OMNICELL, Inc
Form 10-Q
November 08, 2010

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

OR

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

For the transition period from to

Commission File Number 000-33043

Omnicell, Inc.

(Exact name of registrant as specified in its charter)

Delaware (State or other jurisdiction of incorporation or organization)	**94-3166458** (I.R.S. Employer Identification No.)

1201 Charleston Road

Mountain View, CA 94043

(650) 251-6100

(Address, including zip code, of registrant s principal executive offices and registrant s telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes o No o

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

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

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

The number of shares of Registrant s common stock (par value $0.001) outstanding as of November 3, 2010 was 32,959,175.

OMNICELL, INC.

FORM 10-Q

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PART 1 FINANCIAL INFORMATION

Item 1. Financial Statements

OMNICELL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

	September 30, 2010 (unaudited)		December 31, 2009 (1)	
ASSETS				
Current assets:				
Cash and cash equivalents	$	178,625	$	169,230
Accounts receivable, net of allowances of $976 and $868 at September 30, 2010 and December 31, 2009, respectively		45,070		40,826
Inventories		9,345		10,502
Prepaid expenses		11,198		8,780
Deferred tax assets		15,247		15,247
Other current assets		6,882		6,159
Total current assets		266,367		250,744
Property and equipment, net		13,512		13,209
Non-current net investment in sales-type leases		9,345		10,104
Goodwill		28,650		24,982
Other intangible assets		5,164		4,233
Non-current deferred tax assets		8,089		9,666
Other assets		8,610		9,322
Total assets	$	339,737	$	322,260
LIABILITIES AND STOCKHOLDERS EQUITY				
Current liabilities:				
Accounts payable	$	13,695	$	10,313
Accrued compensation		6,747		8,095
Accrued liabilities		8,900		11,997
Deferred service revenue		15,881		14,457
Deferred gross profit		12,521		13,689
Total current liabilities		57,744		58,551
Long-term deferred service revenue		19,169		20,810
Other long-term liabilities		886		595
Total liabilities		77,799		79,956
Stockholders equity:				
Total stockholders equity		261,938		242,304
Total liabilities and stockholders equity	$	339,737	$	322,260

(1) Information derived from our December 31, 2009 audited Consolidated Financial Statements.

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

OMNICELL, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three Months Ended September 30, 2010	Three Months Ended September 30, 2009	Nine Months Ended September 30, 2010	Nine Months Ended September 30, 2009
Revenues:				
Product revenues	$ 43,241	$ 42,854	$ 127,559	$ 127,221
Services and other revenues	13,045	11,103	37,580	31,583
Total revenues	56,286	53,957	165,139	158,804
Cost of revenues:				
Cost of product revenues	19,449	20,087	57,723	59,542
Cost of services and other revenues	6,698	6,621	20,823	20,055
Restructuring charges	39		39	1,209
Total cost of revenues	26,186	26,708	78,585	80,806
Gross profit	30,100	27,249	86,554	77.998
Operating expenses:				
Research and development	6,089	4,981	15,604	13,532
Selling, general and administrative	19,851	21,324	61,789	63,861
Restructuring / asset impairment charges	1,157		1,157	1,315
Total operating expenses	27,097	26,305	78,550	78,708
Income (loss) from operations	3,003	944	8.004	(710)
Interest and other income, net of other expense	159	56	286	433
Income (loss) before provision for (benefit from) income taxes	3,162	1,000	8,290	(277)
Provision for (benefit from) income taxes	1,886	146	4,070	(165)
Net income (loss)	$ 1,276	$ 854	$ 4,220	$ (112)
Net income (loss) per share-basic	$ 0.04	$ 0.03	$ 0.13	$ 0.00
Net income (loss) per share-diluted	$ 0.04	$ 0.03	$ 0.13	$ 0.00
Weighted average shares outstanding:				
Basic	32,822	31,704	32,534	31,578
Diluted	33,540	32,380	33,383	31,578

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

OMNICELL, INC.

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Nine Months Ended September 30, 2010	2009
Cash flows from operating activities:		
Net income (loss)	$ 4,220	$ (112)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	6,493	7,171
Loss on disposal/impairment of fixed assets	147	251
Gain on legal settlement	(2,439)	
Provision for (recovery of) receivable allowance	(674)	648
Share-based compensation expense	6,452	7,271
Income tax benefits from employee stock plans	2,365	
Excess tax benefits from employee stock plans	(4,473)	
Provision for excess and obsolete inventories	646	2,379
Deferred income taxes	1,577	159
Changes in operating assets and liabilities:		
Accounts receivable, net	(4,139)	(886)
Inventories	511	104
Prepaid expenses	(2,419)	(141)
Other current assets	320	3,448
Net investment in sales-type leases	1,007	650
Other assets	(868)	(1,831)
Accounts payable	3,312	1,054
Accrued compensation	(1,513)	(1,268)
Accrued liabilities	(1,714)	1,225
Deferred service revenue	1,016	4,248
Deferred gross profit	(1,168)	1
Other long-term liabilities	291	(97)
Net cash provided by operating activities	8,950	24,314
Cash flows from investing activities:		
Business acquisition, net of cash acquired	(5,703)	
Acquisition of intangible assets and intellectual property	(168)	(122)
Purchases of property and equipment	(4,755)	(2,065)
Net cash used in investing activities	(10,626)	(2,187)
Cash flows from financing activities:		
Proceeds from issuance of common stock under employee stock purchase and stock option plans	6,598	3,746
Excess tax benefits from employee stock plans	4,473	
Net cash provided by financing activities	11,071	3,746
Net increase in cash and cash equivalents	9,395	25,873
Cash and cash equivalents at beginning of period	169,230	120,439
Cash and cash equivalents at end of period	$ 178,625	$ 146,312

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

OMNICELL, INC.

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

Note 1. Organization & Summary of Significant Accounting Policies

Description of the Company. Omnicell, Inc. (Omnicell, our, us, we, or the Company) was incorporated in California in 1992 under the name Omnicell Technologies, Inc. and reincorporated in Delaware in 2001 as Omnicell, Inc. Our major products are medication and supply dispensing systems which are sold in our principal market, which is the healthcare industry. Our market is primarily located in the United States.

Basis of Presentation. These interim condensed consolidated financial statements are unaudited but reflect, in the opinion of management, all adjustments, consisting of normal recurring adjustments and accruals, necessary to present fairly the financial position of Omnicell and its subsidiaries as of September 30, 2010, the results of operations for the three and nine months ended September 30, 2010 and 2009, and cash flows for the nine months ended September 30, 2010 and 2009. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles, or GAAP, have been condensed or omitted in accordance with the rules and regulations of the Securities and Exchange Commission, or SEC. These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2009.

Our results of operations for the three and nine months ended September 30, 2010 and cash flows for the nine months ended September 30, 2010 are not necessarily indicative of results that may be expected for the year ending December 31, 2010, or for any future period.

Use of estimates. The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Principles of consolidation. The condensed consolidated financial statements include the accounts of our wholly-owned subsidiaries. All significant inter-company accounts and transactions have been eliminated in consolidation.

Fair value of financial instrument. We value our financial assets and liabilities on a recurring basis using the fair value hierarchy established in Accounting Standards Codification (ASC) 820. ASC 820 describes three levels of inputs that may be used to measure fair value, as follows:

Level 1 inputs, which include quoted prices in active markets for identical assets or liabilities;

Level 2 inputs, which include observable inputs other than Level 1 inputs, such as quoted prices for similar assets or liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the asset or liability; and

Level 3 inputs, which include unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the underlying asset or liability. Level 3 assets and liabilities include those whose fair value measurements are determined using pricing models, discounted cash flow methodologies or similar valuation techniques, as well as significant management judgment or estimation.

At September 30, 2010 and December 31, 2009, our financial assets utilizing Level 1 inputs included cash equivalents. For these items, quoted market prices are readily available and fair value approximates carrying value. We do not currently have any material financial instruments utilizing Level 2 and Level 3 inputs.

Accounting policy for shipping costs. Outbound freight billed to customers is recorded as product revenue. The related shipping and handling cost is expensed as part of selling general and administrative expense. Such shipping and handling expenses totaled $0.5 million and $0.6 million for the three months ending September 30, 2010 and 2009 respectively. For the nine months ending September 30, 2010 and 2009, the shipping and handling expenses totaled $1.5 million and $1.5 million, respectively.

Concentration of revenues and accounts receivable. There were no customers accounting for 10% or more of revenues in the three months ended September 30, 2010 and 2009. Additionally, there were no customers accounting for 10% or more of revenues in the nine months ended September 30, 2010 and 2009. No customer accounted for 10% or more of accounts receivable at either September 30, 2010 or December 31, 2009.

Sales of accounts receivable. We offer our customers multi-year, non-cancelable payment terms. Generally we sell non-U.S. government receivables to third-party leasing companies on a non-recourse basis. We reflect the financing costs on the sale of these receivables as a component of our revenue. We record our revenue at the net present value of the multi-year payment stream using the contractual interest rate charged to us by the third-party leasing company. We record the sale of our accounts receivables as true sales in accordance with ASC 860, Transfers and Servicing. During the nine months ended September 30, 2010 and 2009, we transferred non-recourse accounts receivable totaling $40.2 million and $30.1 million, respectively, which approximated fair value, to third party leasing companies. At September 30, 2010 and December 31, 2009, accounts receivable included $0.9 million and $1.6 million, respectively, due from third party leasing companies for transferred non-recourse accounts receivable.

Dependence on suppliers. We have supply agreements for construction and supply of several sub-assemblies and inventory management of sub-assemblies used in our hardware products. In 2009 and 2010 there was one significant supplier. There are no minimum purchase requirements. The contracts may be terminated by either the supplier or by us without cause and at any time upon delivery of from two to six months notice. Purchases from the one significant supplier for the three and nine months ended September 30, 2010 were approximately $5.2 million and $14.1 million, respectively. Purchases from this significant supplier for the comparable periods in 2009 were approximately $5.1 million and $15.7 million, respectively.

Income Taxes. We record a tax provision for the anticipated tax consequences of the reported results of operations. In accordance with GAAP, the provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for operating losses and tax credit carry forwards. Deferred tax assets and liabilities are measured using the enacted tax rates expected to apply to taxable income in the periods in which those tax assets and liabilities are expected to be realized or settled. In the event that we determine all or part of the net deferred tax assets are not realizable in the future, we will record a valuation allowance that would be charged to earnings in the period such determination is made.

In accordance with ASC 740, we recognize the tax benefit from an uncertain tax position if it is more likely than not that the tax position will be sustained on examination by the taxing authorities, based on the technical merits of the position. The tax benefits recognized in the financial statements from such positions are then measured based on the largest benefit that has a greater than 50% likelihood of being realized upon ultimate settlement. The calculation of tax liabilities involves significant judgment in estimating the impact of uncertainties in the application of GAAP and complex tax laws. Resolution of these uncertainties in a manner inconsistent with management s expectations could have a material impact on our financial condition and operating results.

Total comprehensive income (loss). Total comprehensive income (loss) is the same as net income (loss) for the three and nine months ended September 30, 2010 and 2009.

Segment Information. We manage our business on the basis of one reportable segment. Our products and technologies share similar distribution channels and customers and are sold primarily to hospitals and healthcare facilities to improve patient safety and care and enhance operational efficiency. Our sole operating segment is medication and supply dispensing systems. Substantially all of our long-lived assets are located in the United States. For the three and nine months ended September 30, 2010 and 2009, substantially all of our total revenues and gross profits were generated by the medication and supply dispensing systems operating segment from customers in the United States.

Recently Issued Accounting Pronouncements.

In October 2009, the FASB issued Accounting Standards Updates (ASU) 2009-13 and 2009-14, or ASU 2009-13 and ASU 2009-14, which amended ASC 605, Revenue Recognition, and ASC 985-605, Software - Revenue Recognition, respectively. ASU 2009-13 requires companies to allocate arrangement consideration in multiple-element arrangements based on an element s estimated selling price if vendor-specific or other third-party evidence of selling price is not available. ASU 2009-14 revises the guidance regarding the types of arrangements that fall under the scope of the software recognition guidance, providing a scope exception for many transactions that were previously within the scope of Subtopic ASC 985-605, including tangible products containing software components and non-software components that function together to deliver the product s essential functionality and places them under Subtopic ASC 605-25, thus requiring the new multiple-element revenue allocation under ASU 2009-13. Both

ASU 2009-13 and ASU 2009-14 are effective for fiscal years beginning on or after June 15, 2010. Earlier application is permitted. We are currently evaluating the impact of the adoption of these ASUs on our consolidated financial statements. We intend to adopt these ASUs at the beginning of fiscal year 2011.

In July 2010, the FASB issued Disclosure about the Credit Quality of Financing Receivables and the Allowance for Credit Losses as ASU 2010-20, amending ASC 310, Receivables . The intent of ASU 2010-20 is to improve the disclosures that an entity provides about the credit quality of its financing receivables and the related allowance for credit losses. As a result of these amendments, an entity is required to disaggregate by portfolio segment or class certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses. For public entities, the new disclosures for the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010, with new disclosures about period activity effective for interim and annual reporting periods beginning on or after December 15, 2010. We are currently evaluating the impact of the adoption of ASU 2010-20 on our consolidated financial statements.

Note 2. Acquisition

On September 29, 2010, Omnicell, Inc. completed the acquisition of all of the outstanding capital stock of Pandora Data Systems (Pandora), a provider of analytical software for medication diversion detection and regulatory compliance, for $6.0 million in cash. Pandora solutions are installed in over 700 acute care hospitals in the United States and interface to all major medication management systems in the market

In connection with the acquisition, we recorded $3.7 million of goodwill, equal to the excess of the purchase prices of the fair values of the net tangible and intangible assets acquired. The following table summarizes the Fair Value acquisition accounting for Pandora on the September 29, 2010 purchase date (amounts in thousands of dollars):

		Fair Values Acquired
Cash	$	297
Accounts receivable/other		416
Indemnification asset		1,000
Intangibles		2,420
Goodwill		3,668
Total assets		7,801
Accrued compensation/other		291
Deferred service revenue		510
Litigation contingency		1,000
Total liabilities		1,801
Net assets acquired	$	6,000
Cash consideration	$	6,000

The $0.4 million fair value of accounts receivable consists of gross contractual commitments from customers less the amount not expected to be collected. The $0.5 million of deferred service revenue represents the fair value, using estimated discounted cash flow, of acquired remaining performance obligations under service contracts.

Additionally, an acquired legal contingency related to a contractual dispute between Pandora and a third party resulted in a liability accrual of $1.0 million, measured under ASC 450 Contingencies guidance. An indemnification asset of $1.0 million was also recorded, since the former shareholders of Pandora have agreed to indemnify Omnicell against losses related to the litigation and a portion of the purchase price was placed

in escrow to secure the indemnification obligations of the former Pandora shareholders.

The fair values and useful lives for the identified intangible assets in the table below were determined by management, with assistance of valuation specialists. No residual values were assumed for the acquired intangible assets.

		Thousands of Dollars	Useful Life (years)
Trade name	$	90	3
Customer relationships		1,290	16
Non-compete agreements		60	3
Acquired technology	$	980	7
Finite-lived intangibles acquired		2,420	
Weighted avg. life of intangibles			11.5

Operating results of Pandora have been combined with our operating results from the date of acquisition. Pro forma combined operating results for Omnicell and Pandora for the nine months ended September 30, 2010 and 2009 have been omitted since the acquisition of Pandora is not material.

Note 3. Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing net income (loss) for the period by the weighted average number of shares outstanding during the period, less shares subject to repurchase. Diluted net income (loss) per share is computed by dividing net income (loss) for the period by the weighted average number of shares less shares subject to repurchase plus, if dilutive, potential common stock outstanding during the period. Potential common stock include the effect of outstanding dilutive stock options, restricted stock awards and restricted stock units computed using the treasury stock method for those arrangements which are in the money. Potential common stock which is out of the money is excluded as the impact would be anti-dilutive. Additionally, in a period of net loss such as the nine months ended September 30, 2009, all potential common stock is excluded and, as a result, the basic and diluted net loss per share is identical. The total number of shares of potential common stock excluded from the calculations of diluted net income (loss) per share for the nine months ended September 30, 2010 and 2009 was 2,019,161 and 4,332,258, respectively.

The calculation of basic and diluted net income (loss) per share is as follows (in thousands, except per share amounts):

	Three Months Ended September 30.		Nine Months Ended September 30.	
	2010	2009	2010	2009
Basic:				
Net income (loss)	$ 1,276	$ 854	$ 4,220	$ (112)
Weighted average shares outstanding - basic	32,822	31,704	32,534	31,578
Net income (loss) per share basic	$ 0.04	$ 0.03	$ 0.13	$ 0.00
Diluted:				
Net income (loss)	$ 1,276	$ 854	$ 4,220	$ (112)
Weighted average shares outstanding - basic	32,822	31,704	32,534	31,578
Add: Dilutive effect of employee stock plans	718	676	849	
Weighted average shares outstanding - diluted	33,540	32,380	33,383	31,578
Net income (loss) per share - diluted	$ 0.04	$ 0.03	$ 0.13	$ 0.00

Note 4. Inventories

Inventories consist of the following (in thousands):

	September 30, 2010	December 31, 2009
Raw materials	$ 4,263	$ 3,589
Work in process	299	171
Finished goods	4,783	6,742
Total	$ 9,345	$ 10,502

Note 5. Net Investment in Sales-Type Leases

Our sales-type leases are for terms generally ranging up to five years. Sales-type lease receivables are collateralized by the underlying equipment. The components of our net investment in sales-type leases are as follows (in thousands):

	September 30, 2010		December 31, 2009	
Net minimum lease payments to be received	$	16,689	$	17,164
Less unearned interest income portion		2,002		2,001
Net investment in sales-type leases		14,687		15,163
Less current portion(1)		5,342		5,059
Non-current net investment in sales-type leases(2)	$	9,345	$	10,104

The minimum lease payments under sales-type leases as of September 30, 2010 are as follows (in thousands):

2010 (remaining three months)	$	1,839
2011		7,308
2012		3,273
2013		2,519
2014		1,362
Thereafter		388
Total	$	16,689

(1) A component of other current assets. This amount is net of allowance for doubtful accounts of $0.2 million at September 30, 2010 and $0 at December 31, 2009.
(2) Net of allowance for doubtful accounts of $0.3 million at September 30, 2010 and $0.6 million at December 31, 2009.

Note 6. Goodwill and Other Intangible Assets

Under ASC 350, Intangibles Goodwill and Other, goodwill and intangible assets with an indefinite life are not subject to amortization. Rather, we evaluate these assets for impairment at least annually or more frequently if events and changes in circumstances suggest that the carrying amount may not be recoverable.

Goodwill and other intangible assets consist of the following (in thousands):

	September 30, 2010			December 31, 2009			
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Amortization Life
Finite-lived intangibles:							

Customer relationships	$ 4,474	$ 1,274	$ 3,200	$ 3,184	$ 999	$ 2,185	5-16 years
Acquired technology	10,344	9,058	1,286	9,364	7,888	1,476	3-7 years
Patents	623	142	481	455	110	345	20 years
Non-compete agreements	780	673	107	720	493	227	3 years
Trade name	90		90				3 years
Total finite-lived intangibles	16,311	11,147	5,164	13,723	9,490	4,233	
Goodwill	28,650		28,650	24,982		24,982	Indefinite
Net intangibles & goodwill	$ 44,961	$ 11,147	$ 33,814	$ 38,705	$ 9,490	$ 29,215	

Amortization expense totaled $0.6 million and $0.6 million for the three months ended September 30, 2010 and 2009, respectively. Amortization expense totaled $1.7 million and $1.8 million for the nine months ended September 30, 2010 and 2009, respectively.

Estimated annual expected amortization expense of the finite-lived intangible assets at September 30, 2010 is as follows (in thousands):

2010 (remaining three months)	$	544
2011		767
2012		767
2013		755
2014		654
Thereafter		1,677
Total	$	5,164

The following goodwill roll-forward table consists of a single segment / single reporting unit (in thousands):

		Gross Carrying Amount		Accumulated Impairment Losses		Net Carrying Amount
Beginning balance, January 1, 2010	$	24,982	$		$	24,982
Goodwill acquired during year		3,668				3,668
Impairment losses						
Ending balance, September 30, 2010	$	28,650	$		$	28,650

Note 7. Deferred Gross Profit

Deferred gross profit consists of the following (in thousands):

		September 30, 2010		December 31, 2009
Sales of medication and supply dispensing systems, which have been delivered and invoiced but not yet installed	$	19,555	$	20,876
Cost of revenues, excluding installation costs		(7,034)		(7,187)
Deferred gross profit	$	12,521	$	13,689

Note 8. Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

		September 30, 2010		December 31, 2009
Accrued Group Purchasing Organization (GPO) fees	$	2,635	$	2,932
Advance payments from customers		1,714		662
Pre-acquisition contingency		1,165		5,269

Rebates and lease buyouts		987		1,140
Other		2,399		1,994
Total	$	8,900	$	11,997

Note 9. Commitments

The following table summarizes our contractual obligations at September 30, 2010 (in thousands):

	Total	Less than one year	One to three Years	Three to five years	More than five years
Operating leases (1)	$ 7,394	$ 3,904	$ 2,875	$ 615	$
Commitments to contract manufacturers and suppliers (2)	3,896	3,896			
Total	$ 11,290	$ 7,800	$ 2,875	$ 615	$

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(1) Commitments under operating leases relate primarily to leasehold property and office equipment. In April 2010, we entered into a lease agreement to replace certain expiring leases with approximately 25,000 square feet of office space in Nashville, Tennessee. The new lease is for a term of 60 months, and commenced July 2010, with two five-year renewal options. The base rental commitment for the initial five-year term totals $1.7 million.

(2) We purchase components from a variety of suppliers and use contract manufacturers to provide manufacturing services for our products. During the normal course of business, we issue purchase orders with estimates of our requirements several months ahead of the delivery dates.

Note 10. Legal Proceedings

Flo Healthcare Solutions, LLC. On December 11, 2007, we acquired Rioux Vision, Inc., which had an existing lawsuit in progress at the time of that acquisition. Omnicell has since been defending that lawsuit, as Rioux Vision, a wholly-owned subsidiary of Omnicell. On October 26, 2006, Rioux Vision was served with a complaint in a lawsuit entitled Flo Healthcare Solutions, LLC v. Rioux Vision, Inc., Case Number 1:06-cv-02600, in the United States District Court for the Northern District of Georgia, alleging claims of patent infringement regarding certain features of the mobile carts sold by Rioux Vision. On December 11, 2008, we were served with a complaint in a lawsuit entitled Flo Healthcare Solutions, LLC v. Omnicell, Inc., Case Number 1:06-cv-02600, in the same Court alleging similar claims of patent infringement regarding Omnicell s sale of the mobile carts acquired in the Rioux acquisition. In accordance with Accounting Standards Codification, or ASC, 805, Business Combinations, we recorded a pre-acquisition contingency based on our assessment of its fair value in our preliminary purchase price allocation. The fair value for this pre-acquisition contingency represents the amount we and Rioux agreed to adjust the purchase price as a result of our acceptance of any and all costs and risks relating to this contingency. The pre-acquisition contingency was recorded as an accrued liability as of the acquisition date, and up to September 30, 2010.

On March 4, 2009, we filed, but did not serve, a complaint against Flo Healthcare Solutions, or Flo, entitled Omnicell, Inc. v. Flo Healthcare Solutions LLC, Case Number C09 00923, in the United States District Court for the Northern District of California, with respect to the infringement of Omnicell s U.S. Patent Number 6,604,019. Flo received a courtesy copy of the complaint. On March 10, 2009, we consented to a motion that Flo filed requesting a stay of the Flo Healthcare Solutions LLC v. Rioux Vision, Inc. lawsuit pending the final outcome, including all appeals, of the inter parties reexamination of U.S. Patent No. 6,721,178, currently before the United States Patent and Trademark Office or the Reexamination, which was granted. We consented to a similar motion filed by Flo with respect to the stay of the Flo Healthcare Solutions LLC v. Omnicell, Inc. lawsuit, which was also granted. Under a tolling agreement between the parties, we agreed to dismiss without prejudice the Omnicell, Inc. v. Flo Healthcare Solutions LLC lawsuit, and Omnicell and Flo agreed to toll further actions under all three lawsuits pending the final outcome, including all appeals, of the Reexamination. The parties have requested oral hearings with the United States Patent and Trademark Office s Board of Patent Appeals and Interferences and are awaiting its response.

On September 30, 2010, Omnicell settled all pending litigation in the Northern District of Georgia with Flo Healthcare LLC, which is now part of the entity InterMetro Industries Corporation. Additionally, Omnicell paid InterMetro $2.7 million, and entered into a patent cross-license agreement with InterMetro, wherein Omnicell received an ongoing license to the patent at issue in the suits, and InterMetro received licenses to two Omnicell patents. The parties jointly filed a motion of dismissal for each of the cases with the Georgia court on October 25, 2010. In connection with this settlement, $2.4 million of previously accrued liabilities were released and this gain was recorded as a reduction to selling, general and administrative expense in the three months ending September, 30, 2010.

Medacist Solutions Group, LLC. On July 8, 2009, Medacist Solutions Group LLC filed a complaint against Omnicell in U.S. District Court in the Southern District of New York, entitled Medacist Solutions Group LLC v. Omnicell, Inc., case number 09 CV 6128, alleging infringement of Medacist s U.S. Patent Number 6,842,736. The complaint also, among other claims, alleges that Omnicell breached the terms of a nondisclosure agreement it had entered into with Medacist, and that Omnicell misappropriated Medacist s trade secrets and confidential information in violation of the NDA. Medacist is seeking unspecified monetary damages and an injunction against the Company s infringement of the specified patent and/or misuse of any of Medacist s trade secrets pursuant to the NDA or in violation of California code. Omnicell has

responded to the complaint, denies the claims, and intends to defend the matter vigorously. In June 2010, the Court issued its Civil Case Management Plan and Scheduling Order indicating that discovery in the case will be conducted through March 11, 2011.

On October 20, 2010, the Company filed a declaratory judgment complaint against Medacist Solutions Group, LLC in the U.S. District Court in the Northern District of California, entitled Omnicell, Inc. and Pandora Data Systems, Inc. v. Medacist Solutions Group, LLC, Case Number 10-cv-4746. Pandora Data Systems, Inc. has a non-exclusive license to Medacist s U.S. Patent Number 6,842,736. The Company seeks an order declaring that Omnicell, as now-owner of Pandora Data Systems, Inc., is entitled to certain rights and benefits under the license. On October 21, 2010, Medacist was served with the complaint. Medacist has not yet filed a response to the complaint.

As required under ASC 450, Contingencies, we accrue for contingencies when we believe that a loss is probable and that we can reasonably estimate the amount of any such loss. We have made an assessment of the probability of incurring any such losses and such amounts are reflected in accrued liabilities in our consolidated financial statements. Except as otherwise indicated above, the outcomes in these matters are not probable and/or reasonably estimable. We believe that we have valid defenses with respect to legal matters pending against us. However, litigation is inherently unpredictable, and it is possible that cash flows or results of operations could be materially affected in any particular period by the unfavorable resolution of one or more of these contingencies or because of the diversion of management s attention and the creation of significant expenses.

Note 11. Stockholders Equity

During 2008, our board of directors authorized stock repurchase programs for the repurchase of up to $90.0 million of our common stock. All repurchased shares were recorded as treasury stock and were accounted for under the cost method. No repurchased shares have been retired. The timing, price and volume of the repurchases are based on market conditions, relevant securities laws and other factors. The stock repurchase program does not obligate us to repurchase any specific number of shares, and we may terminate or suspend the repurchase program at any time. From the inception of the program in February 2008 through September 30, 2010, we repurchased a total of 4,066,296 shares at an average cost of $16.00 per share through open market purchases.

During the nine months ended September 30, 2010, we did not repurchase any shares through the stock repurchase programs. As of September 30, 2010, we had $25.0 million of remaining authorized funds to repurchase additional shares under the stock repurchase programs. Additionally, for the three months and nine months ended September 30, 2010, we withheld 7,777 shares and 20,264 shares, respectively, from employees to satisfy tax withholding obligations on the vesting of restricted stock units**.** For the three and nine months ended September 30, 2009, 6,298 shares and 13,220 shares, respectively, were withheld from employees to satisfy tax withholding obligation on the vesting of restricted stock units.

Note 12. Stock Option Plans and Share-Based Compensation

Stock Option Plans

At September 30, 2010, 1,176,513 shares of common stock were reserved for future issuance under our 2009 Equity Incentive Plan, or the 2009 Plan. At September 30, 2010, $7.8 million of total unrecognized compensation cost related to non-vested stock options was expected to be recognized over a weighted average period of 2.5 years.

A summary of option activities under the 1999 Equity Incentive Plan, as amended, the 2003 Equity Incentive Plan, as amended, and the 2004 Equity Incentive Plan (collectively, the Prior Plans) and the 2009 Plan for the nine months ended September 30, 2010 is presented below:

Options:	**Number of Shares (in thousands)**		**Weighted-Average Exercise Price**
Outstanding at December 31, 2009	4,748	$	12.61
Granted	383	$	12.55
Exercised	(378)	$	8.61
Forfeited	(66)	$	15.19
Expired	(100)	$	15.98
Outstanding at September 30, 2010	4,587	$	12.82
Exercisable at September 30, 2010	3,495	$	12.84

Restricted Stock and Restricted Stock Units

The non-employee members of our Board of Directors are granted restricted stock on the day of our annual meeting of stockholders and such shares of restricted stock vest on the date of the subsequent year s annual meeting of stockholders, provided such non-employee director remains a director on such date. Restricted stock units, or RSUs, are granted to certain of our employees and generally vest over a period of four years and are expensed ratably on a straight-line basis over the vesting period. The fair value of both restricted stock and RSUs granted pursuant to our equity incentive plans is the product of the number of shares granted and the grant date fair value of our common stock. Our unrecognized compensation cost related to nonvested restricted stock at September 30, 2010 is approximately $0.6 million and is expected to be recognized over a weighted average period of 0.6 years. Expected future compensation expense relating to RSUs outstanding on September 30, 2010 is $4.2 million and is expected to be recognized over a weighted-average period of 2.6 years. A summary of activity of both restricted stock and RSUs for the nine months ended September 30, 2010 is presented below:

	Restricted Stock			**Restricted Stock Units**		
	Number of Shares (in thousands)		**Weighted - Average Grant Date Fair Value Per Share**	**Number of Shares (in thousands)**		**Weighted-Average Grant Date Fair Value Per Share**
Non-vested, December 31, 2009	52	$	9.25	264	$	14.32

Granted	79	$	12.91	128	$	12.46
Vested	(54)	$	9.40	(88)	$	15.16
Forfeited		$		(8)	$	16.95
Non-vested, September 30, 2010	77	$	12.91	296	$	13.19

Employee Stock Purchase Plan

We have an Employee Stock Purchase Plan, or ESPP, under which employees can purchase shares of our common stock based on a percentage of their compensation, but not greater than 15% of their earnings, up to a maximum of $25,000 of fair value per year. The purchase price per share must be equal to the lower of 85% of the fair value of the common stock at the beginning of a 24-month offering period or the end of each six-month purchasing period. As of September 30, 2010, 2,959,030 shares had been issued under the ESPP. As of September 30, 2010, there were a total of 2,372,525 shares reserved for future issuance under the ESPP. During the nine months ended September 30, 2010, 451,014 shares of common stock were purchased under the ESPP.

Share-based Compensation

We account for share-based awards granted to employees and directors including employee stock option awards, restricted stock and RSUs issued pursuant to our equity incentive plans and employee stock purchases made under our ESPP using the estimated grant date fair value method of accounting in accordance with ASC 718, Stock Compensation.

The impact on our results for share-based compensation for the three and nine months ended September 30, 2010 and 2009 was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	2009	2010	2009
Cost of product and service revenues	$ 293	$ 360	$ 993	$ 1,025
Research and development expenses	159	284	537	843
Selling, general and administrative expenses	1,746	1,769	4,922	5,403
Total share-based compensation expenses	$ 2,198	$ 2,413	$ 6,452	$ 7,271

We value options and ESPP shares using the Black-Scholes-Merton option-pricing model.

Note 13. Restructuring and impairment

During the third quarter of 2010, we implemented a restructuring plan to close our offices in Bangalore, India and in The Woodlands, Texas, and consolidate the activities of these two locations with our Mountain View, California and Nashville, Tennessee operations in an effort to increase the efficiency of operations and promote collaboration among our engineering teams. . We substantially completed this consolidation by September 30, 2010.

The roll-forward of restructuring liabilities for the quarter ending September 30, 2010 appears below:

	Severance / relocation	Facility closure / move	Subtotal (cash items)	Impairment (noncash)
Beginning balance, July 1, 2010	$	$	$	$ n/a
Accruals	790	183	973	223
Payments	(532)	(46)	(578)	
Ending balance, September 30, 2010	$ 258	$ 137	$ 395	$ n/a

The third quarter 2010 restructuring charges consisted of $0.3 million in severance for departing employees and $0.5 million relocation benefits for transferring employees, $0.2 million of exit and disposal costs related to the closed facilities, and $0.2 million for impairment of leasehold improvements and certain service tax reimbursement claims. Substantially all the remaining restructuring accrued liabilities of $0.4 million at September 30, 2010 will be paid by December 31, 2010, with the exception of small cease-use liabilities for the Texas office extending through the third quarter of 2011.

During the first quarter of 2009, we implemented a restructuring plan whereby we reduced our headcount from 844 full-time employees at December 31, 2008 to 756 full-time employees at March 31, 2009 to balance our expenses with our then-current business expectations. The restructuring plan accounted for a reduction of 103 employees, which was partially offset by hiring for newly created positions during the quarter. Affected employees were eligible to receive a severance package that included severance pay, continuation of benefits and outplacement services. We recorded a charge of $2.5 million in the first quarter of 2009 in connection with the restructuring. We did not incur any additional charges associated with this restructuring beyond the first quarter of 2009 and we paid all of the accrued severance costs by the end of 2009.

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

Forward-Looking Statements

This Quarterly Report on Form 10-Q contains forward-looking statements. The forward looking statements are contained principally in the sections entitled Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operations. These statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements. Forward-looking statements include, but are not limited to, statements about:

- the extent and timing of future revenues;
- the size and/or growth of our market or market-share;
- the opportunity presented by new products or emerging markets;
- the operating margins or earnings per share goals we may set;
- our ability to align our cost structure with our current business expectations;
- our ability to protect our intellectual property and operate our business without infringing upon the intellectual property rights of others; and
- our estimates regarding the sufficiency of our cash resources.

In some cases, you can identify forward-looking statements by terms such as anticipates, believes, could, estimates, expects, intends, ma potential, predicts, should, will, would and similar expressions intended to identify forward-looking statements. Forward-looking statements reflect our current views with respect to future events, are based on assumptions, and are subject to risks and uncertainties. We discuss many of these risks in this Quarterly Report on Form 10-Q in greater detail in Part II Section 1A. Risk Factors below. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our estimates and assumptions only as of the date of this Quarterly Report on Form 10-Q. You should also read our Annual Report on Form 10-K and the documents that we reference in the Annual Report on Form 10-K and have filed as exhibits, completely and with the understanding that our actual future results may be materially different from what we expect. All references in this report to Omnicell, Inc., Omnicell, our, us, we or the Company

collectively refer to Omnicell, Inc., a Delaware corporation, and its subsidiaries.

Except as required by law, we assume no obligation to update any forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in any forward-looking statements, even if new information becomes available in the future.

Overview

We were incorporated in California in 1992 under the name Omnicell Technologies, Inc. and reincorporated in Delaware in 2001 as Omnicell, Inc. We are a leading provider of medication control and patient safety solutions for acute care health facilities. Over 1,700 hospitals have installed our automated hardware/software solutions for controlling, dispensing, acquiring, verifying and tracking medications and medical and surgical supplies. We have designed our products to enable healthcare professionals to improve patient safety through reduced medication errors, and improved administrative controls and medical safety, while simultaneously improving workflow and increasing operational efficiency. Our products are designed to allow nurses, pharmacists and other clinicians to spend more time on patient care while at the same time providing confirmation that the right patients are receiving the right medication, at the right time, in the right dose, via the right route.

We sell our medication dispensing and supply automation systems, and generate substantially all our revenue, in the United States. However, we have seen an increase in our revenue from our international operations and we expect such revenue from our international operations to increase in future periods as we continue to grow our international business. Our sales force is organized by geographic region in the United States and Canada. We also sell through distributors in Australia, Asia, Europe, and South America.

We operate in one business segment, the design, manufacturing, selling and servicing of medication and supply dispensing systems. Our management team evaluates our performance based on company-wide, consolidated results. In general, we recognize revenue when our systems are installed. Installation generally takes place two weeks to nine months after our systems are ordered. The installation process at our customers sites includes internal procedures associated with large capital expenditures and additional time associated with adopting new technologies. Given the length of time necessary for our customers to plan for and complete their acceptance of the installation of our systems, our focus is on shipping products based on the installation dates requested by our customers and working at the customer s pace. The amount of revenue recognized in future periods may depend on, among other things, the terms and timing of lease contract renewals, additional product sales and the size of such transactions. We believe that future revenue will be affected by the competitiveness of our products and services.

Operating Environment During the Three Months and Nine Months ended September 30, 2010

Our revenues continue to show modest growth year-over-year, primarily in service revenue, while product revenue has remained flat, mostly due to customer installation schedules. Our profitability improved with both product margins and service margins showing gains year over year. We believe our solutions are attractive relative to our competition. In particular:

- We have continued to differentiate ourselves through a strategy intended to create the best customer experience in healthcare;

- We have delivered industry-leading products with differentiated product features that are designed to appeal to nurses and pharmacists such as SinglePointe , Tissue Center System and Anywhere RN ; and

- The market environment of increased patient safety awareness and increased regulatory control has driven our solutions to be a high priority in customers capital budgets.

We maintain a development staff with expertise in hospital logistics and computerized automated solutions that allows us to regularly deliver new innovations to the market. Our ability to grow revenue and maintain positive cash flow is dependent on our ability to continue to receive orders from customers, the volume of installations we are able to complete, our ability to meet customers needs and provide a quality installation experience, and our flexibility in manpower allocations among customers to complete installations on a timely basis.

During the third quarter we achieved similar performance levels compared to the second quarter of 2010. Product revenues increased by 2.9% or $1.2 million, while service revenues increased by 3.0% or $0.4 million. Overall gross margins improved in the third quarter as compared to the second quarter by 0.7% to 53.5% with service gross margins increasing to 48.4% on revenues of $13.0 million as compared to 46.2% gross margins on $12.7 million in revenues in the prior quarter. Product gross margins increased modestly to 55.0% on revenue of $43.2 million as compared to 54.8% margins on revenue of $42.0 million in the prior quarter. The increase in overall gross margins was driven by favorable product mix and operational efficiency in our production and customer service operations.

We believe that our gross margins will continue to fluctuate based on the mix of products installed, fluctuation in the percentage of revenues derived from our international business and the related costs and changes in service and installation headcount compared to our revenue level. International business carries lower gross margins because our international distributors bear the cost of installation, support and most of the sales effort, and therefore demand lower pricing. Cash decreased during the nine months ended September 30, 2010 by $9.4 million due to the acquisition of Pandora, higher than prior year capital expenditures and the litigation settlement with Flo Healthcare Solutions LLC, offset by improved net income and cash generated from stock option exercises and related tax benefits. Net cash provided by operating activities totaled $9.0 million during the nine months ended September 30, 2010.

Critical Accounting Policies and Estimates

Our 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 U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of any contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We regularly review our estimates and assumptions, which are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of certain assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates and assumptions. We believe that the following critical accounting policies are affected by significant judgments and estimates used in the preparation of our condensed consolidated financial statements:

- Revenue recognition;
- Provision for reserves;
- Valuation and impairment of goodwill, other intangible assets and other long lived assets;
- Inventory;
- Valuation of share-based awards; and
- Accounting for income taxes.

During the nine months ended September 30, 2010, there were no significant changes in our critical accounting policies and estimates.

Please refer to Management s Discussion and Analysis of Financial Condition and Results of Operations contained in Part II, Item 7 of our Annual Report on Form 10-K for our fiscal year ended December 31, 2009 for a more complete discussion of our critical accounting policies and estimates.

Recent Accounting Pronouncements

In October 2009, the FASB issued Accounting Standards Updates (ASU) 2009-13 and 2009-14, or ASU 2009-13 and ASU 2009-14, which amended ASC 605, Revenue Recognition, and ASC 985-605, Software-Revenue Recognition, respectively. ASU 2009-13 requires companies to allocate arrangement consideration in multiple-element arrangements based on an element s estimated selling price if vendor-specific or other third-party evidence of selling price is not available. ASU 2009-14 revises the guidance regarding the types of arrangements that fall under the scope of the software recognition guidance, providing a scope exception for many transactions that were previously within the scope of Subtopic ASC 985-605, including tangible products containing software components and non-software components that function together to deliver the product s essential functionality and places them under Subtopic ASC 605-25, thus requiring the new multiple-element revenue allocation under ASU 2009-13. Both ASU 2009-13 and ASU 2009-14 are effective for fiscal years beginning on or after June 15, 2010. Earlier application is permitted. We are currently evaluating the impact of the adoption of these ASUs on our consolidated financial statements. We expect that our adoption of these ASUs will require substantial amounts of management s time and attention and may result in increased operating expenses. We intend to adopt these ASUs at the beginning of fiscal year 2011.

In July 2010, the FASB issued Disclosure about the Credit Quality of Financing Receivables and the Allowance for Credit Losses as ASU 2010-20, amending ASC 310, Receivables. The intent of ASU 2010-20 is to improve the disclosures that an entity provides about the credit quality of its financing receivables and the related allowance for credit losses. As a result of these amendments, an entity is required to disaggregate by portfolio segment or class certain existing disclosures and provide certain new disclosures about its financing receivables and related allowance for credit losses. For public entities, the new disclosures for the end of a reporting period are effective for interim and annual reporting periods ending on or after December 15, 2010, with new disclosures about period activity effective for interim and annual reporting periods beginning on or after December 15, 2010. We are currently evaluating the impact of the adoption of ASU 2010-20 on our consolidated financial statements.

Results of Operations

	Three Months Ended September 30, (in thousands, except percentages)				Nine Months Ended September 30, (in thousands, except percentages)			
	2010		2009		2010		2009	
	$	% of Revenue	$	% of Revenue	$	% of Revenue	$	% of Revenue
Revenues:								
Product revenue	$ 43,241	76.8%	$ 42,854	79.4%	$ 127,559	77.2%	$ 127,221	80.1%
Service and other revenues	13,045	23.2%	11,103	20.6%	37,580	22.8%	31,583	19.9%
Total revenues	56,286	100.0%	53,957	100.0%	165,139	100.0%	158,804	100.0%
Cost of revenues:								
Cost of product revenues	19,449	34.5%	20,087	37.2%	57,723	35.0%	59,542	37.5%
Cost of service and other revenues	6,698	11.9%	6,621	12.3%	20,823	12.6%	20,055	12.6%
Restructuring charges	39	0.1%		%	39		1,209	0.8%
Total cost of revenues	26,186	46.5%	26,708	49.5%	78,585	47.6%	80,806	50.9%
Gross profit	30,100	53.5%	27,249	50.5%	86,554	52.4%	77,998	49.1%
Operating expenses:								
Research and development	6,089	10.8%	4,981	9.3%	15,604	9.4%	13,532	8.5%
Selling, general and administrative	19,851	35.3%	21,324	39.5%	61,789	37.4%	63,861	40.2%
Restructuring charges	1,157	2.0%		%	1,157	0.7%	1,315	0.8%
Total operating expenses	27,097	48.1%	26,305	48.8%	78,550	47.5%	78,708	49.5%
Income (loss) from operations	3,003	5.4%	944	1.7%	8,004	4.9%	(710)	(0.4)%
Interest and other income, net of other expense	159	0.3%						