

Cardiovascular Systems Inc  
Form 10-Q  
May 14, 2010

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**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, DC 20549**

**FORM 10-Q  
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF  
THE SECURITIES EXCHANGE ACT OF 1934  
For the quarterly period ended March 31, 2010  
Commission File No. 000-52082**

**CARDIOVASCULAR SYSTEMS, INC.**  
(Exact name of registrant as specified in its charter)

**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**No. 41-1698056**  
(IRS Employer  
Identification No.)

**651 Campus Drive**  
**St. Paul, Minnesota 55112-3495**  
(Address of Principal Executive Offices)  
**Registrant's telephone number (651) 259-1600**

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the 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 (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). YES  NO

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

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

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

The number of shares outstanding of the registrant's common stock as of May 14, 2010 was: Common Stock, \$0.001 par value per share, 15,002,150 shares.

**Cardiovascular Systems, Inc.**  
**Consolidated Financial Statements**  
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**PART I. FINANCIAL INFORMATION**  
**ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)**  
**Cardiovascular Systems, Inc.**  
**Consolidated Balance Sheets**  
(Dollars in Thousands, except per share and share amounts)  
(Unaudited)

	<b>March 31, 2010</b>	<b>June 30, 2009</b>
<b>ASSETS</b>		
Current assets		
Cash and cash equivalents	\$ 23,552	\$ 33,411
Accounts receivable, net	9,801	8,474
Inventories	4,562	3,369
Auction rate securities put option	2,800	
Investments	16,375	
Prepaid expenses and other current assets	991	798
Total current assets	58,081	46,052
Auction rate securities put option		2,800
Investments		20,000
Property and equipment, net	1,959	1,719
Patents, net	1,704	1,363
Other assets	216	436
Total assets	\$ 61,960	\$ 72,370
<b>LIABILITIES AND STOCKHOLDERS EQUITY</b>		
Current liabilities		
Current maturities of long-term debt	\$ 20,601	\$ 25,823
Accounts payable	4,943	4,751
Accrued expenses	6,335	5,600
Total current liabilities	31,879	36,174
Long-term liabilities		
Long-term debt, net of current maturities	8,183	4,379
Grant payable	2,963	
Lease obligation and other liabilities	659	1,485
Total long-term liabilities	11,805	5,864
Total liabilities	43,684	42,038
Commitments and contingencies		
Stockholders' equity		
Common stock, \$0.001 par value; authorized 100,000,000 common shares at March 31, 2010 and June 30, 2009; issued and outstanding 14,864,089 at	15	14

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March 31, 2010 and 14,113,904 at June 30, 2009, respectively

Additional paid in capital	153,975	146,455
Common stock warrants	11,208	11,282
Accumulated deficit	(146,922)	(127,419)
Total stockholders' equity	18,276	30,332
Total liabilities and stockholders' equity	\$ 61,960	\$ 72,370

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

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**Cardiovascular Systems, Inc.**  
**Consolidated Statements of Operations**  
(Dollars in thousands, except per share and share amounts)  
(Unaudited)

	Three Months Ended		Nine Months Ended	
	March 31,		March 31,	
	2010	2009	2010	2009
Revenues	\$ 16,519	\$ 15,115	\$ 46,814	\$ 40,766
Cost of goods sold	3,847	3,920	10,850	11,954
Gross profit	12,672	11,195	35,964	28,812
Expenses				
Selling, general and administrative	16,382	14,253	47,150	45,626
Research and development	2,459	3,428	7,421	11,851
Total expenses	18,841	17,681	54,571	57,477
Loss from operations	(6,169)	(6,486)	(18,607)	(28,665)
Other (expense) income				
Interest expense	(341)	(971)	(1,075)	(1,831)
Interest income	58	171	245	3,180
Decretion of redeemable convertible preferred stock warrants		3,157		2,991
Gain (impairment) on investments		300		(1,933)
State income taxes	(66)		(66)	
Total other (expense) income	(349)	2,657	(896)	2,407
Net loss	\$ (6,518)	\$ (3,829)	\$ (19,503)	\$ (26,258)
Decretion of redeemable convertible preferred stock		25,778		22,781
Net (loss) income available to common shareholders	\$ (6,518)	\$ 21,949	\$ (19,503)	\$ (3,477)
Net (loss) income per common share:				
Basic	\$ (0.44)	\$ 2.63	\$ (1.33)	\$ (0.57)
Diluted	\$ (0.44)	\$ (0.32)	\$ (1.33)	\$ (0.57)
Weighted average common shares used in computation:				
Basic	14,878,859	8,343,660	14,681,014	6,096,523
Diluted	14,878,859	12,048,581	14,681,014	6,096,523

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



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**Cardiovascular Systems, Inc.**  
**Consolidated Statements Cash Flows**  
(Dollars in thousands)  
(Unaudited)

	<b>Nine Months Ended March 31,</b>	
	<b>2010</b>	<b>2009</b>
<b>Cash flows from operating activities</b>		
Net loss	\$ (19,503)	\$ (26,258)
Adjustments to reconcile net loss to net cash used in operations		
Depreciation and amortization of property and equipment	399	305
Provision for doubtful accounts	77	95
Amortization of patents	36	27
Decretion of redeemable convertible preferred stock warrants		(2,991)
Amortization of debt discount	216	1,023
Stock-based compensation	6,460	4,931
Impairment on Investments		1,933
Gain on auction rate securities put option		(2,700)
Changes in assets and liabilities		
Accounts receivable	(1,404)	(3,290)
Inventories	(1,193)	1,039
Prepaid expenses and other assets	77	1,938
Accounts payable	192	(1,446)
Accrued expenses and other liabilities	2,872	(1,042)
Net cash used in operations	(11,771)	(26,436)
<b>Cash flows from investing activities</b>		
Expenditures for property and equipment	(639)	(750)
Sales of investments	3,625	
Costs incurred in connection with patents	(377)	(312)
Cash acquired in Replidyne merger, net of transaction costs paid		37,805
Net cash provided by investing activities	2,609	36,743
<b>Cash flows from financing activities</b>		
Proceeds from employee stock purchase plan	702	
Payment of deferred financing costs	(50)	
Issuance of common stock warrants		1,814
Issuance of convertible preferred stock warrants		75
Exercise of stock options and warrants	285	502
Proceeds from long-term debt	4,411	18,031
Payments on long-term debt	(6,045)	(480)
Net cash (used in) provided by financing activities	(697)	19,942
Net change in cash and cash equivalents	(9,859)	30,249
<b>Cash and cash equivalents</b>		



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Beginning of period	33,411	7,595
End of period	\$ 23,552	\$ 37,844

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

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**CARDIOVASCULAR SYSTEMS, INC.**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(For the three and nine months ended March 31, 2010 and 2009)**  
**(dollars in thousands, except per share and share amounts)**  
**(unaudited)**

**1. Business Overview**

***Company Description and Merger***

Cardiovascular Systems, Inc. was incorporated as Replidyne, Inc. in Delaware in 2000. On February 25, 2009, Replidyne, Inc. completed its reverse merger with Cardiovascular Systems, Inc., a Minnesota corporation incorporated in 1989 ( CSI-MN ), in accordance with the terms of the Agreement and Plan of Merger and Reorganization, dated as of November 3, 2008 (the Merger Agreement ). Pursuant to the Merger Agreement, CSI-MN continued after the merger as the surviving corporation and a wholly owned subsidiary of Replidyne. At the effective time of the merger, Replidyne, Inc. changed its name to Cardiovascular Systems, Inc. ( CSI ) and CSI-MN merged with and into CSI, with CSI continuing after the merger as the surviving corporation. These transactions are referred to herein as the merger.

Unless the context otherwise requires, all references herein to the Company, CSI, we, us and our refer to CSI prior to the completion of the merger and to CSI following the completion of the merger and the name change, and all references to Replidyne refer to Replidyne prior to the completion of the merger and the name change. CSI is considered the accounting acquirer in the merger and financial results presented for all periods reflect historical CSI results.

The Company develops, manufactures and markets devices for the treatment of vascular diseases. The Company has completed a pivotal clinical trial in the United States to demonstrate the safety and efficacy of the Company's Diamondback 360° PAD system in treating peripheral arterial disease. Prior to the merger, Replidyne was a biopharmaceutical company focused on discovering, developing, in-licensing and commercializing innovative anti-infective products.

**2. Summary of Significant Accounting Policies**

***Interim Financial Statements***

The Company has prepared the unaudited interim consolidated financial statements and related unaudited financial information in the footnotes in accordance with accounting principles generally accepted in the United States of America ( GAAP ) and the rules and regulations of the Securities and Exchange Commission ( SEC ) for interim financial statements. The year end consolidated balance sheet was derived from audited consolidated financial statements, but does not include all disclosures as required by accounting principles generally accepted in the United States of America. These interim consolidated financial statements reflect all adjustments consisting of normal recurring accruals, which, in the opinion of management, are necessary to present fairly the Company's consolidated financial position, the results of its operations and its cash flows for the interim periods. These interim consolidated financial statements should be read in conjunction with the consolidated annual financial statements and the notes thereto included in the Form 10-K filed by the Company with the SEC on September 28, 2009. The nature of the Company's business is such that the results of any interim period may not be indicative of the results to be expected for the entire year.

***Fair Value of Financial Instruments***

Effective July 1, 2008, the Company adopted fair value guidance issued by the FASB, which provides a framework for measuring fair value under Generally Accepted Accounting Principles and expands disclosures about fair value measurements. In February 2008 the FASB provided a one-year deferral on the effective date of the guidance for non-financial assets and non-financial liabilities, except those that are recognized or disclosed in the financial statements at least annually. This guidance did not have a material impact on the Company's financial position or consolidated results of operations for the three months ended March 31, 2010.

The fair value guidance classifies inputs into the following hierarchy:

*Level 1 Inputs* quoted prices in active markets for identical assets and liabilities

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*Level 2 Inputs* observable inputs other than quoted prices in active markets for identical assets and liabilities  
*Level 3 Inputs* unobservable inputs

The following table sets forth the fair value of the Company's auction rate securities that were measured on a recurring basis as of March 31, 2010. Assets are measured on a recurring basis if they are remeasured at least annually:

	<b>Trading Securities</b>	<b>Level 3 Auction Rate Securities Put Option</b>
Balance at June 30, 2009	\$ 20,000	\$ 2,800
Sale of investments	(3,625)	
Balance at March 31, 2010	\$ 16,375	\$ 2,800

As of March 31, 2010, the Company believes that the carrying amounts of its other financial instruments, including accounts receivable, accounts payable and accrued liabilities approximate their fair value due to the short-term maturities of these instruments. The carrying amount of long-term debt approximates fair value based on interest rates currently available for debt with similar terms and maturities.

***Use of Estimates***

The preparation of the Company's consolidated financial statements in conformity with accounting principles generally accepted in the United States of America requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates.

***Revenue Recognition***

The Company sells the majority of its products via direct shipment to hospitals or clinics. The Company recognizes revenue when all of the following criteria are met: persuasive evidence of an arrangement exists; delivery has occurred; the sales price is fixed or determinable; and collectability is reasonably assured. These criteria are met at the time of delivery when the risk of loss and title passes to the customer. The Company records estimated sales returns, discounts and rebates as a reduction of net sales in the same period revenue is recognized.

The Company also considers FASB guidance that addresses the timing and method of revenue recognition for revenue arrangements that include the delivery of more than one product or service. In these cases, the Company recognizes revenue from each element of the arrangement as long as separate values for each element can be determined, the Company has completed its obligation to deliver or perform on that element, and collection of the resulting receivable is reasonably assured.

***Recent Accounting Pronouncements***

In January 2010, the FASB issued further guidance regarding additional disclosures relating to fair value of transfers in and out of Levels 1 and 2 and for activity in Level 3 and clarifies certain other existing disclosure requirements. This guidance had no impact on the Company's financial position, results of operations or cash flows.

In October 2009, the FASB issued guidance providing principles for allocation of consideration among its multiple-elements, allowing more flexibility in identifying and accounting for separate deliverables under an arrangement. The guidance introduces an estimated selling price method for valuing the elements of a bundled arrangement if vendor-specific objective evidence or third-party evidence of selling price is not available, and significantly expands related disclosure requirements. This standard is effective on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Alternatively, adoption may be on a retrospective basis, and early application is permitted. The Company is currently evaluating the impact of adopting this pronouncement.

**3. Selected Consolidated Financial Statement Information**

***Inventories***

Inventories are stated at the lower of cost or market with cost determined on a first-in, first-out ( FIFO ) method of valuation. The establishment of inventory allowances for excess and obsolete inventories is based on estimated exposure on specific inventory items.

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At March 31, 2010 and June 30, 2009, respectively, inventories were comprised of the following:

	<b>March 31, 2010</b>	<b>June 30, 2009</b>
<b>Inventories</b>		
Raw materials	\$ 1,501	\$ 1,536
Work in process	246	348
Finished goods	2,815	1,485
	<b>\$ 4,562</b>	<b>\$ 3,369</b>

**Investments**

The Company's investments include AAA rated auction rate securities (ARS) issued primarily by state agencies and backed by student loans substantially guaranteed by the Federal Family Education Loan Program (FFELP). In February 2008, the Company was informed that there was insufficient demand for auction rate securities, resulting in failed auctions for \$23,000 of the Company's auction rate securities. Currently, these affected securities are not liquid and will not become liquid until a future auction for these investments are successful, they are redeemed by the issuer, or they mature. The Company has collected all interest due on its auction rate securities and has no reason to believe that it will not collect all interest due in the future.

On November 7, 2008, the Company accepted an offer from UBS AG (UBS), providing rights related to the Company's ARS (the Rights). The Rights permit the Company to require UBS to purchase the Company's ARS at par value, which is defined for this purpose as the liquidation preference of the ARS plus accrued but unpaid dividends or interest, at any time during the period of June 30, 2010 through July 2, 2012. Conversely, UBS has the right, in its discretion, to purchase or sell the Company's ARS at any time until July 2, 2012, so long as the Company receives payment at par value upon any sale or disposition. The Company expects to sell its ARS under the Rights. However, if the Rights are not exercised before July 2, 2012 they will expire and UBS will have no further rights or obligation to buy the Company's ARS. So long as the Company holds ARS, they will continue to accrue interest as determined by the auction process or the terms of the ARS if the auction process fails. Prior to accepting the UBS offer, the Company recorded ARS as investments available-for-sale. The Company recorded unrealized gains and losses on available-for-sale securities in accumulated other comprehensive income in the stockholders' equity section of the balance sheet. Realized gains and losses were accounted for on the specific identification method. After accepting the UBS offer, the Company recorded ARS as trading investments and unrealized gains and losses are included in earnings. During the nine months ended March 31, 2010, issuers of the Company's ARS have redeemed \$3,625 at par value. At March 31, 2010, the Company recorded \$16,375 as the fair value of the ARS. The ARS are classified as a current asset at March 31, 2010, due to the expectation the Company will sell its ARS to UBS AG under the Rights prior to April 1, 2011.

The Rights represent a firm agreement in accordance with FASB guidance, which defines a firm agreement as an agreement with an unrelated party, binding on both parties and usually legally enforceable, with the following characteristics: a) the agreement specifies all significant terms, including the quantity to be exchanged, the fixed price, and the timing of the transaction, and b) the agreement includes a disincentive for nonperformance that is sufficiently large to make performance probable. The enforceability of the Rights results in a put option and should be recognized as a free standing asset separate from the ARS. At March 31, 2010, the Company recorded \$2,800 as the fair value of the put option asset. The Company considered the expected time until the Rights are exercised, carrying costs of the Rights, and the expected credit risk attributes of the Rights and UBS in their valuation of the put option. The Company has elected to measure the put option at fair value, which permits an entity to elect the fair value option for recognized financial assets, in order to match the changes in the fair value of the ARS. As a result, unrealized gains and losses are included in earnings.

In determining fair value of its ARS, the Company utilized various valuation methods and considered, among other factors, estimates of present value of the ARS based upon expected cash flows, the likelihood and potential timing of

issuers of the ARS exercising their redemption rights at par value, the likelihood of a return of liquidity to the market for these securities and the potential to sell the securities in secondary markets.

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On March 29, 2010, the Company entered into an amended and restated loan and security agreement with Silicon Valley Bank. The agreement includes a \$10,000 term loan and a \$15,000 line of credit. The terms of each of these loans are as follows:

The \$10,000 term loan has a fixed interest rate of 9.0% and a final payment amount equal to 1.0% of the loan amount due at maturity. This term loan has a 36 month maturity, with repayment terms that include interest only payments during the first six months followed by 30 equal principal and interest payments. This term loan also includes an acceleration provision that requires the Company to pay the entire outstanding balance, plus a penalty ranging from 1.0% to 3.0% of the principal amount, upon prepayment or the occurrence and continuance of an event of default. In connection with entering into the agreement, the Company amended a warrant previously granted to Silicon Valley Bank. The warrants provide an option to purchase 8,493 shares of common stock at an exercise price of \$5.48 per share. This warrant is immediately exercisable and expires ten years after the date of amendment. The balance outstanding on the term loan at March 31, 2010 was \$10,000.

The \$15,000 line of credit has a two year maturity and a floating interest rate equal to the prime rate, plus 2.0%, with an interest rate floor of 6.0%. Interest on borrowings is due monthly and the principal balance is due at maturity. Borrowings on the line of credit are based on (a) 80% of eligible domestic receivables, plus (b) the lesser of 40% of eligible inventory or 25% of eligible domestic receivables or \$2,500, minus (c) to the extent in effect, certain loan reserves as defined in the agreement. Accounts receivable receipts are deposited into a lockbox account in the name of Silicon Valley Bank. The accounts receivable line of credit is subject to non-use fees, annual fees, and cancellation fees. There was no balance outstanding on the line of credit at March 31, 2010. The agreement provides that initially 50% of the outstanding principal balance of the \$10,000 term loan reduces available borrowings under the line of credit. Upon the achievement of certain financial covenants, the amount reducing available borrowings will be reduced to zero. There was not an outstanding balance on the line of credit at March 31, 2010.

Prior to the amendment and restatement, the Company's loan and security agreement with Silicon Valley Bank included a \$3,000 term loan, a \$10,000 accounts receivable line of credit, and a \$5,500 term loan that reduced the availability of funds on the accounts receivable line of credit.

Borrowings from Silicon Valley Bank are secured by all of the Company's assets, other than the Company's auction rate securities. The borrowings are subject to prepayment penalties and financial covenants, including maintaining certain liquidity and fixed charge coverage ratios, and certain three-month EBITDA targets. The agreement also includes subjective acceleration clauses which permit Silicon Valley Bank to accelerate the due date under certain circumstances, including, but not limited to, material adverse effects on the Company's financial status or otherwise. Any non-compliance by the Company under the terms of debt arrangements could result in an event of default under the Silicon Valley Bank loan, which, if not cured, could result in the acceleration of this debt.

***Loan Payable***

At March 31, 2010 and June 30, 2009, the Company maintained a margin loan with UBS Bank USA with maximum available borrowings, including interest, equal to the par value of auction rate securities held. At March 31, 2010 and June 30, 2009, maximum available borrowings were \$19,325 and \$22,950, respectively. This maximum borrowing amount is not set forth in the written agreement for the loan and may be adjusted from time to time by UBS Bank in its sole discretion. The margin loan bears interest at variable rates that equal the lesser of (i) 30 day LIBOR plus 1.25% or (ii) the applicable reset rate, maximum auction rate or similar rate as specified in the prospectus or other documentation governing the pledged taxable student loan auction rate securities; however, interest expense charged on the loan will not exceed interest income earned on the auction rate securities. The loan is due on demand and UBS Bank will require the Company to repay it in full from the proceeds received from a public equity offering where net proceeds exceed \$50,000. In addition, if at any time any of the Company's auction rate securities may be sold, exchanged, redeemed, transferred or otherwise conveyed for no less than their par value, then the Company must

immediately effect such a transfer and the proceeds must be used to pay down outstanding borrowings under this loan. The margin requirements are determined by UBS Bank but are not included in the written loan agreement and are therefore subject to change. As of March 31, 2010 and June 30, 2009, the margin requirements include maximum borrowings, including interest, of \$19,325 and \$22,950, respectively. If these margin requirements are not maintained, UBS Bank may require the Company to make a loan payment in an amount necessary to comply with the applicable margin requirements or demand repayment of the entire outstanding balance. The Company has maintained the margin requirements under the loans. The outstanding balance on this loan at March 31, 2010 was \$19,232 and is included in debt maturities during the three months ending June 30, 2010.



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As of March 31, 2010, debt maturities (including debt discount) were as follows:

Three months ending June 30, 2010	\$ 19,196
Fiscal 2011	2,302
Fiscal 2012	3,811
Fiscal 2013	3,475
Total	\$ 28,784
Less: Current Maturities	(20,601)
Long-term debt	\$ 8,183

**5. Stock Options and Restricted Stock Awards**

The Company has a 2007 Equity Incentive Plan (the "2007 Plan"), under which options to purchase common stock and restricted stock awards have been granted to employees, directors and consultants at exercise prices determined by the board of directors; and the Company also granted options and restricted stock awards under its 1991 Stock Option Plan (the "1991 Plan") and 2003 Stock Option Plan (the "2003 Plan") (the 2007 Plan, the 1991 Plan and the 2003 Plan collectively, the "Plans"). The 1991 Plan and 2003 Plan permitted the granting of incentive stock options and nonqualified options. A total of 485,250 shares of common stock were originally reserved for issuance under the 1991 Plan, but with the execution of the 2003 Plan no additional options were granted under it. A total of 2,458,600 shares of common stock were originally reserved for issuance under the 2003 Plan but with the approval of the 2007 Plan no additional options will be granted under it. The 2007 Plan originally allowed for the granting of up to 1,941,000 shares of common stock as approved by the board of directors in the form of nonqualified or incentive stock options, restricted stock awards, restricted stock unit awards, performance share awards, performance unit awards or stock appreciation rights to officers, directors, consultants and employees of the Company. The Plan was amended in February 2009 to increase the number of authorized shares to 2,509,969. The amended 2007 Plan also includes a renewal provision whereby the number of shares shall automatically be increased on the first day of each fiscal year through July 1, 2017, by the lesser of (i) 970,500 shares, (ii) 5% of the outstanding common shares on such date, or (iii) a lesser amount determined by the board of directors. On July 1, 2009 the number of shares available for grant was increased by 705,695 under the 2007 Plan's renewal provision.

All options granted under the Plans become exercisable over periods established at the date of grant. The option exercise price is determined by the closing price of the Company's common stock at the date of grant. In addition, the Company has granted nonqualified stock options to employees, directors and consultants outside of the Plans.

In estimating the value of the Company's common stock prior to the merger for purposes of granting options and determining stock-based compensation expense, the Company's management and board of directors conducted stock valuations using two different valuation methods: the option pricing method and the probability weighted expected return method. Both of these valuation methods took into consideration the following factors: financing activity, rights and preferences of the Company's preferred stock, growth of the executive management team, clinical trial activity, the FDA process, the status of the Company's commercial launch, the Company's mergers and acquisitions and public offering processes, revenues, the valuations of comparable public companies, the Company's cash and working capital amounts, and additional objective and subjective factors relating to the Company's business. The Company's management and board of directors set the exercise prices for option grants based upon their best estimate of the fair market value of the common stock at the time they made such grants, taking into account all information available at those times.

Following the merger, the Company's stock valuations are based upon the market price for the common stock.

Stock option activity for the nine months ended March 31, 2010 is as follows:

Number of	Weighted Average
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	<b>Options(a)</b>	<b>Exercise Price</b>
Options outstanding at June 30, 2009	3,707,882	\$ 10.43
Options granted	12,940	\$ 5.01
Options exercised	(37,313)	\$ 8.36
Options forfeited or expired	(154,088)	\$ 8.92
Options outstanding at March 31, 2010	3,529,421	\$ 10.46

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- (a) Includes the effect of options granted, exercised, forfeited or expired from the 1991 Plan, 2003 Plan, 2007 Plan, and options granted outside the stock option plans described above.

Options typically vest over two to three years. An employee's unvested options are forfeited when employment is terminated; vested options must be exercised at or within 90 days of termination to avoid forfeiture. The Company determines the fair value of options using the Black-Scholes option pricing model. The estimated fair value of options, including the effect of estimated forfeitures, is recognized as expense on a straight-line basis over the options' vesting periods.

The fair value of each restricted stock award is equal to the fair market value of the Company's common stock at the date of grant. Vesting of restricted stock awards range from one to three years. The estimated fair value of restricted stock awards, including the effect of estimated forfeitures, is recognized on a straight-line basis over the restricted stock's vesting period. Restricted stock award activity for the nine months ended March 31, 2010 is as follows:

	<b>Number of Shares</b>	<b>Weighted Average Fair Value</b>
Restricted stock awards outstanding at June 30, 2009	744,377	\$ 10.81
Restricted stock awards granted	693,822	\$ 7.37
Restricted stock awards forfeited	(157,972)	\$ 8.54
Restricted stock awards vested	(173,427)	\$ 6.81
Restricted stock awards outstanding at March 31, 2010	1,106,800	\$ 8.38

**6. Texas Production Facility**

Effective on September 9, 2009, the Company entered into the Build-To-Suit Lease Agreement (the Lease Agreement) with the Pearland Economic Development Corporation (the PEDC) for the construction and lease of an approximately 46,000 square foot production facility located in Pearland, Texas (the Facility). The Facility will primarily serve as an additional manufacturing location for the Company.

The Lease Agreement provides that the PEDC will lease the Facility and the land immediately surrounding the Facility (the Leased Premises) to the Company for an initial term of ten years, beginning the later of the date of Substantial Completion of the project (as that term is defined in the Lease Agreement) or April 1, 2010 (the Commencement Date). Annual fixed rent payments are \$414 for each of the first five years of the initial term and \$460 for each of the last five years of the initial term. Rent is payable in monthly installments beginning thirty days after the Commencement Date. The Company will also be responsible for paying the future taxes and operating expenses on the Leased Premises. The lease has been classified as an operating lease for financial statement purposes. Upon an event of default under the Lease Agreement, the Company will be liable for the difference between the

balance of the rent owed for the remainder of the term and the fair market rental value of the Leased Premises for such period.

The Company has the option to renew the lease for up to two additional periods of five years each. If the Company elects to exercise one or both of these options, the rent for such extended terms will be set at the prevailing market rental rates at such times, as determined in the Lease Agreement. After the Commencement Date and until shortly before the tenth anniversary of the Commencement Date, the Company will have the option to purchase all, but not less than all, of the Leased Premises at fair market value, as determined in the Lease Agreement. Further, within six years of the Commencement Date and subject to certain conditions, the Company has options to cause the PEDC to make two additions or expansions to the Facility of a minimum of 34,000 and 45,000 square feet each.

The Company and the PEDC previously entered into a Corporate Job Creation Agreement (the Job Creation Agreement ), dated June 17, 2009 (the Effective Date ). The Job Creation Agreement provided the Company with \$2,975 in net cash incentive funds, which the Company received on or about September 9, 2009. The Company has recognized the net cash incentive funds received of \$2,975 as a long term liability on the balance sheet. The liability will be reduced over a 60 month period as expenditures are incurred using a systematic methodology that is intended to reduce the majority of the liability in the first 24 months of the agreement. The Company believes it will be able to comply with the conditions specified in the grant agreement. The PEDC will provide the Company with an additional \$1,700 of net cash incentive funds (collectively with the \$2,975 that the Company previously received, the Cash Incentives ), in the following amounts and upon achievement of the following milestones:

\$1,020, upon the hiring of the 75<sup>th</sup> full-time employee at the Facility; and

\$680, upon the hiring of the 125<sup>th</sup> full-time employee at the Facility.

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In order to retain all of the Cash Incentives, beginning one year and 90 days after the Commencement Date, the Company must not have fewer than 25 full-time employees at the Facility for more than 120 consecutive days. Failure to meet this requirement will result in an obligation to make reimbursement payments to the PEDC in the following percentages during the following time periods:

100% of all the Cash Incentives received, if the failure occurs within 24 months from the Effective Date;

60% of all the Cash Incentives received, if the failure occurs between 24 and 36 months from the Effective Date;

40% of all the Cash Incentives received, if the failure occurs between 36 and 48 months from the Effective Date; and

20% of all the Cash Incentives received, if the failure occurs between 48 and 60 months from the Effective Date.

The Company will not have any reimbursement requirements for the Cash Incentives after 60 months from the Effective Date.

The Job Creation Agreement also provides the Company with a net \$1,275 award, of which \$510 will be funded by a grant from the State of Texas for which the Company has applied through the Texas Enterprise Fund program (the TEF Award ). The PEDC has committed, by resolution, to guarantee the TEF Award and will make payment to the Company for the remaining \$765 in three installments. The grant from the State of Texas for the TEF Award is subject to reimbursement if the Company fails to meet certain job creation targets, as agreed to by the Company and the State of Texas.

## **7. Commitment and Contingencies**

### ***ev3 Legal Proceedings***

The Company is party to a legal proceeding with ev3 Inc., ev3 Endovascular, Inc. and FoxHollow Technologies, Inc., together referred to as the Plaintiffs, which filed a complaint on December 28, 2007 in the Ramsey County District Court for the State of Minnesota against the Company and former employees of FoxHollow currently employed by the Company, which complaint was subsequently amended.

The complaint, as amended, alleges the following:

That certain of the Company's employees (i) violated provisions in their employment agreements with their former employer FoxHollow, barring them from misusing FoxHollow confidential information and from soliciting or encouraging employees of FoxHollow to join the Company, and (ii) breached a duty of loyalty owed to FoxHollow.

That the Company and certain of its employees misappropriated trade secrets of one or more of the Plaintiffs.

That all defendants engaged in unfair competition and conspired to gain an unfair competitive and economic advantage for the Company to the detriment of the Plaintiffs.

That (i) the Company tortiously interfered with the contracts between FoxHollow and certain of the Company's employees by allegedly procuring breaches of the non-solicitation encouragement provision in those agreements, and (ii) one of the Company's employees tortiously interfered with the contracts between certain of the Company's employees and FoxHollow by allegedly procuring breaches of the confidential information provision in those agreements.

The Plaintiffs seek, among other forms of relief, an award of damages in an amount greater than \$50, a variety of forms of injunctive relief, exemplary damages under the Minnesota Trade Secrets Act, and recovery of their attorney fees and litigation costs. Although the Company has requested the information, the Plaintiffs have not yet disclosed what specific amount of damages they claim.

The Company is defending this litigation vigorously, and believes that the outcome of this litigation will not have a materially adverse effect on the Company's business, operations, cash flows or financial condition. The Company has

not recognized any expense related to the settlement of this matter as an adverse outcome of this action is not probable. If the Company is not successful in this litigation, it could be required to pay substantial damages and could be subject to equitable relief that could include a requirement that the Company terminate or otherwise alter the terms or conditions of employment of certain employees, including certain key sales personnel who were formerly employed by FoxHollow. In any event, the defense of this litigation, regardless of the outcome, could result in substantial legal costs and diversion of management's time and efforts from the operation of business.

**Table of Contents****8. Earnings Per Share****Basic**

The following table presents a reconciliation of the numerators and denominators used in the basic earnings per common share computations:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2010	2009	2010	2009
Numerator				
Net loss	\$ (6,518)	\$ (3,829)	\$ (19,503)	\$ (26,258)
Plus: Accretion of redeemable convertible preferred stock (a)		25,778		22,781
Net (loss) income available to common shareholders	\$ (6,518)	\$ 21,949	\$ (19,503)	\$ (3,477)
Denominator				
Weighted average common shares outstanding	14,878,859	8,343,660	14,681,014	6,096,523
Net loss per common share basic	\$ (0.44)	\$ 2.63	\$ (1.33)	\$ (0.57)

(a) The calculation for accretion of redeemable convertible preferred stock marks the redeemable convertible preferred stock to fair value, which equals or exceeds the amount of any undeclared dividends on the redeemable convertible preferred stock.

**Diluted**

The following table presents a reconciliation of the numerators and denominators used in the diluted earnings per common share computations:

	Three Months Ended March 31,		Nine Months Ended March 31,	
	2010	2009	2010	2009
Numerator	\$ (6,518)	\$ 21,949	\$ (19,503)	\$ (3,477)

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Net (loss) income available to common stockholders				
Less: Decretion of redeemable convertible preferred stock(a)			(25,778)	
Net loss available in diluted calculation	\$ (6,517)	\$ (3,829)	\$ (19,503)	\$ (3,477)
Denominator				
Weighted average common shares basic	14,878,859	8,343,660	14,681,014	6,096,523
Effect of dilutive stock options and warrants (b)(c)				
Conversion of redeemable convertible preferred stock(a)		3,704,921		
Weighted average common shares outstanding diluted	14,878,859	12,048,581	14,681,014	6,096,523
Net loss per common share diluted	\$ (0.44)	\$ (0.32)	\$ (1.33)	\$ (0.57)

(a) The calculation for decretion of redeemable convertible preferred stock marks the redeemable convertible preferred stock to fair value, which equals or exceeds the amount of any undeclared dividends on the redeemable convertible preferred stock. These amounts have been excluded from the calculation for the nine months ended March 31, 2009 because they are anti-dilutive.

(b) At March 31, 2010 and 2009, 3,089,366 and



3,120,330  
warrants,  
respectively,  
were  
outstanding.  
The effect of the  
shares that  
would be issued  
upon exercise of  
these warrants  
has been  
excluded from  
the calculation  
of diluted loss  
per share  
because those  
shares are  
anti-dilutive.

- (c) At March 31,  
2010 and 2009,  
3,529,421 and  
3,963,579 stock  
options,  
respectively,  
were  
outstanding.  
The effect of the  
shares that  
would be issued  
upon exercise of  
these options  
has been  
excluded from  
the calculation  
of diluted loss  
per share  
because those  
shares are  
anti-dilutive.

**9. Subsequent Event**

On April 14, 2010, the Company entered into a loan and security agreement with Partners for Growth III, L.P. (PFG). The agreement provides that PFG will make loans to the Company up to \$4,000. The agreement has a five-year maturity until April 14, 2015. The loans bear interest at a floating per annum rate equal to 2.75% above Silicon Valley Bank's prime rate, and such interest is

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payable monthly. The principal balance of and any accrued and unpaid interest on any notes are due on the maturity date and may not be prepaid by the Company at any time in whole or in part.

Under the agreement, PFG provided the Company with an initial loan of \$1,500 on April 15, 2010. In addition, for a period of one year until April 14, 2011, the Company may request additional proceeds from time to time, in minimum increments of \$250, up to \$4,000. After this period, the Company may only request additional proceeds (in increments of not less than \$250) equal to the aggregate principal amount converted into the Company's common stock through an optional conversion or mandatory conversion. At any time prior to the maturity date, PFG may at its option convert any amount into the Company's common stock at the conversion price set forth in each note, which conversion price will be subject to adjustment upon certain events as provided in such note. The initial note has an initial conversion price of \$5.43, which equaled the ten-day volume weighted average price per share of the Company's common stock prior to the date of the agreement. The Company may also effect at any time a mandatory conversion of amounts, subject to certain terms, conditions and limitations provided in the agreement, including a requirement that the ten-day volume weighted average price of the Company's common stock prior to the date of conversion is at least 15% greater than the conversion price.

The loans are secured by certain of the Company's assets including, among other things, accounts receivable, deposit accounts, inventory, equipment, general intangibles, investment property and certain other claims, rights and interests. PFG's security interests are subject only to (a) the first security interests held by Silicon Valley Bank, except that PFG holds a first security interest in certain intellectual property, and (b) the liens of the Pearland Economic Development Corporation associated with the Company's planned manufacturing facility in Pearland, Texas. The PFG loan and security agreement contains customary covenants limiting the Company's ability to, among other things, incur debt or liens, make certain investments and loans, effect certain redemptions of and declare and pay certain dividends on its stock, permit or suffer certain change of control transactions, dispose of collateral, or change the nature of its business. In addition, the PFG loan and security agreement contains financial covenants requiring the Company to maintain certain liquidity and fixed charge coverage ratios, and certain three-month EBITDA targets. If the Company does not comply with the various covenants, PFG may, subject to various customary cure rights, decline to provide additional loans, require amortization of the loan over its remaining term, or require the immediate payment of all amounts outstanding under the loan and foreclose on any or all collateral, depending on which financial covenants are not maintained.

In connection with the execution of the PFG loan and security agreement, the Company issued a warrant to PFG on April 14, 2010 which allows PFG to purchase 147,330 shares of the Company's common stock at a price per share of \$5.43, which price was based on the ten-day volume weighted average price per share of the Company's common stock prior to the date of the agreement. The warrant vests with respect to 50% on the issue date, and thereafter, vests pro rata from time to time according to a percentage equal to (a) the additional loans actually drawn until April 14, 2011, divided by (b) \$2,500. The warrant expires on the fifth anniversary of the issue date, subject to earlier expiration in accordance with the terms.

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**ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS**

You should read the following discussion and analysis of our financial condition and results of operations together with our financial statements and the related notes appearing under Item 1 of Part 1. Some of the information contained in this discussion and analysis or set forth elsewhere in this quarterly report, including information with respect to our plans and strategy for our business and expected financial results, includes forward-looking statements that involve risks and uncertainties. You should review the Risk Factors discussed in our Form 10-K for the year ended June 30, 2009 for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis.

**OVERVIEW**

We are a medical device company focused on developing and commercializing interventional treatment systems for vascular disease. Our initial product, the Diamondback 360°, is a minimally invasive catheter system for the treatment of peripheral arterial disease, or PAD. We also intend to pursue approval of our product for coronary use.

We were incorporated as Replidyne, Inc. in Delaware in 2000. On February 25, 2009, Replidyne, Inc. completed its business combination with Cardiovascular Systems, Inc., a Minnesota corporation ( CSI-MN ), in accordance with the terms of the Agreement and Plan of Merger and Reorganization, dated as of November 3, 2008 (the Merger Agreement ). Pursuant to the Merger Agreement, CSI-MN continued after the merger as the surviving corporation and a wholly owned subsidiary of Replidyne. Replidyne changed its name to Cardiovascular Systems, Inc. ( CSI ) and CSI-MN merged with and into CSI, with CSI continuing after the merger as the surviving corporation. These transactions are referred to herein as the merger. Unless the context otherwise requires, all references herein to the Company, CSI, we, us and our refer to CSI-MN prior to the completion of the merger and to CSI following the completion of the merger and the name change, and all references to Replidyne refer to Replidyne prior to the completion of the merger and the name change. Replidyne was a biopharmaceutical company focused on discovering, developing, in-licensing and commercializing anti-infective products.

At the closing of the merger, Replidyne's net assets, as calculated pursuant to the terms of the Merger Agreement, were approximately \$36.6 million as adjusted. As of immediately following the effective time of the merger, former CSI stockholders owned approximately 80.2% of the outstanding common stock of the combined company, and Replidyne stockholders owned approximately 19.8% of the outstanding common stock of the combined company.

CSI was incorporated in Minnesota in 1989. From 1989 to 1997, we engaged in research and development on several different product concepts that were later abandoned. Since 1997, we have devoted substantially all of our resources to the development of the Diamondback 360°.

From 2003 to 2005, we conducted numerous bench and animal tests in preparation for application submissions to the FDA. We initially focused our testing on providing a solution for coronary in-stent restenosis, but later changed the focus to PAD. In 2006, we obtained an investigational device exemption from the FDA to conduct our pivotal OASIS clinical trial, which was completed in January 2007. The OASIS clinical trial was a prospective 20-center study that involved 124 patients with 201 lesions.

In August 2007, the FDA granted us 510(k) clearance for the use of the Diamondback 360° as a therapy in patients with PAD. We commenced commercial introduction of the Diamondback 360° in the United States in September 2007. We market the Diamondback 360° in the United States through a direct sales force and expend significant capital on our sales and marketing efforts to expand our customer base and utilization per customer. We manufacture the Diamondback 360° internally at our facilities.

As of March 31, 2010, we had an accumulated deficit of \$146.9 million. We expect our losses to continue but generally decline as revenue grows from continued commercialization activities, development of additional product enhancements, accumulation of clinical data on our products, and further regulatory submissions. To date, we have financed our operations primarily through the private placement of equity securities and completion of the merger.

**CRITICAL ACCOUNTING POLICIES AND SIGNIFICANT JUDGMENTS AND ESTIMATES**

Our management's discussion and analysis of our financial condition and results of operations are based on our consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The



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preparation of our consolidated financial statements requires us to make estimates, assumptions and judgments that affect amounts reported in those statements. Our estimates, assumptions and judgments, including those related to revenue recognition, allowance for doubtful accounts, excess and obsolete inventory, investments, and stock-based compensation are updated as appropriate at least quarterly. We use authoritative pronouncements, our technical accounting knowledge, cumulative business experience, judgment and other factors in the selection and application of our accounting policies. While we believe that the estimates, assumptions and judgments that we use in preparing our consolidated financial statements are appropriate, these estimates, assumptions and judgments are subject to factors and uncertainties regarding their outcome. Therefore, actual results may materially differ from these estimates.

Some of our significant accounting policies require us to make subjective or complex judgments or estimates. An accounting estimate is considered to be critical if it meets both of the following criteria: (1) the estimate requires assumptions about matters that are highly uncertain at the time the accounting estimate is made, and (2) different estimates that reasonably could have been used, or changes in the estimate that are reasonably likely to occur from period to period, would have a material impact on the presentation of our financial condition, results of operations, or cash flows.

**RESULTS OF OPERATIONS**

The following table sets forth, for the periods indicated, our results of operations expressed as dollar amounts (in thousands), and, for certain line items, the changes between the specified periods expressed as percent increases or decreases:

	Three Months Ended March 31,			Nine Months Ended March 31,		
	2010	2009	Percent Change	2010	2009	Percent Change
Revenues	\$ 16,519	\$ 15,115	9.3%	\$ 46,814	\$ 40,766	14.8%
Cost of goods sold	3,847	3,920	(1.8)	10,850	11,954	(9.2)
Gross profit	12,672	11,195	13.2	35,964	28,812	24.8
Expenses:						
Selling, general and administrative	16,382	14,253	14.9	47,150	45,626	3.3
Research and development	2,459	3,428	(28.3)	7,421	11,851	(37.4)
Total expenses	18,841	17,681	6.6	54,571	57,477	(5.1)
Loss from operations	(6,169)	(6,486)	(4.9)	(18,607)	(28,665)	(35.1)
Other (expense) income:						
Interest expense	(341)	(971)	(64.9)	(1,075)	(1,831)	(41.3)
Interest income	58	171	(66.1)	245	3,180	(92.3)
Decretion of redeemable convertible preferred stock warrants		3,157			2,991	
Gain (impairment) on investments		300			(1,933)	
Other	(66)			(66)		
Total other (expense) income	(349)	2,657	113.1	(896)	2,407	137.2
Net loss	(6,518)	(3,829)	70.2	(19,503)	(26,258)	(25.7)
		25,778			22,781	

Decretion of redeemable  
convertible preferred stock

Net income (loss) available to common shareholders	\$ (6,518)	\$ 21,949	129.7	\$ (19,503)	\$ (3,477)	460.8
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***Comparison of Three Months Ended March 31, 2010 with Three Months Ended March 31, 2009***

*Revenues.* Revenues increased by \$1.4 million, or 9.3%, from \$15.1 million for the three months ended March 31, 2009 to \$16.5 million for the three months ended March 31, 2010. This increase was attributable to a \$792,000, or 5.8%, increase in sales of the Diamondback 360° and a \$612,000, or 43.1%, increase in sales of supplemental and other products during the three months ended March 31, 2010 compared to the three months ended March 31, 2009. Supplemental products include our Viper product line and distribution partner products, some of which have been introduced over the last year. As of March 31, 2010, we had a 151-person direct sales organization. As of March 31, 2009, we had a 119-person direct sales organization. We expect our revenue to increase as we continue to increase the number of physicians using the devices, increase the usage per physician, continue to focus on physician education programs, and introduce new and improved products. Currently, all of our revenues are in the United States, however, we may potentially sell internationally in the future.

*Cost of Goods Sold.* Cost of goods sold decreased by \$73,000, or 1.8%, from \$3.9 million for the three months ended March 31, 2009 to \$3.8 million for the three months ended March 31, 2010. This decrease in cost of goods sold resulted in an increase to gross margin of 3%, from 74% for the three months ended March 31, 2009 to 77% for the three months ended March 31, 2010. Cost of goods sold represents the cost of materials, labor and overhead for single-use catheters, guidewires, control units, and other ancillary products. The increase in gross margin from the three months ended March 31, 2009 to March 31, 2010 is primarily due to manufacturing efficiencies, product cost reductions, and shipment of fewer lower margin control units. Cost of goods sold for the three

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months ended March 31, 2010 and 2009 includes \$157,000 and \$434,000, respectively, for stock-based compensation. We expect that gross margin will stay fairly consistent in the future as sales volumes increase, although quarterly fluctuations could occur based on timing of new product introductions, sales mix, pricing changes, or other unanticipated circumstances.

*Selling, General and Administrative Expenses.* Our selling, general and administrative expenses increased by \$2.1 million, or 14.9%, from \$14.3 million for the three months ended March 31, 2009 to \$16.4 million for the three months ended March 31, 2010. The primary reason for the increase was sales and marketing expenses, which included the building of our sales team along with additional marketing programs. Selling, general and administrative expenses for the three months ended March 31, 2010 and 2009 includes \$1.7 million and \$1.4 million, respectively, for stock-based compensation. We expect our selling, general and administrative expenses to increase in the future due primarily to the costs associated with expanding our sales and marketing programs and organization to further commercialize our products, though that growth should be at a lower rate than revenue growth.

*Research and Development Expenses.* Research and development expenses decreased by \$0.9 million, or 28.3%, from \$3.4 million for the three months ended March 31, 2009 to \$2.5 million for the three months ended March 31, 2010. Research and development expenses relate to specific projects to improve our product or expand into new markets, such as the development of a new control unit, shaft designs, crown designs, and PAD and coronary clinical trials. The reduction in these expenses related to the decreased numbers and sizes of PAD development projects in fiscal 2010, as well as the timing of those projects. Research and development expenses for the three months ended March 31, 2010 and 2009 includes \$300,000 and \$220,000, respectively, for stock-based compensation. As we continue to expand our product portfolio within the market for the treatment of peripheral arteries and leverage our core technology into the coronary market, we expect to incur research and development expenses for the remainder of the fiscal year at a slightly higher rate than that incurred for the three months ended March 31, 2010, although fluctuations could occur based on the number of projects and studies and the timing of expenditures.

*Interest Expense.* Interest expense decreased by \$630,000, from \$971,000 for the three months ended March 31, 2009 to \$341,000 for the three months ended March 31, 2010. The decrease was primarily due to significantly reduced amortization of the debt discount during the three months ended March 31, 2010 due to the refinancing of debt in April 2009.

*Interest Income.* Interest income decreased by \$113,000, from \$171,000 for the three months ended March 31, 2009 to \$58,000 for the three months ended March 31, 2010. The decrease was primarily due to lower investment balances and reduced yields on investments.

*Gain (Impairment) on Investments.* Gain (impairment) on investments was \$300,000 for the three months ended March 31, 2009 and was due to an increase in the fair value of investments. There was no gain (impairment) on investments for the three months ended March 31, 2010.

*Decretion of Redeemable Convertible Preferred Stock.* Decretion of redeemable convertible preferred stock reflects the change in estimated fair value of preferred stock at the balance sheet dates. Decretion of redeemable convertible preferred stock for the three months ended March 31, 2009 was \$25.8 million. There was no decretion of redeemable convertible preferred stock during the three months ended March 31, 2010 because all preferred stock was converted to common stock in conjunction with the merger.

**Comparison of the Nine Months Ended March 31, 2010 with Nine Months Ended March 31, 2009**

*Revenues.* Revenues increased by \$6.0 million, or 14.8%, from \$40.8 million for the nine months ended March 31, 2009 to \$46.8 million for the nine months ended March 31, 2010. This increase was attributable to a \$4.2 million, or 11.4%, increase in sales of the Diamondback 360° and a \$1.8 million, or 50.4% increase in sales of supplemental and other products during the nine months ended March 31, 2010 compared to the nine months ended March 31, 2009. Supplemental products include our Viper product line and distribution partner products, some of which have been introduced over the last year.

*Cost of Goods Sold.* Cost of goods sold decreased by \$1.1 million, or 9.2%, from \$12.0 million for the nine months ended March 31, 2009 to \$10.9 million for the nine months ended March 31, 2010. This decrease in cost of goods sold resulted in an increase to gross margin of 6%, from 71% for the nine months ended March 31, 2009 to 77% for the nine months ended March 31, 2010. Cost of goods sold represents the cost of materials, labor and overhead for

single-use catheters, guidewires, control units, and other ancillary products. The increase in gross margin from the nine months ended March 31, 2009 to March 31, 2010 is primarily due to manufacturing efficiencies, product cost reductions, and shipment of fewer lower margin control units. Cost of goods sold for the nine months ended March 31, 2010 and 2009 includes \$434,000 and \$367,000, respectively, for stock-based compensation.



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*Selling, General and Administrative Expenses.* Selling, general and administrative expenses increased by \$1.5 million, or, 3.3%, from \$45.6 million for the nine months ended March 31, 2009 to \$47.1 million for the nine months ended March 31, 2010. The primary reasons for the increase included increased sales and marketing expenses of \$3.8 million, from building our sales team along with additional marketing programs, partially offset by reduced consulting and professional services primarily from a \$1.7 million write-off of previously capitalized initial public offering costs in fiscal 2009. Selling, general and administrative expenses for the nine months ended March 31, 2010 and 2009 includes \$5.2 million and \$4.1 million, respectively, for stock-based compensation.

*Research and Development Expenses.* Research and development expenses decreased by \$4.5 million, or 37.4%, from \$11.9 million for the nine months ended March 31, 2009 to \$7.4 million for the nine months ended March 31, 2010. The reduction in these expenses related to costs of a coronary clinical trial occurring during the nine months ended March 31, 2009, along with the decreased number and size of PAD development projects in fiscal 2010, as well as the timing of those projects. Research and development expenses for the nine months ended March 31, 2010 and 2009 includes \$876,000 and \$441,000, respectively, for stock-based compensation.

*Interest Expense.* Interest expense decreased by \$756,000, or 41.3%, from \$1.8 million for the nine months ended March 31, 2009 to \$1.1 million for the nine months ended March 31, 2010. The decrease was primarily due to significantly reduced amortization of the debt discount during the nine months ended March 31, 2010 due to the refinancing of debt in April 2009.

*Interest Income.* Interest income decreased by \$2.9 million, from \$3.2 million for the nine months ended March 31, 2009 to \$245,000 for the nine months ended March 31, 2010. The decrease was due to \$2.8 million recorded during the nine months ended March 31, 2009 related to accepting the UBS offer to repurchase our auction rate securities, establishing an auction rate securities put option agreement.

*Gain (Impairment) on Investments.* Gain (impairment) on investments was \$(1.9) million for the nine months ended March 31, 2009. This was due to a \$1.6 million decrease in the fair value of investments and also the recognition of \$343,000 in a previously recorded other comprehensive loss. There was no gain (impairment) of investments during the nine months ended March 31, 2010.

*Accretion of Redeemable Convertible Preferred Stock.* Accretion of redeemable convertible preferred stock reflects the change in estimated fair value of preferred stock at the balance sheet dates. Accretion of redeemable convertible preferred stock for the nine months ended March 31, 2009 was \$22.8 million. There was no accretion of redeemable convertible preferred stock during the nine months ended March 31, 2010 because all preferred stock was converted to common stock in conjunction with the merger.

**LIQUIDITY AND CAPITAL RESOURCES**

We had cash and cash equivalents of \$23.6 million at March 31, 2010 and \$33.4 million at June 30, 2009. During the nine months ended March 31, 2010, net cash used in operations amounted to \$11.8 million. As of March 31, 2010, we had an accumulated deficit of \$146.9 million. We have historically funded our operating losses primarily from the issuance of common and preferred stock, convertible promissory notes, and debt. We have incurred negative cash flows and net losses since inception.

On February 25, 2009, we completed the merger, in accordance with the terms of the Merger Agreement. At closing, Replidyne's net assets, as calculated pursuant to the terms of the Merger Agreement, were approximately \$36.6 million as adjusted.

In February 2008, we were notified that recent conditions in the global credit markets have caused insufficient demand for auction rate securities, resulting in failed auctions for \$23.0 million of our auction rate securities. These securities are currently not liquid, as we have an inability to sell the securities due to continued failed auctions. At March 31, 2010, we maintained a margin loan with UBS Bank USA with maximum available borrowings, including interest, equal to the par value of auction rate securities held. At March 31, 2010, maximum available borrowings were \$19.3 million. This maximum borrowing amount is not set forth in the written agreement for the loan and may be adjusted from time to time by UBS Bank in its sole discretion. The margin loan bears interest at variable rates that equal the lesser of (i) 30 day LIBOR plus 1.25% or (ii) the applicable reset rate, maximum auction rate or similar rate as specified in the prospectus or other documentation governing the pledged taxable student loan auction rate securities; however, interest expense charged on the loan will not exceed interest income earned on the auction rate

securities. The loan is due on demand and UBS Bank will require us to repay it in full from the proceeds received from a public equity offering where net proceeds exceed \$50.0 million. In addition, if at any time any of our auction rate securities may be sold, exchanged, redeemed, transferred or otherwise conveyed for no less than their par value, then we must immediately effect such a transfer and the proceeds must be used to pay down outstanding borrowings under this loan. The margin requirements are determined by UBS Bank but are not included in the written

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loan agreement and are therefore subject to change. If these margin requirements are not maintained, UBS Bank may require us to make a loan payment in an amount necessary to comply with the applicable margin requirements or demand repayment of the entire outstanding balance. We have maintained the margin requirements under the loans from both UBS entities. The outstanding balance on this loan at March 31, 2010 was \$19.2 million.

***Silicon Valley Bank***

On March 29, 2010, we entered into an amended and restated loan and security agreement with Silicon Valley Bank. The agreement includes a \$10.0 million term loan and a \$15.0 million line of credit. The terms of each of these loans are as follows:

The \$10.0 million term loan has a fixed interest rate of 9.0% and a final payment amount equal to 1.0% of the loan amount due at maturity. This term loan has a 36 month maturity, with repayment terms that include interest only payments during the first six months followed by 30 equal principal and interest payments. This term loan also includes an acceleration provision that requires us to pay the entire outstanding balance, plus a penalty ranging from 1.0% to 3.0% of the principal amount, upon prepayment or the occurrence and continuance of an event of default. In connection with entering into the agreement, we amended a warrant previously granted to Silicon Valley Bank. The warrant provides an option to purchase 8,493 shares of common stock at an exercise price of \$5.48 per share. This warrant is immediately exercisable and expires ten years after the date of amendment. The balance outstanding on the term loan at March 31, 2010 was \$10.0 million.

The \$15.0 million line of credit has a two year maturity and a floating interest rate equal to the prime rate, plus 2.0%, with an interest rate floor of 6.0%. Interest on borrowings is due monthly and the principal balance is due at maturity. Borrowings on the line of credit are based on (a) 80% of eligible domestic receivables, plus (b) the lesser of 40% of eligible inventory or 25% of eligible domestic receivables or \$2.5 million, minus (c) to the extent in effect, certain loan reserves as defined in the agreement. Accounts receivable receipts are deposited into a lockbox account in the name of Silicon Valley Bank. The accounts receivable line of credit is subject to non-use fees, annual fees, and cancellation fees. There was no balance outstanding on the line of credit at March 31, 2010. The agreement provides that initially 50% of the outstanding principal balance of the \$10.0 million term loan reduces available borrowings under the line of credit. Upon the achievement of certain financial covenants, the amount reducing available borrowings will be reduced to zero. There was not an outstanding balance on the line of credit at March 31, 2010.

Prior to the amendment and restatement, our loan and security agreement with Silicon Valley Bank included a \$3.0 million term loan, a \$10.0 million accounts receivable line of credit, and a \$5.5 million term loan that reduced the availability of funds on the accounts receivable line of credit.

Borrowings from Silicon Valley Bank are secured by all of our assets, other than our auction rate securities. The borrowings are subject to prepayment penalties and financial covenants, including maintaining certain liquidity and fixed charge coverage ratios and certain three-month EBITDA targets. The agreement also includes subjective acceleration clauses which permit Silicon Valley Bank to accelerate the due date under certain circumstances, including, but not limited to, material adverse effects on our financial status or otherwise. Any non-compliance by us under the terms of our debt arrangements could result in an event of default under the Silicon Valley Bank loan, which, if not cured, could result in the acceleration of this debt.

***Partners for Growth***

On April 14, 2010, we entered into a loan and security agreement with Partners for Growth III, L.P. (PFG). The agreement provides that PFG will make loans to us up to \$4.0 million. The agreement has a five-year maturity until April 14, 2015. The loans bear interest at a floating per annum rate equal to 2.75% above Silicon Valley Bank's prime rate, and such interest is payable monthly. The principal balance of and any accrued and unpaid interest on any notes are due on the maturity date and may not be prepaid by us at any time in whole or in part.

Under the agreement, PFG provided us with an initial loan of \$1,500,000 on April 15, 2010. In addition, for a period of one year until April 14, 2011, we may request additional proceeds from time to time, in minimum increments of \$250,000, up to \$4.0 million. After this period, we may only request additional proceeds (in increments

of not less than \$250,000) equal to the aggregate principal amount converted into our common stock through an optional conversion or mandatory conversion. At any time prior to the maturity date, PFG may at its option convert any amount into our common stock at the conversion price set forth in each note, which conversion price will be subject to adjustment upon certain events as provided in such note. The initial agreement has an initial conversion price of \$5.43, which

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equaled the ten-day volume weighted average price per share of our common stock prior to the date of the agreement. We may also effect at any time a mandatory conversion of amounts, subject to certain terms, conditions and limitations provided in the agreement, including a requirement that the ten-day volume weighted average price of our common stock prior to the date of conversion is at least 15% greater than the conversion price.

The loans are secured by certain assets including, among other things, accounts receivable, deposit accounts, inventory, equipment, general intangibles, investment property and certain other claims, rights and interests. PFG's security interests are subject only to (a) the first security interests held by Silicon Valley Bank, except that PFG holds a first security interest in certain intellectual property, and (b) the liens of the Pearland Economic Development Corporation associated with our planned manufacturing facility in Pearland, Texas. The PFG loan and security agreement contains customary covenants limiting our ability to, among other things, incur debt or liens, make certain investments and loans, effect certain redemptions of and declare and pay certain dividends on our stock, permit or suffer certain change of control transactions, dispose of collateral, or change the nature of our business. In addition, the PFG Loan and Security Agreement contains financial covenants requiring us to maintain certain liquidity and fixed charge coverage ratios, and certain three-month EBITDA targets. If we do not comply with the various covenants, PFG may, subject to various customary cure rights, decline to provide additional loans, require amortization of the loan over its remaining term, or require the immediate payment of all amounts outstanding under the loan and foreclose on any or all collateral, depending on which financial covenants are not maintained.

In connection with the execution of the PFG loan and security agreement, we issued a warrant to PFG on April 14, 2010 which allows PFG to purchase 147,330 shares of our common stock at a price per share of \$5.43, which price was based on the ten-day volume weighted average price per share of our common stock prior to the date of the agreement. The warrant vests with respect to 50% on the issue date, and thereafter, vests pro rata from time to time according to a percentage equal to (a) the additional loans actually drawn until April 14, 2011, divided by (b) \$2.5 million. The warrant expires on the fifth anniversary of the issue date, subject to earlier expiration in accordance with the terms.

The reported changes in cash and cash equivalents and investments for the nine months ended March 31, 2010 and 2009 are summarized below.

*Cash and Cash Equivalents.* Cash and cash equivalents was \$23.6 million and \$33.4 million at March 31, 2010 and June 30, 2009, respectively. This decrease is primarily attributable to net cash used in operations offset by net cash of \$3.0 million received under an agreement to establish a manufacturing facility in Texas and proceeds from debt of \$4.4 million.

*Investments.* Investments were \$16.3 million and \$20.0 million at March 31, 2010 and June 30, 2009, respectively. Our investments include AAA rated auction rate securities issued primarily by state agencies and backed by student loans substantially guaranteed by the Federal Family Education Loan Program, or FFELP. The federal government insures loans in the FFELP so that lenders are reimbursed at least 97% of the loan's outstanding principal and accrued interest if a borrower defaults. Approximately 99.2% of the par value of our auction rate securities is supported by student loan assets that are guaranteed by the federal government under the FFELP.

In February 2008, we were informed that there was insufficient demand for auction rate securities, resulting in failed auctions for \$23.0 million of our auction rate securities. Currently, these affected securities are not liquid and will not become liquid until a future auction for these investments is successful, they are redeemed by the issuer, they mature, or they are repurchased by UBS.

On November 7, 2008, we accepted an offer from UBS AG (UBS), providing rights related to our auction rate securities (the Rights). The Rights permit us to require UBS to purchase our auction rate securities at par value, which is defined for this purpose as the liquidation preference of the auction rate securities plus accrued but unpaid dividends or interest, at any time during the period of June 30, 2010 through July 2, 2012. Conversely, UBS has the right, in its discretion, to purchase or sell our auction rate securities at any time until July 2, 2012, so long as we receive payment at par value upon any sale or disposition. We expect to sell our auction rate securities under the Rights. If the Rights are not exercised before July 2, 2012 they will expire and UBS will have no further rights or obligation to buy our auction rate securities. At March 31, 2010 and June 30, 2009, we have determined the fair value of our auction rate security rights to be \$2.8 million. As long as we hold auction rate securities, they will continue to accrue interest as

determined by the auction process or the terms of the auction rate securities if the auction process fails.

*Operating Activities.* Net cash provided by (used in) operating activities was \$(11.8) million and \$(26.4) million for the nine months ended March 31, 2010 and 2009, respectively. For the nine months ended March 31, 2010 and 2009, we had a net loss of

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\$19.5 million and \$26.3 million, respectively. Changes in working capital accounts also contributed to the net cash provided by (used in) operating activities for the nine months ended March 31, 2010 and 2009. Significant changes in working capital during these periods included:

Cash (used in) accounts receivable of \$(1.4) million and \$(3.3) million during the nine months ended March 31, 2010 and 2009, respectively. The reduction in amount used between periods is due to lower revenue growth in fiscal year 2010.

Cash (used in) provided by inventories of \$(1.2) million and \$1.0 million during the nine months ended March 31, 2010 and 2009, respectively. For the nine months ended March 31, 2010, cash (used in) inventories was primarily due to the timing of inventory purchases and shipments. For the nine months ended March 31, 2009, cash provided by inventories was due to improved inventory management.

Cash provided by prepaid expenses and other current assets of \$77,000 and \$1.9 million during the nine months ended March 31, 2010 and 2009, respectively. For the nine months ended March 31, 2010, cash provided by prepaid expenses and other current assets was primarily due to payment timing of vendor deposits and other expenditures. For the nine months ended March 31, 2009, cash provided by prepaid expenses and other current assets was primarily due to payment timing of vendor deposits and effect of the merger with Replidyne.

Cash provided by (used in) accounts payable of \$192,000 and \$(1.4) million during the nine months ended March 31, 2010 and 2009, respectively. For the nine months ended March 31, 2010 and 2009, cash provided by (used in) accounts payable was primarily due to timing of purchases, vendor payments, and effect of the merger with Replidyne.

Cash provided by (used in) accrued expenses and other liabilities of \$2.9 million and \$(1.0) million during the nine months ended March 31, 2010 and 2009, respectively. For the nine months ended March 31, 2010, cash provided by accrued expenses and other liabilities was primarily due to receipt of \$3.0 million in net cash under an agreement to establish a manufacturing facility in Texas. For the nine months ended March 31, 2009, cash provided by (used in) accrued expenses and other liabilities was primarily due to timing of payments and effect of the merger with Replidyne.

*Investing Activities.* Net cash provided by investing activities was \$2.6 million and \$36.7 million for the nine months ended March 31, 2010 and 2009, respectively. Cash provided by investing activities primarily related to net cash acquired in the merger with Replidyne along with the redemption of certain auction rate securities, offset by purchases of property and equipment. Net cash provided by the merger with Replidyne was \$37.8 million for the nine months ended March 31, 2009. Cash provided by the redemption of auction rate securities was \$3.6 million for the nine months ended March 31, 2010. Purchases of property and equipment (used) cash of \$(639,000) and \$(750,000) for the nine months ended March 31, 2010 and 2009, respectively.

*Financing Activities.* Net cash (used in) provided by financing activities was \$(647,000) and \$19.9 million in the nine months ended March 31, 2010 and 2009, respectively.

Cash provided by financing activities during these periods included:

Proceeds from long-term debt of \$4.4 million and \$18.0 million during the nine months ended March 31, 2010 and 2009, respectively;

Proceeds from purchases under our employee stock purchase plan of \$702,000 during the nine months ended March 31, 2010;

Exercise of stock options and warrants of \$285,000 and \$502,000 during the nine months ended March 31, 2010 and 2009, respectively;

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Issuance of common stock warrants of \$1.8 million during the nine months ended March 31, 2009; and

Issuance of convertible preferred stock warrants of \$75,000 during the nine months ended March 31, 2009.

Cash (used in) financing activities in these periods included:

Payment of deferred financing costs of \$50,000 during the nine months ended March 31, 2010.

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Payment of long-term debt of \$(6.0) million and \$(480,000) during the nine months ended March 31, 2010 and 2009, respectively.

Our future liquidity and capital requirements will be influenced by numerous factors, including the extent and duration of future operating losses, the level and timing of future revenue and expenditures, the results and scope of ongoing research and product development programs, working capital required to support our revenue growth, the receipt of and time required to obtain regulatory clearances and approvals, our sales and marketing programs, the continuing acceptance of our products in the marketplace, competing technologies and market and regulatory developments. As of March 31, 2010, we believe our current cash and cash equivalents and available debt capacity will be sufficient to fund working capital requirements, capital expenditures and operations for the foreseeable future. We intend to retain any future earnings to support operations and to finance the growth and development of our business, and we do not anticipate paying any dividends in the foreseeable future.

**INFLATION**

We do not believe that inflation has had a material impact on our business and operating results during the periods presented.

**OFF-BALANCE SHEET ARRANGEMENTS**

Since inception, we have not engaged in any off-balance sheet activities as defined in Item 303(a)(4) of Regulation S-K.

**RECENT ACCOUNTING PRONOUNCEMENTS**

In January 2010, the FASB issued further guidance regarding additional disclosures relating to fair value of transfers in and out of Levels 1 and 2 and for activity in Level 3 and clarifies certain other existing disclosure requirements. This guidance had no impact on our financial position, results of operations or cash flows.

In October 2009, the FASB issued guidance providing principles for allocation of consideration among its multiple-elements, allowing more flexibility in identifying and accounting for separate deliverables under an arrangement. The guidance introduces an estimated selling price method for valuing the elements of a bundled arrangement if vendor-specific objective evidence or third-party evidence of selling price is not available, and significantly expands related disclosure requirements. This standard is effective on a prospective basis for revenue arrangements entered into or materially modified in fiscal years beginning on or after June 15, 2010. Alternatively, adoption may be on a retrospective basis, and early application is permitted. We are currently evaluating the impact of adopting this pronouncement.

**PRIVATE SECURITIES LITIGATION REFORM ACT**

The Private Securities Litigation Reform Act of 1995 provides a safe harbor for forward-looking statements. Such forward-looking information is included in this Form 10-Q, including Item 2 of Part I, and in other materials filed or to be filed by the Company with the Securities and Exchange Commission (as well as information included in oral statements or other written statements made or to be made by the Company). Forward-looking statements include all statements based on future expectations. This Form 10-Q contains forward-looking statements that involve risks and uncertainties, including approval of our product for coronary use; our expectation that our losses will continue but generally decline; our plans to continue to expand our sales and marketing efforts; the expected benefits of the Rights from UBS; our expectation of increased revenue, and selling, general and administrative expenses; the possibility of selling our products internationally in the future; our expectation that research and development expenses for the remainder of the fiscal year will be incurred at a slightly higher rate than for the three months ended March 31, 2010; our expectation that gross margin will stay fairly consistent; the sufficiency of our current and anticipated financial resources; and our belief that our current cash and cash equivalents and available debt will be sufficient to fund working capital requirements, capital expenditures and operations for the foreseeable future.

In some cases, you can identify forward-looking statements by the following words: anticipate, believe, continue, could, estimate, expect, intend, may, ongoing, plan, potential, predict, project, should, will, these terms or other comparable terminology, although not all forward-looking statements contain these words.

Forward-looking statements are only predictions and are not guarantees of performance. These statements are based on our management's beliefs and assumptions, which in turn are based on their interpretation of currently available information.



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These statements involve known and unknown risks, uncertainties and other factors that may cause our results or our industry's actual results, levels of activity, performance or achievements to be materially different from the information expressed or implied by these forward-looking statements. These factors include regulatory developments in the U.S. and foreign countries; the experience of physicians regarding the effectiveness and reliability of the Diamondback 360°; success of our clinical trials; competition from other devices; unanticipated developments affecting our estimates regarding expenses, future revenues and capital requirements; our inability to expand our sales and marketing organization; our actual research and development efforts and needs; the sufficiency of UBS's financial resources to purchase our auction rate securities; our ability to obtain and maintain intellectual property protection for product candidates; our actual financial resources; and general economic conditions. These and additional risks and uncertainties are described more fully in our Form 10-K filed with the SEC on September 28, 2009. Copies of filings made with the SEC are available through the SEC's electronic data gathering analysis and retrieval system (EDGAR) at [www.sec.gov](http://www.sec.gov).

You should read these risk factors and the other cautionary statements made in this Form 10-Q as being applicable to all related forward-looking statements wherever they appear in this Form 10-Q. We cannot assure you that the forward-looking statements in this Form 10-Q will prove to be accurate. Furthermore, if our forward-looking statements prove to be inaccurate, the inaccuracy may be material. You should read this Form 10-Q completely. Other than as required by law, we undertake no obligation to update these forward-looking statements, even though our situation may change in the future.

### **ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

The primary objective of our investment activities is to preserve our capital for the purpose of funding operations while at the same time maximizing the income we receive from our investments without significantly increasing risk or availability. To achieve these objectives, our investment policy allows us to maintain a portfolio of cash equivalents and investments in a variety of marketable securities, including money market funds and U.S. government securities. Our cash and cash equivalents as of March 31, 2010 include liquid money market accounts. Due to the short-term nature of these investments, we believe that there is no material exposure to interest rate risk.

In February 2008, we were informed that there was insufficient demand for ARS, resulting in failed auctions for \$23.0 million of our ARS. Currently, affected securities of \$16.4 million are not liquid and will not become liquid until a future auction for these investments is successful or they are redeemed by the issuer or they mature. For discussion of the related risks, see Management's Discussion and Analysis of Financial Condition and Results of Operations Critical Accounting Policies and Significant Judgments and Estimates Investments.

### **ITEM 4T. CONTROLS AND PROCEDURES**

#### **Evaluation of Disclosure Controls and Procedures**

Our Chief Executive Officer and Chief Financial Officer, referred to collectively herein as the Certifying Officers, are responsible for establishing and maintaining our disclosure controls and procedures. The Certifying Officers have reviewed and evaluated the effectiveness of the Company's disclosure controls and procedures (as defined in Rules 240.13a-15(e) and 15d-15(e) promulgated under the Securities Exchange Act of 1934 (the Exchange Act)) as of March 31, 2010. Based on that review and evaluation, which included inquiries made to certain other employees of the Company, the Certifying Officers have concluded that, as of the end of the period covered by this Report, the Company's disclosure controls and procedures, as designed and implemented, are effective in ensuring that information relating to the Company required to be disclosed in the reports that the Company files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's rules and forms, including ensuring that such information is accumulated and communicated to the Company's management, including the Chief Executive Officer and the Chief Financial Officer, as appropriate to allow timely decisions regarding required disclosure.

#### **Changes in Internal Control Over Financial Reporting**

There were no changes in our internal controls over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the three months ended March 31, 2010 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 1. LEGAL PROCEEDINGS**

Refer to Item 3 (Legal Proceedings) in the Company's Annual Report on Form 10-K for the year ended June 30, 2009 and Item 1 (Legal Proceedings) in the Company's Quarterly Reports on Form 10-Q for the quarterly periods ended September 30, 2009 and December 31, 2009.

**ITEM 1A. RISK FACTORS**

In addition to the other information set forth in this report, including the important information in Private Securities Litigation Reform Act, you should carefully consider the Risk Factors discussed in our Form 10-K for the year ended June 30, 2009 for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in this report, and materially adversely affect our financial condition or future results. Although we are not aware of any other factors that we currently anticipate will cause our forward-looking statements to differ materially from our future actual results, or materially affect the Company's financial condition or future results, additional risks and uncertainties not currently known to us or that we currently deem to be immaterial might materially adversely affect our actual business, financial condition and/or operating results.

**ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS**

None.

**ITEM 3. DEFAULTS UPON SENIOR SECURITIES**

None.

**ITEM 5. OTHER INFORMATION**

Under our loan and security agreement with Silicon Valley Bank we are required to maintain certain financial covenants. Period to the amendment and restatement of this agreement on March 29, 2010, we were not in compliance with one of the financial covenants for the month ended February 28, 2010, which would have constituted an event of default under the agreement and all amounts outstanding under the agreement would have been due to Silicon Valley Bank. However, Silicon Valley Bank waived this covenant for such period. The amount outstanding under the agreement with Silicon Valley Bank at February 28, 2010 was \$5.9 million.

**ITEM 6. EXHIBITS**

(a) Exhibits See Exhibit Index on page following signatures

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**SIGNATURES**

Pursuant to the requirements of Section 13 or 15(d) of the Securities Exchange Act of 1934, the Company has duly caused this Report to be signed on its behalf by the undersigned, thereunto duly authorized.

Dated: May 14, 2010

CARDIOVASCULAR SYSTEMS, INC.

By /s/ David L. Martin  
David L. Martin  
President and Chief Executive Officer  
(Principal Executive Officer)

By /s/ Laurence L. Betterley  
Laurence L. Betterley  
Chief Financial Officer  
(Principal Financial and Accounting  
Officer)

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EXHIBIT INDEX  
CARDIOVASCULAR SYSTEMS, INC.  
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<b>Exhibit No.</b>	<b>Description</b>
10.1	Loan and Security Agreement, dated March 29, 2010, by and between Cardiovascular Systems, Inc. and Silicon Valley Bank.
10.2	Amended and Restated Warrant to Purchase Stock, dated March 29, 2010, issued by Cardiovascular Systems, Inc. to Silicon Valley Bank.
10.3	Loan and Security Agreement, dated April 14, 2010, by and between Cardiovascular Systems, Inc. and Partners for Growth III, L.P.
10.4	Intellectual Property Security Agreement, dated April 14, 2010, by and between Cardiovascular Systems, Inc. and Partners for Growth III, L.P.
10.5	Copyright Collateral Agreement and Notice, dated April 14, 2010, by and between Cardiovascular Systems, Inc. and Partners for Growth III, L.P.
10.6	Domain Rights Collateral Agreement and Notice, dated April 14, 2010, by and between Cardiovascular Systems, Inc. and Partners for Growth III, L.P.
10.7	Patent Collateral Agreement and Notice, dated April 14, 2010, by and between Cardiovascular Systems, Inc. and Partners for Growth III, L.P.
10.8	Trademark Collateral Agreement and Notice, dated April 14, 2010, by and between Cardiovascular Systems, Inc. and Partners for Growth III, L.P.
10.9	Letter Agreement, dated April 14, 2010, by and between Cardiovascular Systems, Inc. and Partners for Growth III, L.P.
10.10	Senior Convertible Promissory Note, dated April 14, 2010, issued by Cardiovascular Systems, Inc. to Partners for Growth III, L.P.
10.11	Warrant, dated April 14, 2010, issued by Cardiovascular Systems, Inc. to Partners for Growth III, L.P.
10.12	Summary of Amendment to Fiscal 2010 Executive Officer Annual Cash Incentive Compensation.
31.1	Certification of President and Chief Executive Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification of Chief Financial Officer Pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certification of President and Chief Executive Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

32.2 Certification of Chief Financial Officer Pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

Compensatory  
plan or  
agreement.

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