connection with the IPO and 1,357,717 warrants issued privately, and 75,000 in vested stock options and 225,000 in non-vested stock options.

### *Subsequent events*

The Company adopted the provisions of ASC 855 effective June 15, 2009 and, other than the interest rate swap entered into as described in Note 6, management has concluded that there are no other significant subsequent events requiring disclosure through August 6, 2010, which is the date the consolidated financial statements were issued.

### **3. Acquisitions**

#### *Entry into a Material Definitive Agreement*

On June 15, 2010, the Company entered into a stock purchase agreement with the shareholders of First Biomedical, Inc., a Kansas corporation, ( First Biomedical ) to acquire all of the issued and outstanding stock of First Biomedical and completed the acquisition for total consideration of \$17,213,000. Included in the consideration is \$16,463,000 paid in cash and a \$750,000 seller note described in further detail below.

First Biomedical sells, rents, services and repairs new and pre-owned infusion pumps and other medical equipment. First Biomedical also sells a variety of primary and secondary tubing, cassettes, catheters and other disposable items that are utilized with infusion pumps. Headquartered in Olathe, KS, with additional facilities in California and Toronto, First Biomedical is a leading provider to alternate site healthcare facilities and hospitals in the United States and Canada. The acquisition of First Biomedical allows the Company to expand its offerings to existing customers with the addition of biomedical service and repair, while simultaneously bolstering the growth of infusion pump sales within the oncology space and beyond.

First Biomedical's results of operations are included in the Company's consolidated statements of operations from the acquisition date.

**Table of Contents***Purchase Price Allocation*

Pursuant to ASC 805, Business Combinations, the purchase price has been allocated to the assets acquired and liabilities assumed based upon their estimated fair values as of the acquisition date. The purchase price allocation was primarily based upon a valuation using income and cost approaches, and management's estimates and assumptions. The excess of the purchase price over the net tangible and identifiable intangible assets was recorded as goodwill. For tax purposes, goodwill consists of both identifiable intangible assets (customer relationships and non-competition agreements from the table below) and unidentifiable intangible assets (goodwill from the table below). Goodwill is expected to be partially deductible for tax purposes. The purchase price allocation is based on a preliminary analysis and is subject to further adjustments. The allocation of the purchase price to the fair values of the assets acquired and liabilities assumed as of the transaction date is presented below (in thousands):

Current assets	\$ 2,344
Property and equipment	4,772
Goodwill	7,488
Customer relationships	5,100
Non-competition agreements	570
Other assets	131
Current liabilities	(438)
Deferred tax liability	(2,754)
Total purchase price	\$ 17,213



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The stock purchase agreement provides for an adjustment to the purchase price based on final working capital as of the closing balance sheet, which has not yet been finalized.

Acquired property and equipment are being depreciated on a straight-line basis with estimated remaining lives ranging from 1 year to 14.5 years. Intangible assets are being amortized on a straight-line basis with estimated remaining lives ranging from 5 to 15 years reflecting the expected future value.

*Fees*

During the six months ended June 30, 2010, we incurred legal and professional fees directly related to the First Biomedical acquisition totaling approximately \$785,000. All such costs are presented under the caption "General and administrative" within operating expenses in the accompanying consolidated statements of operations.

*Seller Note*

Pursuant to the terms of the Stock Purchase Agreement, as of the date of the acquisition the Company entered into a subordinated promissory note with the former majority shareholder of First Biomedical (the "Seller") in the amount of \$750,000. In accordance with the note, the Company will pay the Seller in equal installments over 24 months, which includes annual interest of 5%.

*Pro Forma Financial Information*

The pro forma financial information in the table below summarizes the combined results of operations of the Company and First Biomedical as though the companies had been combined as of the beginning of each period presented. The pro forma financial information is presented for informational purposes only and is not indicative of the results of operations that would have been achieved if the acquisition had taken place at the beginning of each period presented nor is it indicative of future results. The following pro forma financial information for all periods presented also includes the pro forma depreciation and amortization charges from acquired tangible and intangible assets, and related tax effects:

	<b>Six Months Ended June 30,</b>	
	<b>2010</b>	<b>2009</b>
Net revenues	\$ 26,508	\$ 23,065
Net income	497	561
Earnings per share - basic	0.03	0.03
Earnings per share - diluted	0.02	0.03

*InfuSystem Acquisition - Additional Contingent Payment*

The Stock Purchase Agreement related to the acquisition of InfuSystem provides for a potential additional payment of up to \$12,000,000, or the earn-out, to I-Flow in 2011, provided that certain consolidated net revenue growth targets related to the Company's operations are met. Any amounts ultimately paid out in 2011 per the earn-out would increase Goodwill at the time of payment. No additional payment will be made unless the Company achieves consolidated net revenue CAGR of at least 40% over the three-year period. The consolidated net revenue CAGR for the two-year period ended December 31, 2009, as compared to InfuSystem's 2007 net revenues, was 11%.

**4. Property and Equipment**

Property and equipment consisted of the following as of June 30, 2010 and December 31, 2009 (amounts in thousands):

	<b>June 30, 2010</b>	<b>December 31, 2009</b>
Pump equipment	\$ 25,804	\$ 20,142
Furniture, fixtures and equipment	1,776	1,832
Accumulated depreciation	(10,586)	(8,475)

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Total	\$ 16,994	\$ 13,499
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Included in pump equipment above is \$4,050,000 and \$2,678,000, as of June 30, 2010 and December 31, 2009, respectively, worth of pumps obtained under various capital leases. Included in accumulated depreciation above is \$603,000 and \$278,000, as of June 30, 2010 and December 31, 2009, respectively, associated with the same capital leases. Under the terms of all such capital leases, the Company does not presently hold title to these pumps, and will not obtain title until such time as the capital lease obligations are settled in full.

Depreciation expense for the three and six months ended June 30, 2010 was \$1,171,000 and \$2,343,000, respectively, which was recorded in cost of revenues and general and administrative expenses, for pump equipment and other fixed assets, respectively.

**5. Goodwill and Intangible Assets***Goodwill*

Goodwill arising from business combinations represents the excess of the purchase price over the estimated fair value of the net assets of the businesses acquired. The goodwill amount for the October 25, 2007 acquisition of InfuSystem is \$56,580,000, and is based upon the final valuation analysis. The goodwill amount for the June 15, 2010 acquisition of First Biomedical is \$7,488,000, and is based upon a preliminary valuation analysis and is subject to change until the valuation analysis is final.

*Impairment Testing*

As of October 31, 2009, the Company performed its annual impairment test pursuant to ASC 350 (formerly SFAS No. 142, *Goodwill and Other Intangible Assets*). The fair value of the Company's single reporting unit was estimated using a combined income (discounted cash flow) and market approach (guideline public company) valuation model which indicated that the fair value of its net assets exceeded the carrying value. Based on the results of the valuation, the Company determined there was no impairment of goodwill. No events have occurred subsequent to October 31, 2009 that indicates impairment may have occurred.

The Company has continued to monitor operational performance measures, general economic conditions and its market capitalization. A downward trend in one or more of these factors could cause the Company to reduce the estimated fair value of its reporting unit and recognize a corresponding impairment of goodwill in connection with a future goodwill impairment test.

The Company tests non-amortizable intangible assets (trade names) for impairment in accordance with ASC 350. The Company performed the annual impairment test at October 31, 2009, and determined there was no impairment. No events have occurred subsequent to October 31, 2009 that indicates impairment may have occurred. The intangible assets resulting from the October 25, 2007 acquisition of InfuSystem are based upon the final valuation analysis. The intangible assets resulting from the June 15, 2010 acquisition of First Biomedical are based upon the preliminary valuation analysis and are subject to change.

*Identifiable Intangible Assets*

The carrying amount and accumulated amortization of intangible assets as of June 30, 2010 and December 31, 2009 were as follows (in thousands):

	June 30, 2010	December 31, 2009
Nonamortizable intangible assets		
Trade names	\$ 5,500	\$ 5,500
Amortizable intangible assets		
Physician and customer relationships	32,500	27,400
Non-competition agreements	570	
Software	845	
Total nonamortizable and amortizable intangible assets	39,415	32,900
Less accumulated amortization	(5,103)	(3,989)

Total identifiable intangible assets	\$ 34,312	\$ 28,911
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Amortization expense for intangible assets for the three and six months ended June 30, 2010 was \$534,000 and \$991,000, respectively, compared to \$457,000 and \$914,000, respectively, for the three and six months ended June 30, 2009, which was recorded in operating expenses. Expected annual amortization expense for intangible assets recorded as of June 30, 2010 is as follows (in thousands):

	2010	2011	2012	2013	2014
Amortization expense	\$ 2,368	\$ 2,606	\$ 2,475	\$ 2,311	\$ 2,281

**6. Warrants and Derivative Financial Instruments**

The Company has determined that the warrants discussed in Note 2, issued in connection with the IPO including the Overallotment Units, should be classified as liabilities in accordance with ASC 815 (formerly EITF 00-19). Therefore, the fair value of each instrument must be recorded as a liability on the Company's balance sheet. Changes in the fair values of these instruments will result in adjustments to the amount of the recorded liabilities, and the corresponding gain or loss will be recorded in the Company's statement of operations within (Loss) gain on derivatives. At the date of the conversion of each warrant or portion thereof (or exercise of the warrants or portion thereof, as the case may be), the corresponding liability will be reclassified as equity.

On February 16, 2010 the Company announced an Offer to Exchange common stock for outstanding warrants. At the time, the Company had 35,108,219 outstanding warrants. The exchange offer expired on March 17, 2010. Holders of the Company's warrants had the option to exchange their warrants for either One (1) share of Common Stock for every thirty-five (35) Warrants tendered, or One (1) share of Common Stock for every twenty-five (25) Warrants tendered, provided the recipient agreed to be subject to a lock-up provision precluding transfer of the shares of Common Stock received for six months following the expiration of the Exchange Offer. Based on the final count, 25,635,723 Warrants were properly tendered; 24,766,700 were tendered for shares of Common Stock subject to a lock-up, and 869,023 were tendered for unrestricted shares of Common Stock. Under the terms of the Exchange Offer, the Company issued an aggregate of 1,015,489 shares of Common Stock in exchange for the tendered Warrants. There are 8,329,638 publicly held warrants (issued in connection with the IPO) and 1,142,858 privately held warrants remaining after the exchange.

The fair value of the Company's 8,329,638 and 33,750,502 warrants issued in connection with the IPO outstanding at June 30, 2010 and December 31, 2009, respectively, were liabilities of \$750,000 or \$0.09 per warrant and \$2,025,000 or \$0.06 per warrant, respectively.

On June 11, 2010, the Company terminated the single interest rate swap agreement that fixed its LIBOR-based variable rate on the Kimberly-Clark (I-Flow) loan. The interest rate swap was terminated through a cash settlement in the amount of \$365,000, which was the fair value of the interest rate swap as of the date of the termination. The fair value of the Company's interest rate swap outstanding at December 31, 2009 was a liability of \$645,000. The Company elected not to designate the swap as a cash flow hedge, in accordance with ASC 815. The fair value of the swap was therefore shown on the Company's consolidated balance sheet and the unrealized changes in the value of the swap are shown in the Company's consolidated statement of operations within (Loss) gain on derivatives.

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On July 20, 2010, the Company put in place a single interest rate swap with a July 30, 2010 effective date. The interest rate swap agreement, which expires in June 2014, has a notional value of \$19,500,000 at inception and a fixed rate of 1.40%.

Total derivative liabilities are as follows (in thousands):

	June 30, 2010	December 31, 2009
Warrant liability	\$ 750	\$ 2,025
Interest rate swap liability		645
<b>Total</b>	<b>\$ 750</b>	<b>\$ 2,670</b>

Description	June 30, 2010	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Warrant liability	\$ 750	\$ 750	\$	\$
Interest rate swap liability				
<b>Total</b>	<b>\$ 750</b>	<b>\$ 750</b>		

Description	December 31, 2009	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Warrant liability	\$ 2,025	\$ 2,025	\$	\$
Interest rate swap liability	\$ 645		645	
<b>Total</b>	<b>\$ 2,670</b>	<b>\$ 2,025</b>	<b>\$ 645</b>	

**7. Debt and other Long-term Obligations**

On June 15, 2010, the Company entered into a credit facility with Bank of America, N.A. as Administrative Agent, and KeyBank National Association as Documentation Agent. The facility consists of a \$30,000,000 term loan and a \$5,000,000 revolving credit facility, both of which mature in June 2014. Interest on the term loan is payable at the Company's choice of LIBOR plus 4.5%, or the Bank of America prime rate plus 3.5%. As of June 30, 2010, interest was payable at LIBOR plus 4.5%, which equaled approximately 4.85%.

Proceeds from the new term loan have been used to repay the outstanding balance of the Company's debt held by Kimberly-Clark (I-Flow), as well as contribute to the acquisition consideration for First Biomedical. As of June 30, 2010, the Company had no borrowings on its revolving credit facility.

The new term loan is collateralized by substantially all of the Company's assets and requires the Company to comply with covenants, including but not limited to, financial covenants relating to satisfaction of a total leverage ratio, a fixed charge coverage ratio, and an annual limit on capital expenditures. As of June 30, 2010, the Company believes it was in compliance with all such covenants.

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In conjunction with the new credit facility, the Company incurred deferred debt issuance costs of \$808,000. These costs will be recognized in income using the effective interest method through the maturity date of June 15, 2014. Amortization of these costs for both the three and six months ended June 30, 2010 was \$4,000 which was recorded in interest expense. Also, the Company incurred deferred debt issuance costs in conjunction with the Kimberly-Clark (I-Flow) loan. The remaining unamortized I-Flow debt costs were completely amortized when the term loan was paid in full on June 15, 2010. Total amortization expense for the three and six months ended June 30, 2010 were \$727,000 and \$834,000, respectively.

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In conjunction with the acquisition of First Biomedical, the Company entered into a subordinated promissory note with the former majority shareholder of First Biomedical (the Seller) in the amount of \$750,000. In accordance with the note, the Company will pay the Seller in equal installments over 24 months, which includes annual interest of 5%.

The Company sometimes enters into capital leases to finance the purchase of ambulatory infusion pumps. The pumps are capitalized into property and equipment at their fair market value, which equals the value of the future minimum lease payments, and are depreciated over the useful life of the pumps.

Maturities on the loans and capital lease are as follows (in thousands):

	7/1/10	12/31/10	2011	2012	2013	Thereafter	Total
Term Loan	\$	1,875	\$ 4,125	\$ 4,500	\$ 4,875	\$ 14,625	\$ 30,000
Seller Note		181	375	194			750
Capital Lease		436	947	1,033	944	136	3,496
Total	\$	2,492	\$ 5,447	\$ 5,727	\$ 5,819	\$ 14,761	\$ 34,246

**8. Income Taxes**

Provision for income taxes was a benefit of \$717,000 and \$407,000 for the three and six months ended June 30, 2010, respectively, as compared to a benefit of \$261,000 and \$121,000 for the three and six months ended June 30, 2009. In computing its income tax provision, the Company estimates its effective income tax rate for the full year and applies that rate to income earned through the reporting period. The Company also reflected certain discrete items in its tax provision for the quarter. The income tax benefit for the three and six months ended June 30, 2010 is primarily related to the release of a \$942,000 valuation allowance previously established against existing deferred tax assets. Without the release of the valuation allowance the Company would have reported a tax expense of approximately \$225,000 for the three months ended June 30, 2010 and a tax expense of approximately \$535,000 for the six months ended June 30, 2010.

On June 15, 2010, the Company acquired the stock of First Biomedical, Inc. In accordance with ASC 805, *Business Combinations*, the fair value of the consideration was allocated to the net assets acquired adjusting the book value of the acquired assets to their fair market value. As this was a stock acquisition, the Company's tax basis of the assets acquired did not change. This differential resulted in the recording of deferred tax liabilities of \$2,754,000 in connection with the First Biomedical assets. These new deferred tax liabilities, which are a source of future taxable income, provide strong evidence in support of the valuation allowance reversal.

The Company's realization of its deferred tax assets is dependent upon many factors, including, but not limited to, the Company's ability to generate sufficient taxable income. Certain deferred tax liabilities can also be considered as a source of future taxable income including those resulting from the acquisition. In prior years and through March 31, 2010, the Company had deferred tax assets to which a full valuation allowance was applied. At the end of the first quarter the total valuation allowance was \$942,000. Based upon the weight of available evidence, it was more likely than not that some portion or all of the deferred tax assets would not be realized. During the quarter ended June 30, 2010, as a result of a review of the Company's earnings history, existing deferred tax liabilities including those resulting from the First Biomedical acquisition, the Company has removed the valuation allowance previously applied against the net deferred tax asset.



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**9. Related Party Transactions**