

InfuSystem Holdings, Inc  
Form 10-Q  
November 05, 2008  
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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 September 30, 2008**

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.)

**1551 East Lincoln Avenue, Suite 200**

**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 during the past 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 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 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 October 30, 2008, 17,192,377 shares of the registrant's common stock, par value \$0.0001 per share, were outstanding.

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**INFUSYSTEM HOLDINGS, INC. AND SUBSIDIARY**

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**Table of Contents****PART I-FINANCIAL INFORMATION****Item 1. Financial Statements****INFUSYSTEM HOLDINGS, INC. AND SUBSIDIARY****(formerly HAPC, INC.)****CONSOLIDATED BALANCE SHEETS AS OF SEPTEMBER 30, 2008 AND DECEMBER 31, 2007**

<i>(in thousands, except share data)</i>	<b>September 30, 2008 (Unaudited)</b>	<b>December 31, 2007</b>
<b>ASSETS</b>		
Current Assets:		
Cash and cash equivalents	10,795	3,960
Accounts receivable, less allowance for doubtful accounts of \$1,935 and \$1,638 at September 30, 2008 and December 31, 2007, respectively; September 30, 2008 and December 31, 2007 include \$40 and \$103 due from I-Flow, respectively	4,132	6,304
Inventory supplies	397	364
Prepaid expenses and other current assets	394	1,263
Deferred income taxes	4	4
Total Current Assets	15,722	11,895
Property & equipment, net	11,232	13,504
Deferred debt issuance costs, net	1,424	1,918
Deferred Income Taxes		
Goodwill	56,580	56,544
Intangible assets, net	31,195	32,565
Total Assets	116,153	116,426
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current Liabilities:		
Accounts payable	1,213	1,076
Other current liabilities	776	1,886
Derivative liabilities	3,742	12,407
Current portion of long-term debt; September 30, 2008 and December 31, 2007 include \$3,270 and \$2,044 payable to I-Flow, respectively	3,348	2,044
Total Current Liabilities	9,079	17,413
Long-term debt, net of current portion; September 30, 2008 and December 31, 2007 include \$27,798 and \$30,250 payable to I-Flow, respectively	28,159	30,250
Deferred income taxes	403	4
Total Liabilities	37,641	47,667
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 18,426,421 and 18,315,430, respectively; outstanding 17,192,377 and 16,824,295, respectively	2	2
Additional paid-in capital	80,490	79,437

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Retained deficit	(1,980)	(10,680)
Total Stockholders' Equity	78,512	68,759
Total Liabilities and Stockholders' Equity	116,153	116,426

See Accompanying Notes to Consolidated Financial Statements.

**Table of Contents****INFUSYSTEM HOLDINGS, INC. AND SUBSIDIARY**

(formerly HAPC, INC.)

**CONSOLIDATED STATEMENTS OF OPERATIONS FOR THE THREE AND NINE MONTHS ENDED****SEPTEMBER 30, 2008 AND 2007 (INCLUDING PREDECESSOR FOR THE THREE AND NINE****MONTHS ENDED SEPTEMBER 30, 2007)****(UNAUDITED)**

<i>(in thousands, except per share data)</i>	Three Months Ended September 30, I-Flow Predecessor			Nine Months Ended September 30, I-Flow Predecessor		
	2008	2007	2007	2008	2007	2007
Net revenues	\$ 8,958	\$	\$ 7,822	\$ 26,323	\$	\$ 23,528
Operating expenses:						
Cost of Revenues Product and supply costs	1,340		1,159	4,182		3,746
Cost of Revenues Pump depreciation	978		1,032	2,908		2,307
Provision for doubtful accounts	702		619	2,477		3,278
Amortization of intangibles	456			1,370		
Selling and marketing	1,131		1,036	3,401		3,030
General and administrative	2,703	699	1,732	8,737	3,002	5,340
Total Operating Expenses	7,310	699	5,578	23,075	3,002	17,701
Other income (expense):						
Gain (loss) on derivatives	5,381	(675)		8,665	(675)	
Interest income	11	1,210		14	3,534	
Interest expense	(937)	(18)		(2,828)	(33)	237
Total other income	4,455	517		5,851	2,826	237
Income (loss) before income taxes	6,103	(182)	2,244	9,099	(176)	6,064
Income tax expense	(399)	(323)	(936)	(399)	(752)	(2,460)
Net income (loss)	5,704	(505)	1,308	8,700	(928)	3,604
Net income (loss) per share:						
Basic	0.31	(0.03)	N/A	0.49	(0.05)	N/A
Diluted	0.30	(0.03)	N/A	0.47	(0.05)	N/A
Weighted average shares outstanding:						
Basic	18,442,957*	18,625,252	N/A	17,757,075*	18,625,252	N/A
Diluted	18,794,182	18,625,252	N/A	18,581,789	18,625,252	N/A

\* Includes, from April 25, 2008, the 1,234,044 shares referenced in Notes 9 and 10 to our Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

See Accompanying Notes to Consolidated Financial Statements.



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**INFUSYSTEM HOLDINGS, INC. AND SUBSIDIARY**  
**(formerly HAPC, INC.)**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS FOR**  
**THE NINE MONTHS ENDED SEPTEMBER 30, 2008 AND 2007 (INCLUDING PREDECESSOR FOR**  
**THE NINE MONTHS ENDED SEPTEMBER 30, 2007)**  
**(UNAUDITED)**

<i>(in thousands)</i>	Nine Months Ended September 30,		
	2008	2007	I-Flow Predecessor 2007
<b>OPERATING ACTIVITIES</b>			
Net Income (Loss)	8,700	(928)	3,604
Items included in net income not requiring cash:			
(Gain) loss on derivative liabilities	(8,665)	675	
Provision for doubtful accounts	2,477		3,278
Depreciation	3,041		2,432
Amortization of intangible assets	1,370		
Amortization of deferred debt issuance costs	494		
Loss on disposal of assets	385		241
Interest Income on Investments Held in Trust		(3,528)	
Withdrawal of interest earned on investments held in trust		422	
Stock-based compensation	1,166	1,490	305
Deferred Income Taxes	399		(517)
Changes in current assets and liabilities:			
Decrease (increase) in accounts receivable	(305)		(1,636)
Decrease (increase) in prepaid expenses and other current assets	836	439	(129)
(Decrease) increase in accounts payable and other current liabilities	(628)	768	(953)
<b>NET CASH PROVIDED BY (USED IN) OPERATING ACTIVITIES</b>	<b>9,270</b>	<b>(662)</b>	<b>6,625</b>
<b>INVESTING ACTIVITIES</b>			
Payment of deferred acquisition costs	(105)	(252)	
Capital expenditures	(951)		(2,664)
Proceeds from sale of property			231
<b>NET CASH USED IN INVESTING ACTIVITIES</b>	<b>(1,056)</b>	<b>(252)</b>	<b>(2,433)</b>
<b>FINANCING ACTIVITIES</b>			
Net capital distributions to parent			(5,147)
Principal payments on term loan	(1,226)		
Common stock repurchased to satisfy minimum statutory withholding on stock-based compensation	(113)		
Principal payments on capital lease obligation	(40)		
Proceeds from issuance of warrants		514	
<b>NET CASH (USED IN) PROVIDED BY FINANCING ACTIVITIES</b>	<b>(1,379)</b>	<b>514</b>	<b>(5,147)</b>
<b>Net change in cash and cash equivalents</b>	<b>6,835</b>	<b>(400)</b>	<b>(955)</b>



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Cash and cash equivalents, beginning of period	3,960	427	1,956
Cash and cash equivalents, end of period	10,795	27	1,001

### SUPPLEMENTAL DISCLOSURES

Cash paid for interest (including swap payments/proceeds, and excluding capitalized interest)	\$ 2,334	\$ 4	\$
Cash paid for income taxes	\$ 478	\$ 695	\$ 186

### NON-CASH TRANSACTIONS

Additions to property (a)	\$ 80	\$	\$ 241
Property acquired with a capital lease	\$ 480	\$	\$
Issuance of vested restricted shares (number of shares)	150		

- (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 September 30, but will be included as a cash outflow from investing activities for capital expenditures when paid.

See Accompanying Notes to Consolidated Financial Statements.

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**INFUSYSTEM HOLDINGS, INC. AND SUBSIDIARY**

**(formerly HAPC, INC.)**

**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. (formerly HAPC, INC.) and its consolidated subsidiary, InfuSystem, Inc. ( InfuSystem, together with InfuSystem Holdings, Inc., the Company ) as of September 30, 2008 and December 31, 2007, the results of operations for the three and nine months ended September 30, 2008 and 2007, and cash flows for the nine months ended September 30, 2008 and 2007. The results of operations of InfuSystem, while owned by its prior parent I-Flow Corporation ( Predecessor InfuSystem ), are also presented for the three and nine months ended September 30, 2007; the cash flows of Predecessor InfuSystem are also presented for the nine months ended September 30, 2007. The financial statements of Predecessor InfuSystem presented for the three and nine months ended September 30, 2007 are not those of the Company and were prepared by the former management of Predecessor InfuSystem.

The accompanying unaudited consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States of America ( GAAP ). Results of operations for the three and nine months ended September 30, 2008 are not necessarily indicative of the results for an entire year.

The Company was incorporated in Delaware on August 15, 2005 as a blank check company whose objective was to acquire through a merger, capital stock exchange, asset acquisition or other similar business combination, one or more operating businesses in the healthcare sector.

Substantially all activity through October 25, 2007 relates to the Company s formation, its initial public offering (the IPO ) and efforts related to the acquisition of InfuSystem described below. The Company has selected December 31 as its fiscal year end. The Company completed its IPO on April 18, 2006 and received gross proceeds of \$100,000,000. Substantially all of the net proceeds of the IPO were used to acquire InfuSystem. On September 29, 2006, the Company entered into a Stock Purchase Agreement (as amended, the Stock Purchase Agreement ) with I-Flow Corporation ( I-Flow ), Iceland Acquisition Subsidiary, the Company s wholly-owned subsidiary ( Acquisition Subsidiary ) and InfuSystem, a wholly-owned subsidiary of I-Flow. Upon the closing of the transactions contemplated by the Stock Purchase Agreement on October 25, 2007, Acquisition Subsidiary purchased all of the issued and outstanding capital stock of InfuSystem from I-Flow and concurrently merged with and into InfuSystem. As a result of the merger, Acquisition Subsidiary ceased to exist as an independent entity and InfuSystem, as the corporation surviving the merger, became the Company s wholly-owned subsidiary. Effective October 25, 2007, the Company changed its corporate name from HAPC, INC. to InfuSystem Holdings, Inc., and the Company ceased its existence as a development stage company. Prior to October 25, 2007, the Company was in the development stage. For accounting purposes, the acquisition has been treated as a purchase business combination. The results of InfuSystem are included in the consolidated financial statements subsequent to the acquisition date.

The Company is a provider of ambulatory infusion pump management services for oncologists in the United States. Ambulatory infusion pumps are small, lightweight electronic pumps designed to be worn by patients in their homes which allow patients the freedom to move about while receiving chemotherapy treatments. The pumps are battery powered and attached to intravenous administration tubing, which is in turn attached to a bag or plastic cassette that contains the chemotherapy drug.

The Company s business model is currently highly focused on oncology chemotherapy infusion. To the Company s knowledge, it is the only national ambulatory infusion pump service provider focused on oncology.

The Company supplies electronic ambulatory infusion pumps and associated disposable supply kits to physicians offices, infusion clinics and hospital outpatient chemotherapy clinics to be utilized by patients who receive continuous chemotherapy infusions. The Company obtains an assignment of insurance benefits from the patient, bills the insurance company or patient accordingly and collects payment. The Company provides billing and collection services for the pumps and associated disposable supply kits to physician accounts in the United States. The Company retains title to the pumps during this process.

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The Company purchases electronic ambulatory infusion pumps from a variety of suppliers on a non-exclusive basis. Such pumps are generic in nature and are available to the Company's competitors. The pumps are currently used primarily for continuous infusion of chemotherapy drugs for patients with colorectal cancer.

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The Company has one operating segment, which consists solely of InfuSystem, representing the only reportable segment in accordance with Statement of Financial Accounting Standards ( SFAS ) No. 131, *Disclosures about Segments of an Enterprise and Related Information*.

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

#### *Principles of Consolidation*

The consolidated financial statements include the accounts of the Company and all wholly owned, majority owned or controlled 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, which potentially subjects the Company to concentrations of credit risk related to temporary cash investments that are in excess of the federally insured amounts of \$250,000 per account. The Company has not experienced any losses to date as a result of this policy, and management believes there is little risk of loss.

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

The Company has agreements with third-party payors which provide for payments at amounts different from established rates. Accounts receivable and net revenue are reported at the estimated net realizable amounts from patients, third-party payors and others for 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.

Substantially all of the Company's receivables are related to providing healthcare services to patients. 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.

#### *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 of ambulatory infusion pumps that the Company acquires from third-party manufacturers, is depreciated over five

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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 SFAS No. 144, *Accounting for Impairment or Disposal of Long-Lived Assets*. SFAS No. 144 addresses financial accounting and reporting for the impairment of long-lived assets and for the disposal of long-lived assets. In accordance with SFAS No. 144, 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 periodically reviews the carrying value of long-lived assets to determine whether impairment to such value has occurred. The Company has determined that no impairment existed as of September 30, 2008.

### *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 SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill is tested annually for impairment or more frequently if circumstances indicate the possibility of impairment. The Company has selected October 31 to perform its annual impairment test. Management does not believe impairment of its goodwill existed at September 30, 2008. The goodwill amount for the October 25, 2007 acquisition of InfuSystem, totaling \$56,580,000, increased by \$0 and \$36,000 during the three and nine months ended September 30, 2008, respectively, and is based upon preliminary estimates that are subject to change during the fiscal year ended December 31, 2008 upon completion of the final valuation analysis. Final determination of these estimates could result in an adjustment to the purchase price allocation with an offsetting adjustment to goodwill.

### *Intangible Assets*

Intangible assets consist of trade names and physician relationships, both of which arose from the acquisition of InfuSystem. The Company amortizes the value assigned to the physician relationships on a straight-line basis over the period of expected benefit. Management tests intangible assets for impairment in accordance with SFAS No. 142. The intangible assets resulting from the October 25, 2007 acquisition of InfuSystem are based upon preliminary estimates which are subject to change during the fiscal year ended December 31, 2008 upon completion of the final valuation analysis.

### *Revenue Recognition*

The Company's strategic focus 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 order (or certificate of medical necessity) 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.

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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 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 32% of the Company's gross billings for the nine months ended September 30, 2008. The Company contracts with various individual Blue Cross/Blue Shield affiliates which in the aggregate accounted for approximately 22% of its gross billings for the nine months ended September 30, 2008. No individual payor (other than Medicare and the Blue Cross/Blue Shield entities) accounted for greater than approximately 6% of the Company's gross billings for the nine months ended September 30, 2008.

### *Income Taxes*

The Company accounts for income taxes in accordance with 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*

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, directors and vendors are measured at fair value and recognized as expense over the related vesting periods.

In 2007, the Company adopted the 2007 Stock Incentive 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 the second quarter of 2008, the Company granted both restricted shares and stock options under the 2007 Stock Incentive Plan to management, executive officers and directors.

Share based compensation expense recognized for the three and nine months ended September 30, 2008 was \$479,000 and \$1,166,000, respectively. For the corresponding three and nine month periods in 2007, the amounts were \$264,000 and \$1,490,000, respectively.

### *Warrants and Derivative Financial Instruments*

On April 18, 2006, the Company consummated its 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 to FTN Midwest Securities Corp., the underwriter of its IPO ( FTN Midwest ), pursuant to a partial exercise by FTN Midwest of its overallotment 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.

In September 2000, the Emerging Issues Task Force issued EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in, a Company's Own Stock* ( EITF 00-19 ), 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 EITF 00-19, a contract

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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.

In accordance with EITF 00-19, the 33,750,502 warrants issued in connection with the IPO and overallotment to purchase 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 within Gain (Loss) 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.

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 1,357,717 at an issue price of \$.70 per warrant or a total issue price of \$950,000.

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.

In December 2007, the Company entered into a single interest rate swap to hedge the exposure associated with its floating rate debt. The Company has elected not to designate the swap as a cash flow hedge, in accordance with SFAS No. 133. The fair value of the swap is therefore shown on the Company's balance sheet and the unrealized changes in the value of the swap are shown in the Company's statement of operations within Gain (Loss) on derivatives.

*Deferred Debt Issuance Costs*

Capitalized debt issuance costs include those associated with the Company's term loan with I-Flow. The Company classifies the costs as non-current assets and is amortizing the costs using the interest method through the maturity date of October 2011. 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 for the following periods:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2008	2007	2008	2007
<b>Numerator:</b>				
Net income (loss) (in thousands)	\$ 5,704	\$ (505)	\$ 8,700	\$ (928)
<b>Denominator:</b>				
Weighted average common shares outstanding:				
Basic	18,442,957*	18,625,252	17,757,075*	18,625,252
Dilutive effect of nonvested awards	351,225		824,714	
<b>Diluted</b>	<b>18,794,182</b>	<b>18,625,252</b>	<b>18,581,789</b>	<b>18,625,252</b>
<b>Net Income (Loss) Per Share:</b>				
Basic	\$ 0.31	\$ (0.03)	\$ 0.49	\$ (0.05)
Diluted	\$ 0.30	\$ (0.03)	\$ 0.47	\$ (0.05)

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\* Includes, from April 25, 2008, the 1,234,044 shares referenced in Notes 9 and 10 to our Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.



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For the three and nine months ended September 30, 2008 the following warrants and stock awards 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, 1,357,717 warrants issued privately, and 300,000 non-vested stock options granted under the 2007 Stock Incentive Plan.

*Recently Issued Accounting Pronouncements*

On January 1, 2007, the Company adopted FASB Interpretation No. 48, *Accounting for Uncertainty in Income Taxes* (FIN 48). FIN 48 clarifies the accounting for income taxes by prescribing a minimum probability threshold that a tax position must meet before a financial statement benefit is recognized. The minimum threshold is defined in FIN 48 as a tax position that is more likely than not to be sustained upon examination by the applicable taxing authority, including resolution of any related appeals or litigation processes, based on the technical merits of the position. The tax benefit to be recognized is measured as the largest amount of benefit that is greater than 50% likely of being realized upon ultimate settlement. FIN 48 must be applied to all existing tax positions upon initial adoption. The cumulative effect of applying FIN 48 at adoption, if any, is to be reported as an adjustment to opening retained earnings for the year of adoption. The adoption of FIN 48 did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In September 2006, the FASB issued SFAS No. 157, *Fair Value Measurements*, which relates to the definition of fair value, the methods used to measure fair value and the expanded disclosures about fair value measurements. The provisions of SFAS No. 157 are effective for financial statements issued for fiscal years beginning after November 15, 2007. The Company adopted SFAS No. 157 effective January 1, 2008, and it did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In February 2007, the FASB issued SFAS No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities, including an amendment of FASB Statement No. 115*, which permits entities to choose to measure many financial instruments and certain other items at fair value that are not currently required to be measured at fair value. The objective is to improve financial reporting by providing entities with the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. SFAS No. 159 is effective as of the beginning of an entity's first fiscal year that begins after November 15, 2007. The Company adopted SFAS No. 159 effective January 1, 2008, and it did not have a material effect on the Company's consolidated financial position, results of operations or cash flows.

In December 2007, the FASB issued SFAS No. 141(R), *Business Combinations*. This statement retains the fundamental requirements of the original pronouncement requiring that the acquisition method of accounting, or purchase method, be used for all business combinations. SFAS No. 141(R) requires, among other things, expensing of acquisition related and restructuring related costs, measurement of pre-acquisition contingencies at fair value, measurement of equity securities issued for purchase at the date of close of the transaction and capitalization of in process research and development, all of which represent modifications to current accounting for business combinations. SFAS No. 141(R) is effective for fiscal years beginning after December 15, 2008. Adoption is prospective and early adoption is not permitted. Adoption of SFAS No. 141(R) will not impact the Company's accounting for business combinations closed prior to its adoption, but given the nature of the changes noted above, the Company expects that its accounting for business combinations occurring subsequent to adoption will be significantly different than that applied following current accounting literature.

In March 2008, the FASB issued SFAS No. 161, *Disclosures about Derivative Instruments and Hedging Activities - an amendment of FASB Statement No. 133*. SFAS No. 161 requires enhanced disclosures about an entity's derivative and hedging activities and thereby improves the transparency of financial reporting. SFAS No. 161 is effective for financial statements issued for fiscal years and interim periods beginning after November 15, 2008, with early application encouraged. SFAS No. 161 encourages, but does not require, comparative disclosures for earlier periods at initial adoption. The Company has not yet completed its assessment of the impact upon adoption of SFAS No. 161 on its consolidated financial position, results of operations or cash flows, but the impact is expected to be minimal as the Statement solely addresses disclosure.

**Table of Contents****3. Acquisitions**

No acquisitions were effected during the nine months ended September 30, 2008.

For the three and nine months ended September 30, 2008 cash paid for acquisition related expenses was \$0 and \$105,000, respectively, which related to the October 25, 2007 acquisition of InfuSystem.

*Additional Contingent Payment*

The Stock Purchase Agreement related to the acquisition of InfuSystem also 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 future operations are met. Any amounts ultimately paid out in 2011 per the earn-out will increase Goodwill at the time of payment.

*Purchase Price Allocation*

Pursuant to SFAS No. 141, *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 (trade name and physician relationships from the table below) and unidentifiable intangible assets (goodwill from the table below). Goodwill of \$89,480,000 is expected to be deductible for tax purposes. Goodwill increased by \$36,000 during the nine months ended September 30, 2008. The purchase price allocation, while substantially complete, is subject to further adjustments. Final determination of these estimates could result in an adjustment to the purchase price allocation with an offsetting adjustment to goodwill. The allocation of the purchase price to the fair values of the assets acquired and liabilities assumed is presented below (in thousands):

Current assets	\$ 8,499
Property and equipment	13,980
Goodwill	56,580
Trade Name	5,500
Physician Relationships	27,400
Current liabilities	(3,206)
<b>Total purchase price</b>	<b>\$ 108,753</b>

**4. Property and Equipment**

Property and equipment consisted of the following as of September 30, 2008 and December 31, 2007 (amounts in thousands):

	<b>September 30, 2008</b>	<b>December 31, 2007</b>
Pump equipment	\$ 14,416	\$ 13,816
Furniture, fixtures and equipment	534	413
Accumulated depreciation	(3,718)	(725)
<b>Total</b>	<b>\$ 11,232</b>	<b>\$ 13,504</b>

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Depreciation expense for the three and nine months ended September 30, 2008 was \$1,025,000 and \$3,041,000, respectively, which was recorded in cost of revenues and general and administrative expenses, for pump equipment and other fixed assets, respectively.

**5. Intangible Assets**

The carrying amount and accumulated amortization of intangible assets as of September 30, 2008 and December 31, 2007 were as follows (in thousands):

	September 30, 2008	December 31, 2007
Nonamortizable intangible assets		
Trade names	\$ 5,500	\$ 5,500
Amortizable intangible assets		
Physician relationships	27,400	27,400
<b>Total nonamortizable and amortizable intangible assets</b>	<b>32,900</b>	<b>32,900</b>
Less accumulated amortization	(1,705)	(335)
<b>Total identifiable intangible assets</b>	<b>\$ 31,195</b>	<b>\$ 32,565</b>

Amortization expense for intangible assets for the three and nine months ended September 30, 2008 was \$456,000 and \$1,370,000, respectively, which was recorded in operating expenses. Expected annual amortization expense for intangible assets recorded as of September 30, 2008 is as follows (in thousands):

	2008	2009	2010	2011	2012
Amortization expense	\$ 1,827	\$ 1,827	\$ 1,827	\$ 1,827	\$ 1,827

**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 issued on May 18, 2006, should be classified as liabilities in accordance with 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. 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.

The fair value of the Company's 33,750,502 warrants issued in connection with the IPO outstanding at September 30, 2008 and December 31, 2007 were liabilities of \$3,375,000 or \$0.10 per warrant and \$12,150,000 or \$0.36 per warrant, respectively.

At September 30, 2008, the Company had a single interest rate swap agreement in effect to fix its LIBOR-based variable rate debt. The interest rate swap agreement, which expires in December 2010, had a notional amount of \$19,000,000 on September 30, 2008 and a fixed rate of 4.29%. The fair value of the Company's interest rate swap outstanding at September 30, 2008 and December 31, 2007 was a liability of \$367,000 and \$257,000, respectively.

Total derivative liabilities are as follows (in thousands):

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	September 30, 2008	December 31, 2007
Warrant liability	\$ 3,375	\$ 12,150
Interest rate swap liability	367	257
Total	\$ 3,742	\$ 12,407

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Description	Fair Value Measurements at Reporting Date Using			
	September 30, 2008	Quoted Prices in Active Markets for Identical Liabilities (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Warrant liability	\$ 3,375	\$ 3,375	\$	\$
Interest rate swap liability	367		367	
<b>Total</b>	<b>\$ 3,742</b>	<b>\$ 3,375</b>	<b>\$ 367</b>	<b>\$</b>

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

The Company entered into a \$32,703,000 term loan from I-Flow, subject to the Credit and Guaranty Agreement, dated as of October 25, 2007, by and among the Company, Acquisition Subsidiary and I-Flow (the Credit and Guaranty Agreement). The loan expires on October 25, 2011. The loan bears interest at either LIBOR (subject to a 3% floor) plus 5.5%, or Prime (subject to a 4% floor) plus 4.5%, at the Company's option. The loan is a variable rate loan and therefore fair value approximates book value. At September 30, 2008, the rate in effect was 8.5%. The Company paid \$684,000 and \$2,114,000 in cash interest payments to I-Flow during the three and nine months ended September 30, 2008, respectively.

In April 2008, the Company entered into a five year capital lease covering ambulatory infusion pumps with total principal payments equaling \$480,000 over 60 months. The pumps were capitalized into property plant 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 loan and capital lease are as follows (in thousands):

	2008	2009	2010	2011	2012	Thereafter	Total
Loan	\$ 818	\$ 3,270	\$ 3,679	\$ 23,301	\$	\$	\$ 31,068
Capital Lease	14	86	93	100	108	38	439
<b>Total</b>	<b>\$ 832</b>	<b>\$ 3,356</b>	<b>\$ 3,772</b>	<b>\$ 23,401</b>	<b>\$ 108</b>	<b>\$ 38</b>	<b>\$ 31,507</b>

The loan is collateralized by substantially all of the Company's assets and requires the Company to comply with covenants principally relating to satisfaction of a Fixed Charge Coverage Ratio, a Leverage Ratio, and Minimum Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA).

In conjunction with the Credit and Guaranty Agreement, the Company incurred deferred debt issuance costs of \$2,052,000. These costs will be recognized in income using the interest method through the maturity date of October 2011. Amortization of these costs for the three and nine months ended September 30, 2008 was \$155,000 and \$494,000, respectively, which was recorded in interest expense.

**8. Income Taxes**

Provision for income taxes was \$399,000 for the three and nine months ended September 30, 2008. This compares to \$323,000 and \$752,000 for the three and nine months ended September 30, 2007.

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. At September 30, 2008 and December 31, 2007, a valuation allowance was applied against the net deferred tax assets because it was uncertain whether the benefit of the deferred tax assets would be fully utilized. The valuation allowance has been adjusted to reflect any anticipated refund of prior year taxes.



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The Company and its subsidiary will file a consolidated federal and certain combined state tax returns from October 25, 2007, the date of acquisition, and going forward. Through these filings, income generated by the Company is offset by losses in the consolidated group.

**9. Related Party Transactions**

Two members of the Company's board of directors are former Managing Directors of FTN Midwest, the underwriter of the Company's IPO. Sean McDevitt resigned from his position as Managing Director of FTN Midwest effective January 19, 2007 and Pat LaVecchia resigned from his position as Managing Director of FTN Midwest effective February 2, 2007. FTN Midwest received an underwriting discount of 7%, a non-accountable expense allowance of 1% and an option to purchase 833,333 shares for a fee of \$100. The Company reserved in its treasury 2,000,000 shares of common stock for issuance to Sean McDevitt and 416,666 shares of common stock for issuance to Pat LaVecchia. The consummation of the transaction resulted in 925,531 of these shares being issued at October 25, 2007. The remaining 1,491,135 shares were to be issued six months after the consummation of the transaction; 257,091 of such shares have been issued as of September 30, 2008. The Company is in the process of taking the necessary administrative steps to effectuate issuance of the remaining 1,234,044 shares; there are no contingencies related to the issuance of these shares.

As discussed in Note 7 Debt and other Long-term Obligations, the Company entered into a \$32,703,000 term loan from I-Flow, subject to the Credit and Guaranty Agreement.

Prior to the Company's acquisition of InfuSystem, InfuSystem had been providing billing and collection services to I-Flow for its ON-<sup>®</sup> product. On October 25, 2007, InfuSystem and I-Flow entered into an Amended and Restated Services Agreement (the Services Agreement) pursuant to which InfuSystem agreed to continue to provide I-Flow with these services, and I-Flow agreed to pay InfuSystem a monthly service fee. During the three and nine months ended September 30, 2008, the Company recorded revenues of \$130,000 and \$411,000 from this arrangement; \$40,000 of this amount was an outstanding receivable at September 30, 2008. On November 8, 2007, I-Flow informed InfuSystem that it was terminating the Services Agreement effective May 10, 2008. In May of 2008, the Company extended and amended the Services Agreement, with substantially the same terms as the original agreement. The parties are presently operating without a written agreement.

Steve Watkins, the Chief Executive Officer of the Company, owns 5% of Tu-Effs Limited Partnership, which owns the Madison Heights, Michigan office and warehouse facilities currently leased by the Company. Rent expense for the leased premises was \$58,000 and \$173,000 for the three and nine months ended September 30, 2008, respectively, which was recorded in general and administrative expenses. Both the office and warehouse leases expire on June 30, 2009. As of September 30, 2008, the future minimum lease payments related to the lease obligations were \$173,000.

**10. Commitments and Contingencies**

Certain of the Company's directors committed to purchase up to \$1,000,000 of the Company's warrants from the Company in a private placement at a price of \$.70 per warrant subsequent to the filing of the preliminary proxy statement seeking stockholder approval of the acquisition of InfuSystem. Such officers and directors agreed not to sell or transfer the warrants until after the Company has consummated a business combination. On December 28, 2006, the Company issued 624,286 warrants to purchase common stock to Sean McDevitt, Chairman of the Board of Directors of the Company, at a purchase price of \$0.70 per warrant for an aggregate purchase price of \$437,000. The warrants have an exercise price of \$5.00 per share of common stock and became exercisable commencing on the acquisition date and expire April 11, 2011 or earlier upon redemption by the Company. The Company may call the warrants for redemption in whole and not in part at a price of \$0.01 per warrant at anytime after the warrant becomes exercisable. The warrants cannot be redeemed unless the holder receives written notice not less than 30 days prior to the redemption and if and only if, the reported last price of the common stock equals or exceeds \$8.50 per share for any 20 trading days within a 30 day period ending on the third day of business prior to the notice of redemption to warrant holder. The Company has fully reserved these shares as authorized but not issued. The Company issued to Sean McDevitt an additional 447,143 warrants to purchase common stock at a purchase price of \$0.70 per warrant for an aggregate purchase price of \$313,000 on April 12, 2007. In addition, on

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September 12, 2007, the Company issued 286,288 warrants to purchase common stock to Sean McDevitt, John Voris, Wayne Yetter, Erin Enright and Jean Pierre Millon at a purchase price of \$0.70 per warrant for an aggregate purchase price of \$200,000. The warrants issued to Sean McDevitt on April 12, 2007 and the warrants issued to Sean McDevitt, John Voris, Wayne Yetter, Erin Enright and Jean Pierre Millon on September 12, 2007, are subject to the same terms and conditions as the warrants issued to Sean McDevitt in December 2006. Sean McDevitt and the other warrant purchasers agreed not to sell or transfer their warrant purchases until after the Company had consummated a business combination. The warrants issued and sold in December 2006, April 2007 and September 2007 were not registered under the Securities Act. As a result, the warrants and the common stock issuable upon exercise of the warrants may not be sold unless they have been registered pursuant to a registration statement filed under the Securities Act or pursuant to an available exemption from the registration requirements of the Securities Act as evidenced by an opinion of counsel reasonably satisfactory to the Company.

The initial stockholders and certain of their transferees, who received shares prior to the IPO, are entitled to demand that the Company register the resale of their shares of common stock at any time six months following the consummation of the acquisition, pursuant to the terms of their respective lock-up agreements.

The Company has agreed to reimburse its initial stockholders for (a) any income tax liability incurred by the Company's initial stockholders as a result of the award of their shares and/or the vesting of such shares (other than tax liability due as a result of their sale of such shares) and (b) all reasonable out-of-pocket expenses incurred by the initial stockholders in connection with their activities on the Company's behalf.

The Company is involved in legal proceedings arising out of the ordinary course and conduct of its business, the outcomes of which are not determinable at this time. The Company has insurance policies covering such potential losses where such coverage is cost effective. In the Company's opinion, any liability that might be incurred by it upon the resolution of these claims and lawsuits will not, in the aggregate, have a material adverse effect on its consolidated financial position, results of operations or cash flows.

The Company enters into contracts with payors that require the Company to indemnify the payors against any claims by third parties arising from the Company's actions in connection with the contracts. Such contracts typically provide that the payor will also indemnify the Company against any claims by third parties arising from the payor's actions in connection with the contract. A maximum obligation arising out of these types of agreements is not explicitly stated and, therefore, the overall maximum amount of these obligations cannot be reasonably estimated. Historically, the Company has not been obligated to make significant payments for these obligations and thus, no liabilities have been recorded for these obligations on its balance sheet as of September 30, 2008 and December 31, 2007.

**11. Share-based Compensation**

Effective December 30, 2005, Healthcare Acquisition Partners Holdings, LLC sold the 4,166,667 shares of common stock that it had received upon formation of the Company back to the Company. The shares were purchased for a \$25,000 note payable. Simultaneously, the Company transferred 1,750,001 of these shares to certain members of its management team resulting in aggregate compensation of \$8,435,000 to them, computed at \$4.82 per share, which was charged to expense ratably over the forfeiture period. Of this amount, \$1,490,000 was charged to expense for the nine months ended September 30, 2007. The forfeiture period ended on October 25, 2007, the date of the acquisition, and all amounts were expensed as of that date. These expenses were recorded in general and administrative expenses.

The remaining 2,416,666 shares of the Company's common stock transferred back to the Company and not transferred to members of the Company's management team on December 30, 2005 were being held as treasury shares and reserved for transfer by the Company's board of directors to present or future officers, directors or employees.

On July 24, 2006, the Company reserved for grant to two of the Company's directors 2,416,666 shares of the Company's common stock. These shares were originally held as treasury shares and reserved for transfer to present or future officers, directors or employees. The consummation of the transaction resulted in 925,531 of these shares being issued at October 25, 2007. The remaining 1,491,135 shares were to be issued six months after the consummation of the transaction; 257,091 of such shares have been issued as of September 30, 2008. The Company is in the process of taking the necessary administrative steps to effectuate issuance of the remaining 1,234,044 shares.



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The Company is authorized to issue 1,000,000 shares of preferred stock with such designations, voting and other rights and preferences as may be determined from time to time by the board of directors.

In 2007, the Company adopted the 2007 Stock Incentive 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 the second quarter of 2008, the Company granted both restricted shares and stock options under the 2007 Stock Incentive Plan.

### *Restricted Shares*

On May 6, 2008, the Company granted 600,000 restricted shares to six employees. Share-based compensation expense was calculated based on the market price on the date of grant of \$2.90. Of the 600,000 shares, 150,000 of the shares (or 25%) vested immediately on the grant date. The remaining shares will vest over the following two to three year period, 25% at each vesting date, on each of the respective employee's Company employment anniversary dates. Upon termination of the Participant's employment with the Company for any reason, any then unvested awarded shares shall be immediately and permanently forfeited to the Company for no consideration.

On June 3, 2008, the Company granted 196,000 restricted shares to seven non-employee directors. Share-based compensation expense was calculated based on the market price on the date of grant of \$3.00. The shares will vest on the anniversary of the grant date over the following two years, at 50% of the total shares for each year. In the event that the Participant ceases to be a director of the Company for any reason, then the unvested awarded shares shall be immediately and permanently forfeited to the Company for no consideration.

The weighted average of the grant date fair value of the restricted shares granted during the second quarter of 2008 was \$2.92.

### *Stock Options*

On May 6, 2008, the Company granted 300,000 stock options to a single employee at an exercise price of \$2.90 per share. This also represents the weighted average of the exercise price of options granted as these were the only options granted during the second quarter of 2008. Share-based compensation expense was determined based on the fair value of the options on the grant date of \$1.32. This also represents the weighted average of the fair value of options granted as these were the only options granted during the second quarter of 2008. The fair value of the options on the grant date was calculated using the Black Scholes pricing model. The assumptions used in the model included the grant date stock value of \$2.90, a risk free rate of 3.38%, volatility of 41%, a 6.25 year expected life, and no dividends. The options will vest on the anniversary of the grant date over the following four years, at 25% of the total shares for each year. Upon termination of the Participant's employment with the Company for any reason, any then unvested awarded options shall be immediately and permanently forfeited to the Company for no consideration.

As a result of the stock options and restricted common shares that the Company granted during the second quarter of 2008, we have recorded \$479,000 and \$1,166,000 during the three and nine months ended September 30, 2008, respectively, in stock-based compensation expense in accordance with SFAS No. 123 (R). Of the total expense recorded year to date through September 30, 2008, \$435,000 relates to vested restricted shares and \$731,000 relates to non-vested restricted shares and stock options.

## **12. Employee Benefit Plans**

The Company has enacted a 401(k) defined contribution plan effective February 1, 2008. Employees of the Company working more than 1,040 hours annually may participate in the 401(k) Plan. The Company contributes \$0.33 for each dollar of employee contribution up to a maximum contribution by the Company of 1.32% of each participant's annual salary. The maximum contribution by the Company of 1.32% corresponds to an employee contribution of 4% of annual salary. Participants vest in the Company's contribution ratably over five years. Such contributions totaled \$17,000 and \$46,000 for the three and nine months ended September 30, 2008, respectively. The Company does not provide post-retirement or post-employment benefits to its employees.

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### **Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations** **Executive Overview**

Included in this Quarterly Report on Form 10-Q are the results of operations of both the Company and Predecessor InfuSystem. The financial statements of Predecessor InfuSystem presented for the three and nine months ended September 30, 2007 are not those of the Company and were prepared by the former management of Predecessor InfuSystem. The financial statements of Predecessor InfuSystem for the periods presented may be particularly unrepresentative of the operations of the Company going forward for the following reasons, among others:

Both the Company's financials and Predecessor InfuSystem's financials contain items which require management to make considerable judgments and estimates. There can be no assurance that the judgments and estimates made by the Company's management will be identical or even similar to the historical judgments and estimates made by Predecessor InfuSystem's former management.

The financials of Predecessor InfuSystem contain allocations of certain general and administrative expenses specific to I-Flow.

The Company's financials are prepared utilizing a different basis of accounting than Predecessor InfuSystem's financials. Specific differences include, but are not limited to, the Company's accounting for net property, intangible assets and goodwill at fair value on the date of acquisition in accordance with SFAS No. 141, *Business Combinations*. Predecessor InfuSystem accounted for these items on a historical cost basis.

#### **InfuSystem Holdings, Inc. Overview**

We were formed as a Delaware blank check company in 2005 for the purpose of acquiring through a merger, capital stock exchange, asset acquisition or other similar business combination, one or more operating businesses in the healthcare sector. On September 29, 2006, we entered into a Stock Purchase Agreement with I-Flow Corporation ( "I-Flow" ), Iceland Acquisition Subsidiary, Inc. ( "Acquisition Subsidiary" ) and InfuSystem, Inc. ( "InfuSystem" ). Upon the closing of the transactions contemplated by the Stock Purchase Agreement on October 25, 2007, Acquisition Subsidiary purchased all of the issued and outstanding capital stock of InfuSystem from I-Flow and concurrently merged with and into InfuSystem. As a result of the merger, Acquisition Subsidiary ceased to exist as an independent entity and InfuSystem, as the corporation surviving the merger, became our wholly-owned subsidiary. Effective October 25, 2007, we changed our corporate name from HAPC, INC. to InfuSystem Holdings, Inc.

#### **Results of Operations**

Our results of operations for the three and nine months ended September 30, 2008 are not comparable with the prior periods presented. Effective October 25, 2007, upon our acquisition of InfuSystem, we ceased to be a development stage company and became an operating company. Substantially all activity through October 25, 2007 relates to our formation, initial public offering (the "IPO" ) and efforts related to the acquisition of InfuSystem.

Our revenue consists predominantly of rental revenue derived from our rental of ambulatory infusion pumps which are primarily used for continuous infusion of chemotherapy drugs for patients with colorectal cancer. Our revenue for the quarter ended September 30, 2008 was \$8,958,000; year-to-date revenue was \$26,323,000. Management anticipates that new revenue growth will come from the expansion of the existing use of our ambulatory infusion pumps for the treatment of colorectal cancer as well as the potential future use of our ambulatory infusion pumps for continuous infusion of chemotherapy drugs for the treatment of head, neck and gastric cancers. Another aspect of our business strategy over the next one to three years is to actively pursue opportunities for the expansion of our business through acquisitions, joint ventures and strategic alliances.

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Cost of revenues for the quarter ended September 30, 2008 was \$2,318,000; year-to-date cost of revenues was \$7,090,000. This consisted of product and supply costs, including freight costs for the transport of pumps and supplies to and from oncology practices, and depreciation on our infusion pumps.

Provision for doubtful accounts for the quarter ended September 30, 2008 was \$702,000; year-to-date provision was \$2,477,000.

Amortization of our intangible assets for the quarter ended September 30, 2008 was \$456,000; year-to-date amortization was \$1,370,000.

During the quarter ended September 30, 2008, our selling and marketing expenses were \$1,131,000; year-to-date expenses were \$3,401,000. Selling and marketing expenses during these periods consisted of sales salaries, commissions and associated fringe benefit and payroll-related items, travel and entertainment, marketing, share-based compensation and other miscellaneous expenses.

During the quarter ended September 30, 2008, our general and administrative expenses were \$2,703,000; year-to-date expenses were \$8,737,000. General and administrative expenses during these periods consisted primarily of administrative personnel (including management and officers) salaries, fringes and payroll-related items, professional fees predominantly related to the preparation of our Annual Report on Form 10-K for the fiscal year ended December 31, 2007 (the Form 10-K ) which included the audit of the financial statements contained therein, loss on disposals of infusion pumps, share-based compensation, insurance (including directors and officers insurance) and other miscellaneous expenses. Professional fees associated with the preparation of the Form 10-K were particularly high for primarily two reasons. First, this Form 10-K represented our first annual report as an operating company rather than as a blank check development stage company. Second, due to the nature of the acquisition, we were required to include in the Form 10-K both our own pre- and post-acquisition financial statements and footnotes as well as certain pre-acquisition financial statements and footnotes of InfuSystem during the period that InfuSystem was a wholly-owned subsidiary of I-Flow.

During the quarter ended September 30, 2008, we recorded a gain on derivatives of \$5,381,000; year-to-date we recorded a gain on derivatives of \$8,665,000. These amounts represent unrealized gains which resulted from the change in the fair value of our warrants, combined with unrealized losses resulting from the change in the fair value of our single interest rate swap. For more information, please refer to the discussion under Summary of Significant Accounting Policies Warrants and Derivative Financial Instruments included in Note 2 and Warrants and Derivative Financial Instruments included in Note 6 to our Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

During the quarter ended September 30, 2008, we recorded interest expense of \$937,000; year-to-date interest expense was \$2,828,000. These amounts consist of interest paid to I-Flow on our term loan, the amortization of deferred debt issuance costs incurred in conjunction with the loan, expense associated with the interest rate swap and other interest expense.

During the quarter ended September 30, 2008, we recorded income tax expense of \$399,000; year-to-date income tax expense was \$399,000.

Management believes that there has been no material effect on our operations or financial condition as a result of inflation or changing prices of our ambulatory infusion pumps during the period from December 31, 2007 through September 30, 2008.

**Table of Contents****Liquidity and Capital Resources**

As of September 30, 2008 we had cash resources of \$10,795,000 compared to \$3,960,000 at December 31, 2007. The increase in cash available to us was primarily associated with positive cash flow from operating activities, partially offset by capital expenditures and principal payments on our term loan.

Cash provided by operating activities for the nine months ended September 30, 2008 was \$9,270,000, compared to cash used in operating activities of \$662,000 for the nine months ended September 30, 2007. The increase for the nine months ended September 30, 2008 was due primarily to the acquisition of InfuSystem on October 25, 2007 and the inclusion of its operating results and cash flows.

Cash used in investing activities for the nine months ended September 30, 2008 was \$1,056,000, compared to cash used in investing activities of \$252,000 for the nine months ended September 30, 2007. The increase for the nine months ended September 30, 2008 is primarily due to capital expenditures made for infusion pumps.

Cash used in financing activities for the nine months ended September 30, 2008 was \$1,379,000, compared to cash provided by financing activities of \$514,000 for the nine months ended September 30, 2007. The increase for the nine months ended September 30, 2008 primarily reflects the principal payments on the term loan.

As of September 30, 2008, we had cash and cash equivalents of \$10,795,000, net accounts receivable of \$4,132,000 and net working capital (excluding derivative liabilities) of \$10,385,000. Management believes the current funds, together with expected cash flows from ongoing operations, are sufficient to fund our operations for at least the next 12 months. We intend to further supplement liquidity by securing a line of credit during the fourth quarter of 2008.

We consider 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, which potentially subjects the Company to concentrations of credit risk related to temporary cash investments that are in excess of the federally insured amounts of \$250,000 per account. The Company has not experienced any losses to date as a result of this policy, and management believes there is little risk of loss.

As of September 30, 2008, we did not have a line of credit in place. We have, however, initiated discussions with our main financial institution with the intent to enter into a line of credit. Any line of credit is expected to be collateralized by certain of our assets (as permitted under our Credit and Guaranty Agreement, dated as of October 25, 2007, with I-Flow), and will likely require us to comply with certain covenants relating to profitability and liquidity measures.

**Contractual Obligations**

As of September 30, 2008, future payments related to contractual obligations are as follows (in thousands):

	Payment Due by Period (1) (2)				Total
	Less than 1 Year	1 to 3 Years	3 to 5 Years	More than 5 Years	
Debt obligations	\$ 3,270	\$ 8,176	\$ 19,622	\$	\$ 31,068
Capital lease obligations	78	190	171		439
Operating lease obligations	173				173
Total	\$ 3,521	\$ 8,366	\$ 19,793	\$	\$ 31,680

- (1) The table above does not include any potential payout to I-Flow associated with the earn-out provision. For more information, please refer to the discussion under Acquisitions included in Note 3 to our Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

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- (2) The table above does not include any interest payments associated with our variable rate term debt. For more information, please refer to the discussion under **Debt and other Long-term Obligations** included in Note 7 to our Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

The operating lease obligations represent future minimum lease payments as of September 30, 2008 under a non-cancelable operating lease for our Madison Heights, Michigan office and a non-cancelable operating lease for our warehouse facility at the same location. Both leases expire on June 30, 2009.

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### ***Contingent Liabilities***

We do not have any contingent liabilities.

### ***Off-Balance Sheet Arrangements***

We do not have any off-balance sheet arrangements.

### **Critical Accounting Policies and Estimates**

The preparation of consolidated financial statements in conformity with generally accepted accounting principles requires the appropriate application of certain accounting policies, many of which require management to make estimates and assumptions about future events and their impact on amounts reported in our consolidated financial statements and related notes. Since future events and their impact cannot be determined with certainty, actual results may differ from management's estimates. Such differences may be material to our consolidated financial statements.

Management believes its application of accounting policies, and the estimates inherently required therein, are reasonable. These accounting policies and estimates are periodically reevaluated, and adjustments are made when facts and circumstances dictate a change.

Our accounting policies are more fully described under the heading "Summary of Significant Accounting Policies" in Note 2 to our Consolidated Financial Statements included in this Quarterly Report on Form 10-Q. We believe the following critical accounting estimates are the most significant to the presentation of our financial statements and require the most difficult, subjective and complex judgments:

#### ***Revenue Recognition***

Our strategic focus is rental revenue in the oncology market. Revenues are recognized predominantly under fee for service arrangements through equipment we rent to patients. We recognize 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 we receive a physician's order (or certificate of medical necessity) and assignment of benefits, signed by the physician and patient, respectively, and we have verified actual pump usage and insurance coverage. We recognize rental revenue from electronic infusion pumps as earned, normally on a month-to-month basis. We bill pump rentals at 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 we operate, 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 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.

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

We have agreements with third-party payors which provide for payments at amounts different from established rates. Patient accounts receivable and net revenue are reported at the estimated net realizable amounts from patients, third-party payors and others for services rendered. We perform periodic analyses to assess the accounts receivable balances. We record 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.

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Substantially all of our receivables are related to providing healthcare services to patients. Accounts receivable are reduced by an allowance for amounts that could become uncollectible in the future. Our estimate for 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 our financial position, results of operations, and cash flows.

*Warrants and Derivative Financial Instruments*

On April 18, 2006, we consummated our 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 us one share of common stock at an exercise price of \$5.00. On May 18, 2006, we sold an additional 208,584 units to FTN Midwest Securities Corp. ( FTN Midwest ), the underwriter of our initial public offering, pursuant to a partial exercise by FTN Midwest of its overallocation option. We are required by the Warrant Agreement to register the shares underlying the warrants in the absence of our ability to deliver registered shares to the warrant holders upon warrant exercise.

In September 2000, the Emerging Issues Task Force issued EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to and Potentially Settled in, a Company's Own Stock*, ( EITF 00-19 ) 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 EITF 00-19, 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.

In accordance with EITF 00-19, the 33,750,502 warrants issued in connection with the IPO and overallocation option must be settled in registered shares and are separately accounted for as liabilities as discussed in Note 6 to our Consolidated Financial Statements included in this Quarterly Report on Form 10-Q. The fair value of these warrants is reflected on our balance sheet and the unrealized changes in the value of these warrants are reflected in our statement of operations as Gain (loss) 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, our warrant liabilities will also increase or decrease with a corresponding impact on our results of operations.

Sales of warrants that may be settled in unregistered shares of common stock are treated as equity and included in additional paid in capital as discussed in Note 10 to our Consolidated Financial Statements included in this Quarterly Report on Form 10-Q. The total number of warrants issued to date that may be settled in unregistered shares of common stock is 1,357,717 at an issue price of \$.70 per warrant or a total issue price of \$950,000.

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.

In December 2007, we entered into a single interest rate swap to hedge the exposure associated with our floating rate debt. We have elected not to designate the swap as a cash flow hedge, in accordance with SFAS No. 133. The fair value of the swap is therefore reflected on our balance sheet and the unrealized changes in the value of the swap are reflected in our statement of operations within Gain (loss) on derivatives.

*Income Taxes*

We account for income taxes in accordance with SFAS No. 109, *Accounting for Income Taxes*, which requires that we 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 to our Consolidated Financial Statements included in this Quarterly Report on Form 10-Q.

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*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 SFAS No. 142, *Goodwill and Other Intangible Assets*, goodwill is tested annually for impairment or more frequently if circumstances indicate the possibility of impairment. We have selected October 31 to perform our annual impairment test. Management does not believe impairment of our goodwill existed at September 30, 2008. The goodwill amount for the October 25, 2007 acquisition of InfuSystem, totaling \$56,580,000, is based upon preliminary estimates that are subject to change during the fiscal year ended December 31, 2008 upon completion of the final valuation analysis. Final determination of these estimates could result in an adjustment to the purchase price allocation with an offsetting adjustment to goodwill.

**Item 3. Quantitative and Qualitative Disclosures About Market Risk**

We are exposed to interest rate fluctuations on our underlying variable rate long-term debt. We utilize a single interest rate swap agreement to moderate the majority of such exposure. We do not use derivative financial instruments for trading or other speculative purposes.

At September 30, 2008, the principal plus accrued interest on our term loan with I-Flow Corporation was \$31,068,000. The term loan bears interest at LIBOR (subject to a 3% floor) plus 5.5% or Prime (subject to a 4% floor) plus 4.5%, at our option. The loan is a variable rate loan and therefore fair value approximates book value. Please see Note 7 to our Consolidated Financial Statements included in this Quarterly Report on Form 10-Q for a further discussion of our term loan with I-Flow Corporation.

At September 30, 2008, we had one interest rate swap agreement in effect to fix our LIBOR-based variable rate debt. The interest rate swap agreement, which expires in December 2010, had a notional amount of \$19,000,000 on September 30, 2008 and a fixed rate of 4.29%.

Based on the term loan outstanding and the swap agreement in place at September 30, 2008, a 100 basis point decrease in the applicable interest rates would have decreased our cash flow and pretax earnings for the three months ended September 30, 2008 by approximately \$49,000, while a 100 basis point increase in the applicable interest rates would have increased our cash flow and pretax earnings for the three months ended September 30, 2008 by approximately \$11,000.

We have classified certain warrants as derivative liabilities, which resulted in a liability of \$3,375,000 at September 30, 2008. We classified the warrants as derivative liabilities because there is a possibility that we may be required to settle the warrants in registered shares of common stock. We are required to compare the fair market value of these instruments from the date of the initial recording to their fair market value as of the end of each reporting period and to reflect the change in fair market value in our Consolidated Statements of Operations as a gain or loss for the applicable period.

**Item 4. Controls and Procedures**  
**Disclosure Controls and Procedures**

We maintain disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act)) that are designed to ensure that information required to be disclosed in our reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer (principal executive officer) and Chief Financial Officer (principal accounting and financial officer), as appropriate, to allow timely decisions regarding required financial disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that a control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, with a company have been detected.



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As of the end of the period covered by this Quarterly Report on Form 10-Q, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of September 30, 2008. Based upon that evaluation, our Chief Executive Officer and our Chief Financial Officer each concluded that our disclosure controls and procedures are effective as of the end of the period covered by this Quarterly Report on Form 10-Q.

**Change in Internal Control**

We have made no changes during the nine months ended September 30, 2008 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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**PART II-OTHER INFORMATION**

**Item 6. Exhibits**

**Exhibits**

- 31.1 Certification of Principal Executive Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 31.2 Certification of Principal Financial Officer pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
- 32.1 Certification of the Chief Executive Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
- 32.2 Certification of the Chief Financial Officer pursuant to 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

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**SIGNATURES**

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

INFUSYSTEM HOLDINGS, INC.

Date: November 4, 2008

By: /s/ Sean Whelan  
Sean Whelan  
Chief Financial Officer  
(Principal Financial Officer)