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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 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 June 30, 2012

Commission file number: 1-33818

ENTEROMEDICS INC.
(Exact name of registrant as specified in its charter)

Delaware	**48-1293684**
(State or other jurisdiction of incorporation)	**(IRS Employer Identification No.)**

2800 Patton Road, St. Paul, Minnesota 55113
(Address of principal executive offices, including zip code)

(651) 634-3003
(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 ☒ No ☐

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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.

Large accelerated filer	☐	Accelerated Filer	☐
Non-accelerated filer	☐ (Do not check if a smaller reporting entity)	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 ☒

As of July 31, 2012, 40,958,086 shares of the registrant's Common Stock were outstanding.

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Registered Trademarks and Trademark Applications: In the United States we have registered trademarks for VBLOC®, ENTEROMEDICS® and MAESTRO®, each registered with the United States Patent and Trademark Office. In addition, some or all of the marks VBLOC, MAESTRO and ENTEROMEDICS are the subject of either a trademark registration or application for registration in Australia, Brazil, China, the European Community, Saudi Arabia and Switzerland. The trademarks VBLOC, ENTEROMEDICS and MAESTRO SYSTEM ORCHESTRATING OBESITY SOLUTIONS are registered in Mexico. The trademarks VBLOC, ENTEROMEDICS and MAESTRO SYSTEM ORCHESTRATING OBESITY SOLUTIONS are the subject of pending trademark applications in the United Arab Emirates. This form 10-Q contains other trade names and trademarks and service marks of EnteroMedics and of other companies.

PART I – FINANCIAL INFORMATION

ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

ENTEROMEDICS INC.
(A development stage company)

Condensed Consolidated Balance Sheets
(Unaudited)

	June 30, 2012	December 31, 2011
ASSETS		
Current assets:		
Cash and cash equivalents	$ 26,550,957	$ 28,487,688
Restricted cash	200,000	200,000
Short-term investments available for sale	1,000,764	1,005,411
Accounts receivable	16,933	—
Inventory	1,088,048	1,068,623
Prepaid expenses and other current assets	634,780	804,799
Total current assets	29,491,482	31,566,521
Property and equipment, net	650,179	630,354
Other assets	381,899	288,980
Total assets	$ 30,523,560	$ 32,485,855
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of notes payable	$ 1,000,000	$ 2,307,162
Accounts payable	98,784	434,436
Accrued expenses	3,140,578	6,373,370
Accrued interest payable	508,779	448,821
Total current liabilities	4,748,141	9,563,789
Notes payable, less current portion (net discounts of $415,787 and $216,711 at June 30, 2012 and December 31, 2011, respectively)	8,584,213	2,881,161
Total liabilities	13,332,354	12,444,950
Commitments and contingencies (note 4)		
Stockholders' equity:		
Common stock, $0.01 par value; 125,000,000 shares authorized; 39,667,121 and 36,752,746 shares issued and outstanding at June 30, 2012 and December 31, 2011, respectively	396,671	367,527
Additional paid-in capital	204,093,274	196,384,995
Accumulated other comprehensive income	116	692
Deficit accumulated during development stage	(187,298,855)	(176,712,309)
Total stockholders' equity	17,191,206	20,040,905
Total liabilities and stockholders' equity	$ 30,523,560	$ 32,485,855

See accompanying notes to condensed consolidated financial statements.

ENTEROMEDICS INC.
(A development stage company)

Condensed Consolidated Statements of Operations
(Unaudited)

	Three months ended June 30,		Six months ended June 30,		Period from December 19, 2002 (inception) to June 30, 2012
	2012	2011	2012	2011	
Sales	$ 188,400	$ —	$ 311,493	$ —	$ 311,493
Cost of goods sold	146,009	—	231,520	—	231,520
Gross profit	42,391	—	79,973	—	79,973
Operating expenses:					
Research and development	2,230,289	3,315,165	4,940,524	6,103,417	121,722,098
Selling, general and administrative	2,541,837	2,065,694	5,355,664	4,134,248	53,524,634
Total operating expenses	4,772,126	5,380,859	10,296,188	10,237,665	175,246,732
Operating loss	(4,729,735)	(5,380,859)	(10,216,215)	(10,237,665)	(175,166,759)
Other income (expense):					
Interest income	2,608	1,097	4,160	8,331	4,040,423
Interest expense	(229,289)	(164,262)	(372,894)	(395,862)	(11,935,664)
Change in value of warrant liability	—	—	—	—	(3,840,622)
Other, net	2,871	(13,081)	(1,597)	(17,927)	(265,265)
Net loss	$ (4,953,545)	$ (5,557,105)	$(10,586,546)	$(10,643,123)	$(187,167,887)
Net loss per share—basic and diluted	$ (0.13)	$ (0.20)	$ (0.28)	$ (0.38)	
Shares used to compute basic and diluted net loss per share	38,667,548	27,892,841	37,712,093	27,892,616	

See accompanying notes to condensed consolidated financial statements.

ENTEROMEDICS INC.
(A development stage company)

Condensed Consolidated Statements of Comprehensive Loss
(Unaudited)

	Three months ended June 30,		Six months ended June 30,		Period from December 19, 2002 (inception) to June 30, 2012
	2012	2011	2012	2011	
Net loss	$(4,953,545)	$(5,557,105)	$(10,586,546)	$(10,643,123)	$(187,167,887)
Change in unrealized gain (loss) on available for sale investments	(404)	(40)	(576)	—	116
Comprehensive loss	$(4,953,949)	$(5,557,145)	$(10,587,122)	$(10,643,123)	$(187,167,771)

See accompanying notes to condensed consolidated financial statements.

ENTEROMEDICS INC.
(A development stage company)

Condensed Consolidated Statements of Cash Flows
(Unaudited)

	Six months ended June 30,		Period from December 19, 2002 (inception) to June 30,
	2012	2011	2012
Cash flows from operating activities:			
Net loss	$(10,586,546)	$(10,643,123)	$(187,167,887)
Adjustments to reconcile net loss to net cash used in operating activities:			
Depreciation	125,608	143,328	2,385,646
Loss on sale of equipment	2,443	1,269	76,570
Stock-based compensation	1,410,608	1,394,295	15,873,774
Amortization of commitment fees, debt issuance costs and original issue discount	99,934	124,600	3,986,557
Amortization of short-term investment premium or discount	4,071	(40)	(300,719)
Change in value of warrant liability	—	—	3,840,622
Change in operating assets and liabilities:			
Accounts receivable	(16,933)	—	(16,933)
Inventory	(19,425)	—	(1,088,048)
Prepaid expenses and other current assets	170,019	(476,090)	(634,780)
Other assets	(104,580)	—	(341,913)
Accounts payable	(431,725)	198,697	(130,585)
Accrued expenses	(3,232,792)	(82,601)	3,140,578
Accrued interest payable	59,958	6,909	674,601
Net cash used in operating activities	(12,519,360)	(9,332,756)	(159,702,517)
Cash flows from investing activities:			
Decrease (increase) in restricted cash	—	6,327,031	(200,000)
Purchases of short-term investments available for sale	—	(2,000,000)	(19,890,213)
Maturities of short-term investments available for sale	—	2,000,040	18,854,414
Purchases of short-term investments held to maturity	—	—	(22,414,130)
Maturities of short-term investments held to maturity	—	—	22,750,000
Purchases of property and equipment	(51,803)	(221,348)	(2,883,025)
Net cash (used in) provided by investing activities	(51,803)	6,105,723	(3,782,954)
Cash flows from financing activities:			
Proceeds from stock options exercised	—	2,164	203,018
Proceeds from warrants exercised	1,407,337	10,950	1,724,678
Proceeds from sale of common stock and warrants for purchase of common stock	5,050,000	—	119,404,439
Common stock financing costs	(367,871)	(45,745)	(9,846,301)
Payment to shareholders for fractional shares upon reverse stock split	—	—	(355)
Proceeds from sale of Series A, B and C convertible preferred stock	—	—	63,766,564
Series A, B and C convertible preferred stock financing costs	—	—	(1,658,662)
Proceeds from notes payable and convertible notes payable	5,347,807	—	47,993,774
Repayments on notes payable	(752,841)	(367,188)	(31,178,928)
Debt issuance costs	(50,000)	—	(371,799)
Net cash provided by (used in) financing activities	10,634,432	(399,819)	190,036,428
Net (decrease) increase in cash and cash equivalents	(1,936,731)	(3,626,852)	26,550,957
Cash and cash equivalents:			
Beginning of period	28,487,688	30,840,560	—
End of period	$ 26,550,957	$ 27,213,708	$ 26,550,957
Supplemental disclosure:			
Interest paid	$ 213,001	$ 264,313	$ 7,265,901
Noncash investing and financing activities:			
Cancellation of Alpha Medical, Inc. Series A convertible preferred stock and common stock	$ —	$ —	$ (661,674)
Issuance of Beta Medical, Inc. Series A convertible preferred stock in exchange for Alpha Medical, Inc. Series A convertible preferred stock and common stock	—	—	661,674
Value of warrants issued with debt and for debt commitment	237,349	—	4,070,532
Value of warrants issued with sale of common and preferred stock offerings	—	—	1,684,832
Cashless exercise of warrants	—	—	5,244,778
Conversion of notes and interest payable to Series B and C convertible preferred shares	—	—	6,980,668
Options issued for deferred compensation	—	—	10,898
Common stock issued to Mayo Foundation and for deferred compensation	—	—	1,770,904
Reclassification of warrant liability	—	—	2,932,766
Conversion of convertible preferred stock to common stock	—	—	51,132

See accompanying notes to condensed consolidated financial statements.

EnteroMedics Inc.
(A development stage company)

Notes to Condensed Consolidated Financial Statements
(Unaudited)

(1) Summary of Significant Accounting Policies

Description of Business

EnteroMedics Inc. (formerly Beta Medical, Inc.) (the Company) is developing implantable systems to treat obesity, metabolic diseases and other gastrointestinal disorders. The Company was incorporated in the state of Minnesota on December 19, 2002 and was reincorporated in Delaware on July 22, 2004. The Company is in the development stage and since inception has devoted substantially all of its resources to recruiting personnel, developing its product technology, obtaining patents to protect its intellectual property and raising capital, and only recently has derived revenues from its primary business activity. The Company is headquartered in St. Paul, Minnesota. In January 2006, the Company established EnteroMedics Europe Sárl, a wholly-owned subsidiary located in Switzerland.

Since inception, the Company has incurred losses through June 30, 2012 totaling approximately $187.2 million and has not generated positive cash flows from operations. The Company expects such losses to continue into the foreseeable future as it continues to develop and commercialize its technologies. The Company may need to obtain additional financing and there can be no assurance that the Company will be successful in obtaining additional financing on favorable terms, or at all. If adequate funds are not available, the Company may have to delay development or commercialization of products or license to third parties the rights to commercialize products or technologies that the Company would otherwise seek to commercialize.

Basis of Presentation

The Company has prepared the accompanying condensed consolidated financial statements in conformity with accounting principles generally accepted in the United States of America. The Company’s fiscal year ends on December 31.

The accompanying condensed consolidated financial statements and notes thereto are unaudited. In the opinion of the Company’s management, these statements include all adjustments, which are of a normal recurring nature, necessary to present a fair presentation. Interim results are not necessarily indicative of results for a full year. The condensed consolidated balance sheet as of December 31, 2011 was derived from audited financial statements, but does not include all disclosures required by accounting principles generally accepted in the United States of America. The information included in this Form 10-Q should be read in conjunction with the Company’s Annual Report on Form 10-K for the year ended December 31, 2011.

Use of Estimates

The preparation of 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 amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. All significant intercompany balances and transactions have been eliminated in consolidation.

Fair Value of Financial Instruments

Carrying amounts of certain of the Company’s financial instruments, including cash and cash equivalents, restricted cash, prepaid expenses and other current assets, accounts payable and accrued liabilities approximate fair value due to their short maturities. The fair values of investments in debt and equity securities are disclosed in Note 2. The fair value of the Company’s long-term debt is approximately $9.9 million as of June 30, 2012 based on the present value of estimated future cash flows using a discount rate commensurate with borrowing rates available to the Company. If measured at fair value in the condensed consolidated financial statements, long-term debt (including the current portion) would be classified as Level 2 in the fair value hierarchy.

Restricted Cash

The Company had $200,000 in a cash collateral money market account as of June 30, 2012 and December 31, 2011. Pursuant to the Lease Agreement the Company entered into with Roseville Properties Management Company in July 2008, the Company was required to deliver to Roseville Properties an irrevocable, unconditional, standby letter of credit in the amount of $200,000 on the second anniversary of the commencement of lease payments. The standby letter of credit is to be maintained through October 1, 2013. The irrevocable standby letter of credit was issued by Silicon Valley Bank, who required the Company to set up a restricted cash collateral money market account to fully secure the standby letter of credit.

EnteroMedics Inc.
(A development stage company)

Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

Inventory

The Company accounts for inventory at the lower of cost or market and records any long-term inventory as other assets in the condensed consolidated balance sheets.

Comprehensive Loss

Comprehensive loss is defined as the change in equity of a company during a period from transactions and other events and circumstances excluding transactions resulting from investment owners and distributions to owners. The difference from reported net loss for the three and six months ended June 30, 2012 and the three months ended June 30, 2011 related entirely to changes in unrealized gains (losses) on available for sale investments. There was no difference from reported net loss for the six months ended June 30, 2011 ..

Revenue Recognition

The Company recognizes revenue when persuasive evidence of an arrangement exists, title or risk of loss has passed, the selling price is fixed or determinable and collection is reasonably assured. The Company sells products internationally through distributors and recognizes revenue upon sale to the distributor as these sales are considered to be final and no right of return or price protection exists. Terms of sales to international distributors are generally EXW, reflecting that goods are shipped “ex works,” in which risk of loss is assumed by the distributor at the shipping point. The Company does not provide for rights of return to customers on product sales and therefore does not record a provision for returns.

Research and Development Expenses

Research and development expenses are charged to expense as incurred. Research and development expenses include, but are not limited to, product development, clinical trial expenses, including supplies and devices, regulatory expenses, payroll and other personnel expenses, materials and consulting costs.

Derivative Instruments

The Company accounts for outstanding warrants that are not indexed to the Company’s stock or warrants issued when the Company has insufficient authorized and unissued stock available to share settle the outstanding warrants as derivative instruments, which require that the warrants be classified as a liability and measured at fair value with changes in fair value recognized currently in earnings and recorded separately in the condensed consolidated statements of operations.

Net Loss Per Share

Basic net loss per share is computed by dividing net loss by the weighted-average number of common shares outstanding during the period. Diluted net loss per share is based on the weighted-average common shares outstanding during the period plus dilutive potential common shares calculated using the treasury stock method. Such potentially dilutive shares are excluded when the effect would be to reduce a net loss per share. The Company’s potential dilutive shares, which include outstanding common stock options, unvested common shares subject to repurchase, convertible preferred stock and warrants, have not been included in the computation of diluted net loss per share for all periods as the result would be anti-dilutive.

EnteroMedics Inc.
(A development stage company)

Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

The following table sets forth the computation of basic and diluted net loss per share for the three and six months ended June 30, 2012 and 2011:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Numerator:				
Net loss	$ (4,953,545)	$ (5,557,105)	$(10,586,546)	$(10,643,123)
Denominator for basic and diluted net loss per share:				
Weighted-average common shares outstanding	38,667,548	27,892,841	37,712,093	27,892,616
Weighted-average unvested common shares subject to repurchase	—	—	—	—
Denominator for net loss per common share—basic and diluted	38,667,548	27,892,841	37,712,093	27,892,616
Net loss per share—basic and diluted	$ (0.13)	$ (0.20)	$ (0.28)	$ (0.38)

The following table sets forth the potential shares of common stock that are not included in the calculation of diluted net loss per share because to do so would be anti-dilutive as of the end of each period presented:

	June 30,	
	2012	2011
Stock options outstanding	3,632,544	1,986,991
Warrants to purchase common stock	23,387,377	22,217,523

Recently Issued Accounting Standards

In June 2011, the Financial Accounting Standards Board issued guidance on the presentation of comprehensive income in financial statements. Entities are required to present total comprehensive income either in a single, continuous statement of comprehensive income or in two separate, but consecutive, statements. The Company adopted this standard during the first quarter of 2012 and presents net loss and other comprehensive loss in two separate, but consecutive, statements. The adoption of this standard did not have a material effect on the Company's financial statement disclosures.

There have been no other significant changes in recent accounting pronouncements during the six months ended June 30, 2012 as compared to the recent accounting pronouncements described in the Company's Annual Report on Form 10-K for the year ended December 31, 2011.

(2) Short-term Investments and Fair Value Measurements

Fair value of financial assets and liabilities is defined as the price that would be received to sell an asset or transfer a liability in an orderly transaction between market participants at the measurement date. A fair value hierarchy has been established that prioritizes the inputs to valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described below:

- Level 1—Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.
- Level 2—Quoted prices for similar assets and liabilities, quoted prices for identical or similar assets or liabilities in markets that are not active or model-derived valuations for which all significant inputs are observable, either directly or indirectly.
- Level 3—Prices or valuation techniques that require inputs that are both significant to the fair value measurement and unobservable.

EnteroMedics Inc.
(A development stage company)

Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

The Company's assets that are measured at fair value on a recurring basis are classified within Level 1 or Level 2 of the fair value hierarchy. The Company does not hold any assets that are measured at fair value using Level 3 inputs. The types of instruments the Company invests in that are valued based on quoted market prices in active markets include U.S. treasury securities. Such instruments are classified by the Company within Level 1 of the fair value hierarchy. U.S. treasuries are valued using unadjusted quoted prices for identical assets in active markets that the Company can access.

The types of instruments the Company invests in that are valued based on quoted prices in less active markets, broker or dealer quotations, or alternative pricing sources with reasonable levels of price transparency include U.S. agency securities, commercial paper, U.S. corporate bonds and municipal obligations. Such instruments are classified by the Company within Level 2 of the fair value hierarchy. The Company values these types of assets using consensus pricing or a weighted average price, which is based on multiple pricing sources received from a variety of industry standard data providers (e.g. Bloomberg), security master files from large financial institutions, and other third-party sources. The multiple prices obtained are then used as inputs into a distribution-curve-based algorithm to determine the daily market price.

The following table sets forth by level, within the fair value hierarchy, the Company's financial assets accounted for at fair value as of June 30, 2012. Assets and liabilities are classified in their entirety based on the lowest level of input that is significant to the fair value measurement.

All short-term investments at June 30, 2012 are classified as Level 2 and are as follows:

	Significant Other Observable Inputs Level 2
U.S. agency securities	$ 1,000,764
Total	$ 1,000,764

The short-term investments available for sale at June 30, 2012 had effective maturities of less than one year. The amortized cost and fair value of short-term investments available for sale, and the related gross unrealized gains and losses, were as follows at June 30, 2012:

		Gross Unrealized		
	Cost	Gains	Losses	Fair value
U.S. agency securities	$1,000,648	$ 116	$ —	$1,000,764
Total	$1,000,648	$ 116	$ —	$1,000,764

(3) Inventory

Since inception, inventory related purchases had been used for research and development related activities and had accordingly been expensed as incurred. In December 2011, the Company began receiving Australian Register of Therapeutic Goods (ARTG) listings for components of the Maestro Rechargeable System from the Australian Therapeutic Goods Administration (TGA), with the final components being listed on the ARTG in January 2012. As a result, the Company determined certain assets were recoverable as inventory beginning in December 2011. The Company accounts for inventory at the lower of cost or market and records any long-term inventory as other assets in the condensed consolidated balance sheets. There was approximately $332,000 and $228,000 of long-term inventory as of June 30, 2012 and December 31, 2011, respectively.

EnteroMedics Inc.
(A development stage company)

Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

Current inventory consists of the following as of:

	June 30, 2012	December 31, 2011
Raw materials	$ 221,704	$ 376,580
Work-in-process	840,692	692,043
Finished goods	25,652	—
Inventory	$1,088,048	$1,068,623

(4) Commitments and Contingencies

The Company rents its office, warehouse and laboratory facilities under an operating lease, which expires on September 30, 2015. At June 30, 2012, future minimum payments under the lease are as follows:

Years ending December 31:	
Remaining six months in 2012	$140,724
2013	285,656
2014	291,369
2015	221,789
	$939,538

The Company is exposed to product liability claims that are inherent in the testing, production, marketing and sale of medical devices. Management believes any losses that may occur from these matters are adequately covered by insurance, and the ultimate outcome of these matters will not have a material effect on the Company's financial position or results of operations. The Company is not currently a party to any litigation and is not aware of any pending or threatened litigation that could have a material adverse effect on the Company's business, operating results or financial condition.

(5) Notes Payable

On November 18, 2008 the Company entered into a Loan and Security Agreement (the Prior Loan Agreement) with Silicon Valley Bank (SVB), Venture Lending & Leasing V, Inc. (a private equity fund under the management of Western Technology Investment (WTI)) and Compass Horizon Funding Company LLC (Horizon and, collectively with SVB and WTI, the Lenders), in an aggregate principal amount of up to $20.0 million. On November 21, 2008, SVB and WTI each funded a term loan in the aggregate principal amount of $10.0 million and $5.0 million, respectively. The additional $5.0 million term loan was automatically funded by Horizon on April 28, 2009 when the trading price of the Company's common stock on the NASDAQ Global Market exceeded a target amount specified in the Prior Loan Agreement. On December 1, 2009, the Company repaid the outstanding principal amount due to WTI and Horizon pursuant to the Prior Loan Agreement.

During 2010 and 2011, the Company and SVB entered into four amendments to the Prior Loan Agreement, which modified the payment terms, annual interest rate and financial covenants. A brief summary of the four amendments is provided below.

On February 8, 2010, the Company and SVB entered into the First Amendment to the Prior Loan Agreement, which reduced the annual interest rate from 11.0% to a fixed annual rate of 10.0%, payable monthly, revised the liquidity financial covenant and added a New Capital Transaction covenant.

On July 8, 2010, the Company and SVB entered into a Second Amendment to the Prior Loan Agreement, which modified the repayment terms of the loan such that interest only payments were required through December 31, 2010 followed by 30 equal payments of principal and interest, increased the annual interest rate from 10.0% to a fixed annual rate of 11.0%, payable monthly, revised the liquidity financial covenant and added additional New Capital Transaction requirements. On July 8, 2010, per the terms of the Second Amendment to the Prior Loan Agreement, SVB was issued a warrant to purchase 150,642 shares of the Company's common stock with an exercise price of $2.10 per share.

EnteroMedics Inc.
(A development stage company)

Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

On November 4, 2010, the Company and SVB entered into a Third Amendment (the Third Amendment) to the Prior Loan Agreement, which modified the New Capital Transaction covenant, suspended the liquidity financial covenant and required the Company to maintain a blocked cash collateral account with funds equal to the principal balance outstanding.

On March 3, 2011 the Company entered into a Fourth Amendment (the Fourth Amendment) to the Prior Loan Agreement with SVB. The Fourth Amendment modified the repayment terms of the term loan such that beginning April 1, 2011 through September 30, 2011, the Company was required to make interest only monthly payments on the term loan. Then, beginning on October 1, 2011, the remaining balance due on the term loan started to amortize over 30 equal payments of principal and interest, payable monthly. In addition, the Fourth Amendment amended the interest rate due effective March 1, 2011 on the remaining principal amount of the term loan from 11.0% to a fixed annual rate of 6.25%, payable monthly. The Fourth Amendment reinstated the liquidity financial covenant and eliminated SVB's springing lien on the Company's intellectual property, the New Capital Transactions requirement and the requirement of the Third Amendment to maintain a blocked cash collateral account with funds equal to the principal balance outstanding.

On April 16, 2012, the Company entered into a new Loan and Security Agreement (the Loan Agreement) with SVB, pursuant to which SVB agreed to make term loans to the Company in an aggregate principal amount of up to $20.0 million, on the terms and conditions set forth in the Loan Agreement. The Loan Agreement amends and restates the Prior Loan Agreement, as amended.

Pursuant to the Loan Agreement, a term loan was funded in the aggregate principal amount of $10.0 million on April 23, 2012, a portion of which was used to repay in full the outstanding debt of approximately $4.7 million. The additional $10.0 million available under the Loan Agreement will be funded if the Company meets the primary endpoints of the ReCharge trial as well as certain financial objectives for 2012 prior to February 15, 2013.

The term loans require interest only payments monthly through March 31, 2013 followed by 30 equal payments of principal in the amount of $333,333 plus accrued interest beginning on April 1, 2013 and ending on September 1, 2015, payable monthly. Amounts borrowed under the Loan Agreement bear interest at a fixed annual rate equal to 8.0%. The final payment fee from the Prior Loan Agreement will be due on September 1, 2015. The Company may voluntarily prepay the term loans in full, but not in part, and any voluntary or mandatory prepayment is subject to applicable prepayment premiums and will also include the final payment fee. The Company is required to comply with certain financial covenants that require the Company to generate certain minimum amounts of revenue from the sale of its Maestro System and to implant certain minimum numbers of Maestro Systems during cumulative quarterly measurement periods beginning with the period ended March 31, 2013 and ending with the period ended June 30, 2015.

The Company has granted SVB a security interest in all of the Company's assets, excluding intellectual property except with respect to all license, royalty fees and other revenues and income arising out of or relating to any of the intellectual property and all proceeds of the intellectual property. The Company also has entered into a negative pledge arrangement with SVB pursuant to which it has agreed not to encumber any of its intellectual property without SVB's prior written consent. If the Company does not meet the primary endpoints of the ReCharge trial or does not fully disclose the results of the trial to the public prior to February 15, 2013, and/or if the second term loan has been funded and the Company does not raise a minimum amount of new equity by a specified date, the Company will be required to place certain amounts of cash in a restricted account at SVB.

Pursuant to the Loan Agreement, on April 16, 2012 the Company issued SVB a warrant to purchase 106,746 shares of common stock, exercisable for ten years from the date of grant, at an exercise price of $2.34 per share. If the additional term loan is funded, the Company will be required to issue SVB a second warrant to purchase common stock, which will be exercisable for ten years from the date of grant, at an exercise price per share equal to the average closing price of the Company's common stock for the ten days immediately preceding the funding date. The number of shares issuable pursuant to the warrant will be determined by dividing $250,000 by such price per share.

EnteroMedics Inc.
(A development stage company)

Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

Scheduled debt principal payments are as follows as of June 30, 2012:

Years Ending December 31:	
Remaining six months in 2012	$ —
2013	3,000,000
2014	4,000,000
2015	3,000,000
	10,000,000
Less: Original issue discount	(415,787)
Notes payable, net	$ 9,584,213

(6) Stock-based Compensation

The fair value method of accounting for share-based payments is applied to all share-based payment awards issued to employees and where appropriate, nonemployees, unless another source of literature applies. When determining the measurement date of a nonemployee's share-based payment award, the Company measures the stock options at fair value and remeasures such stock options to the current fair value until the performance date has been reached.

Based on the application of these standards, stock-based compensation expense for stock-based awards under the Company's 2003 Stock Incentive Plan for the three and six months ended June 30, 2012 and 2011 was allocated to operating expenses and employee and nonemployees as follows:

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Research and development	$140,749	$234,794	$ 287,030	$ 471,489
Selling, general and administrative	559,376	499,090	1,123,578	922,806
Total	$700,125	$733,884	$1,410,608	$1,394,295

	Three months ended June 30,		Six months ended June 30,	
	2012	2011	2012	2011
Employees	$681,497	$717,437	$1,360,942	$1,377,848
Nonemployees	18,628	16,447	49,666	16,447
Total	$700,125	$733,884	$1,410,608	$1,394,295

As of June 30, 2012 there was approximately $5.0 million of total unrecognized compensation costs, net of estimated forfeitures, related to employee unvested stock option awards granted after January 1, 2006, which are expected to be recognized over a weighted-average period of 2.61 years.

EnteroMedics Inc.
(A development stage company)

Notes to Condensed Consolidated Financial Statements (Continued)
(Unaudited)

The estimated grant-date fair values of the stock options were calculated using the Black-Scholes valuation model, based on the following assumptions for the three and six months ended June 30, 2012 and 2011:

	Employees Three months ended June 30,		Employees Six months ended June 30,	
	2012	2011	2012	2011
Risk-free interest rates	0.99%-1.05%	2.14%-2.21%	0.99%-1.09%	2.14%-2.68%
Expected life	6.00-6.25 years	6.00-6.25 years	6.00-6.25 years	5.42-6.25 years
Expected dividends	0%	0%	0%	0%
Expected volatility	140.98%-141.05%	121.35%-121.50%	123.18%-141.05%	121.35%-124.40%

	Nonemployees Three months ended June 30,		Nonemployees Six months ended June 30,	
	2012	2011	2012	2011
Risk-free interest rates	0.46%-1.31%	3.14%	0.24%-2.05%	3.14%
Expected life	3.01-9.08 years	9.85 years	2.00-9.25 years	9.85 years
Expected dividends	0%	0%	0%	0%
Expected volatility	115.78%-139.80%	116.90%	83.05%-139.80%	116.90%

Option activity under the Company's 2003 Stock Incentive Plan for the six months ended June 30, 2012 was as follows:

	Shares Available For Grant	Outstanding Options	
		Number of Shares	Weighted-Average Exercise Price
Balance, December 31, 2011	763,829	3,470,908	$ 3.17
Shares reserved	—	—	—
Options granted	(193,000)	193,000	2.44
Options exercised	—	—	—
Options cancelled	31,364	(31,364)	2.35
Balance, June 30, 2012	602,193	3,632,544	3.14

(7) Stock Sales

On April 16, 2012, the Company entered into a securities purchase agreement with a current investor for the sale of 2,271,705 shares of its common stock in a registered direct offering, at a purchase price of $2.223 per share. On April 20, 2012, the offering closed and the Company received gross proceeds of $5.0 million before deducting estimated offering expenses. No warrants were issued in the offering.

(8) Subsequent Events

On July 10, 2012, the Board of Directors of the Company approved the grant of 3,799,690 non-incentive stock options to management. These options have an exercise price of $3.35 per share and vest in increments of 1/48 th per month beginning on July 10, 2012. These options are subject to stockholder approval of an amendment to the 2003 Stock Incentive Plan (the Plan), to increase the number of shares authorized under the Plan and may not be exercised unless and until such approval is obtained.

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

The following discussion should be read in conjunction with the condensed consolidated financial statements and notes thereto appearing elsewhere in this Quarterly Report on Form 10-Q.

Except for the historical information contained herein, the matters discussed in this "Management's Discussion and Analysis of Financial Condition and Results of Operations," are forward-looking statements that involve risks and uncertainties. In some cases, these statements may be identified by terminology such as "may," "will," "should," "expects," "could," "intends," "might," "plans," "anticipates," "believes," "estimates," "predicts," "potential," or "continue," or the negative of such terms and other comparable terminology. These statements involve known and unknown risks and uncertainties that may cause our results, level of activity, performance or achievements to be materially different from those expressed or implied by the forward-looking statements. Factors that may cause or contribute to such differences include, among others, those discussed in Part I, Item 1A, "Risk Factors" of our Annual Report on Form 10-K for the year ended December 31, 2011. Except as may be required by law, we undertake no obligation to update any forward-looking statement to reflect events after the date of this report.

Overview

We are a development stage medical device company with approvals to commercially launch our product in Australia, the European Economic Area and other countries that recognize the European CE Mark. We are focused on the design and development of devices that use neuroblocking technology to treat obesity, metabolic diseases and other gastrointestinal disorders. Our proprietary neuroblocking technology, which we refer to as VBLOC therapy, is designed to intermittently block the vagus nerve using high frequency, low energy, electrical impulses. We have a limited operating history and currently, we only have regulatory approval to sell our product in Australia, the European Economic Area and other countries that recognize the European CE Mark and do not have any other source of revenue. Our initial product is the Maestro System, which uses VBLOC therapy to affect metabolic regulatory control, limit the expansion of the stomach, help control hunger sensations between meals, reduce the frequency and intensity of stomach contractions and produce a feeling of early and prolonged fullness. We were formerly known as Beta Medical, Inc. and were incorporated in Minnesota on December 19, 2002. We later reincorporated in Delaware on July 22, 2004. Since inception, we have devoted substantially all of our resources to the development and commercialization of our Maestro System.

Based on our understanding of vagal nerve function and nerve blocking from our preclinical studies and the results of our clinical trials, we believe the Maestro System may offer obese patients a minimally-invasive treatment that has the potential to result in significant and sustained weight loss. We believe that our Maestro System will allow bariatric surgeons to help obese patients who are concerned about the risks and complications associated with currently available restrictive and malabsorptive surgical procedures. In addition, data from our VBLOC-DM2 ENABLE trial outside the United States demonstrate that VBLOC therapy may hold promise in improving obesity-related co-morbidities such as diabetes and hypertension. We are conducting, or plan to conduct, further studies in each of these co-morbidities to assess VBLOC therapy's potential in addressing multiple indications.

We continue to evaluate the Maestro System in human clinical trials in the United States, Australia, Mexico, Norway and Switzerland. To date, we have not observed any mortality related to our device or any unanticipated adverse device effects in these clinical trials. We have also not observed any long-term problematic clinical side effects in any patients, including in those patients who have been using the Maestro System for more than one year.

In October 2010, we received an unconditional Investigational Device Exemption (IDE) Supplement approval from the U.S. Food and Drug Administration (FDA) to conduct a randomized, double-blind, parallel-group, multicenter pivotal clinical trial, called the ReCharge trial, testing the effectiveness and safety of VBLOC therapy utilizing our second generation Maestro Rechargeable (RC) System. Enrollment and implantation in the ReCharge trial was completed in December 2011 in 233 patients at 10 centers. All patients in the study received an implanted device and were randomized in a 2:1 allocation to treatment or control groups. The control group received a non-functional device during the study period. All patients are expected to participate in a weight management counseling program. The primary endpoints of efficacy and safety will be evaluated at 12 months, or around December 2012. Assuming we achieve favorable results, we plan to use data from the trial to support a premarket approval (PMA) application for the Maestro Rechargeable System. If the FDA grants us approval, we anticipate we will be able to commercialize the Maestro Rechargeable System in the United States in 2014.

If we obtain FDA approval of our Maestro Rechargeable System we intend to market our products in the United States through a direct sales force supported by field technical and marketing managers who provide training, technical and other support services to our customers. Outside the United States we intend to use direct, dealer and distributor sales models as the targeted geography best dictates. To date, we have relied on third-party manufacturers and suppliers for the production of our Maestro System. We currently anticipate that we will continue to rely on third-party manufacturers and suppliers for the production of the Maestro System.

We obtained European CE Mark approval for our Maestro Rechargeable System in March 2011. In January 2012, the final Maestro Rechargeable System components were listed on the Australian Register of Therapeutic Goods (ARTG) by the Therapeutic Goods Administration (TGA). We have been working closely with our Australian distributor, Device Technologies Australia Pty Limited, to bring the Maestro Rechargeable System to the Australian market through a controlled commercial launch and made our first commercial shipment of the Maestro ReChargeable System to Device Technologies Australia Pty Limited in March 2012. We also recently entered into an exclusive, multi-year agreement with Bader Sultan & Brothers Co. W.L.L. for commercialization and distribution of the Maestro ReChargeable System in the Gulf Coast Countries, including Saudi Arabia, Kuwait, Bahrain, Qatar and the United Arab Emirates and made our first commercial shipments to Bader Sultan & Brothers Co. W.L.L. during the second quarter of 2012. We continue to explore additional select international markets to commercialize the Maestro Rechargeable System, including Europe. The method of assessing conformity with applicable regulatory requirements varies depending on the class of the device, but for our Maestro System (which is considered an Active Implantable Medical Device (AIMD) in Australia and the European Economic Area, and falls into Class III within the United States), the method involves a combination of self-assessment by the manufacturer of the safety and performance of the device, and a third-party assessment by a Notified Body, usually of the design of the device and of the manufacturer's quality system. We use DEKRA Certification B.V. (formerly known as KEMA Quality) in the Netherlands as the Notified Body for our CE marking approval process.

We have only recently begun to generate revenue from the sale of products, and we have incurred net losses in each year since our inception. As of June 30, 2012, we had experienced net losses during the development stage of $187.2 million. Although we recently received ARTG listings to sell our Maestro Rechargeable System in Australia and European CE Mark to sell our Maestro Rechargeable System in the European Economic Area and other countries that recognize the European CE Mark, resulting in our first commercial sales in 2012, we expect to incur significant sales and marketing expenses prior to recording sufficient revenue to offset these expenses. We expect our general and administrative expenses to increase as we continue to add the infrastructure necessary to support our initial commercial sales, operate as a public company and develop our intellectual property portfolio. For these reasons, we expect to continue to incur significant and increasing operating losses for the next several years. We have financed our operations to date principally through the sale of capital stock, debt financing and interest earned on investments.

Financial Overview

Revenue

We have received the European CE Mark for our Maestro Rechargeable System, which enables commercialization in the European Economic Area and other countries that recognize the European CE Mark. In January 2012, the final Maestro Rechargeable System components were listed on the ARTG by the Australian TGA and we have been working closely with Device Technologies Australia Pty Limited to bring the Maestro Rechargeable System to the Australian market through a controlled commercial launch and made our first commercial shipment of the Maestro ReChargeable System to Device Technologies Australia Pty Limited in March 2012. We also recently entered into an exclusive, multi-year agreement with Bader Sultan & Brothers Co. W.L.L. for commercialization and distribution of the Maestro ReChargeable System in the Gulf Coast Countries, including Saudi Arabia, Kuwait, Bahrain, Qatar and the United Arab Emirates and made our first commercial shipments to Bader Sultan & Brothers Co. W.L.L. during the second quarter of 2012. For the three and six months ended June 30, 2012, we recognized $188,000 and $311,000 in revenue, respectively.

In the United States, we completed enrollment and device implantation in our ReCharge pivotal trial for obesity in December 2011. The primary endpoints of efficacy and safety will be evaluated at 12 months, or around December 2012. Assuming we achieve favorable results, we plan to use data from that trial to pursue a PMA from the FDA to allow us to commence sales in the United States. If the FDA grants us approval, we anticipate we will be able to commercialize the Maestro Rechargeable System in the United States in 2014. Any revenue from initial sales of a new product in the United States or internationally is difficult to predict and in any event will only modestly reduce our continued losses resulting from our research and development and other activities.

Research and Development Expenses

Our research and development expenses primarily consist of engineering, product development and clinical and regulatory expenses, incurred in the development of our Maestro System. Research and development expenses also include employee compensation, including stock-based compensation, consulting services, outside services, materials, supplies, including those related to our various clinical trials, depreciation and travel. We expense research and development costs as they are incurred. From inception through June 30, 2012, we have incurred a total of $121.7 million in research and development expenses. With the completion of enrollment and device implantation in our ReCharge pivotal trial for obesity in late 2011, we expect research and development expenditures to decrease in 2012 as we turn our primary focus to supporting this new clinical trial in addition to the continued follow-up on existing trials, such as VBLOC-DM2 ENABLE and EMPOWER.

Selling, General and Administrative Expenses

Our selling, general and administrative expenses consist primarily of compensation for executive, finance, market development and administrative personnel, including stock-based compensation. Other significant expenses include costs associated with attending medical conferences, professional fees for legal, including legal services associated with our efforts to obtain and maintain broad protection for the intellectual property related to our products, and accounting services, cash management fees, consulting fees and travel expenses. From inception through June 30, 2012, we have incurred $53.5 million in selling, general and administrative expenses. We expect selling, general and administrative expenses to increase modestly in 2012 as we continue a controlled commercial launch in Australia, the Gulf Coast Countries of the Middle East and possibly other select international markets.

Results of Operations

Comparison of the Three Months Ended June 30, 2012 and 2011

Sales. Sales were $188,000 for the three months ended June 30, 2012, compared to no sales for the three months ended June 30, 2011. The $188,000 of sales for the three months ended June 30, 2012 are the result of continued commercial shipments of the Maestro ReChargeable System. Our first commercial shipments of the Maestro ReChargeable System occurred during the first quarter of 2012.

Cost of Goods Sold. Cost of goods sold were $146,000 for the three months ended June 30, 2012, compared to no cost of goods sold for the three months ended June 30, 2011. Gross margin was 22.5% for the three months ended June 30, 2012.

Research and Development Expenses. Research and development expenses were $2.2 million for the three months ended June 30, 2012, compared to $3.3 million for the three months ended June 30, 2011. The decrease of $1.1 million, or 32.7%, is primarily due to decreases of $626,000, $366,000 and $129,000 in device costs, professional services and compensation and benefits expense, respectively. The decreases in device costs and professional services are the result of our ReCharge pivotal trial for obesity which began to ramp up in early 2011 with the first enrollments and device implantations occurring late in the first quarter of 2011. Ongoing costs in 2012 are for follow-up visits, which are significantly less than the implant costs. The decrease in compensation and benefits expense is primarily due to a decrease in stock based compensation, the result of grants becoming fully expensed prior to the second quarter.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $2.5 million for the three months ended June 30, 2012, compared to $2.1 million for the three months ended June 30, 2011. The increase of $476,000, or 23.1%, is primarily due to increases of $255,000, $129,000 and $120,000 in compensation and benefits, professional services and travel expense, respectively, all as a result of international commercialization efforts.

Interest Expense. Interest expense was $229,000 for the three months ended June 30, 2012, compared to $164,000 for the three months ended June 30, 2011. The increase of $65,000, or 39.6%, was the result of an increase in the gross principal balance outstanding from approximately $6.0 million on June 30, 2011 to $10.0 million on June 30, 2012 which was the result of the April 2012 modification to the loan agreement that also increased our annual interest rate from 6.25% to 8.00% effective April 23, 2012 with interest only payments through March 31, 2013.

Comparison of the Six Months Ended June 30, 2012 and 2011

Sales. Sales were $311,000 for the six months ended June 30, 2012, compared to no sales for the six months ended June 30, 2011. The $311,000 of sales for the six months ended June 30, 2012 are the result of our first commercial shipments of the Maestro ReChargeable System beginning in the first quarter of 2012.

Cost of Goods Sold. Cost of goods sold were $232,000 for the six months ended June 30, 2012, compared to no cost of goods sold for the six months ended June 30, 2011. Gross margin was 25.7% for the six months ended June 30, 2012.

Research and Development Expenses. Research and development expenses were $4.9 million for the six months ended June 30, 2012, compared to $6.1 million for the six months ended June 30, 2011. The decrease of $1.2 million, or 19.1%, is primarily due to decreases of $991,000, $184,000 and $96,000 in device costs, employee stock based compensation and professional services, respectively. The decreases in device costs and professional services are primarily the result of the completion of enrollments and device implantation in our ReCharge pivotal trial for obesity in late 2011. Ongoing costs in 2012 are for follow-up visits, which are significantly less than the implant costs. The decrease in employee stock based compensation is primarily due to the result of grants becoming fully expensed prior to the second quarter.

Selling, General and Administrative Expenses. Selling, general and administrative expenses were $5.4 million for the six months ended June 30, 2012, compared to $4.1 million for the six months ended June 30, 2011. The increase of $1.2 million, or 29.5%, is primarily due to increases of $611,000, $446,000 and $181,000 in compensation and benefits, professional services and travel expense, respectively, all as a result of international commercialization efforts.

Interest Expense. Interest expense was $373,000 for the six months ended June 30, 2012, compared to $396,000 for the six months ended June 30, 2011, a slight decrease of $23,000, or 5.8%. Loan modifications occurred in March 2011 and April 2012. The March 2011 loan modification reduced the interest rate from 11.00% to 6.25% with interest only payments through September 30, 2011. The principal balance was approximately $6.0 million at the time of the modification. The April 2012 loan modification increased the interest rate from 6.25% to 8.00% effective April 23, 2012 with interest only payments through March 31, 2013. The April 2012 loan modification resulted in the principal balance increasing from $4.7 million to $10.0 million.

Liquidity and Capital Resources

We have incurred losses since our inception in December 2002 and, as of June 30, 2012 we had experienced net losses during the development stage of $187.2 million. We have financed our operations to date principally through the sale of capital stock, debt financing and interest earned on investments. Through December 31, 2011, we had received net proceeds of $173.8 million from the sale of common stock and preferred stock, including $39.1 million from our initial public offering in November 2007 and $71.5 million from public, private placement and registered direct offerings from 2009 through 2011. In addition, through December 31, 2011 we had received $35.8 million in debt financing, $746,000 to finance equipment purchases and $35.0 million to finance working capital. On April 20, 2012, we completed the sale of 2,271,705 shares of common stock in a registered direct offering at a purchase price of $2.223 per share. We received gross proceeds of $5.0 million before deducting estimated offering expenses.

As of June 30, 2012, we had $27.8 million in cash, cash equivalents, restricted cash and short-term investments. Of this amount $23.5 million was invested in short-term money market funds that are not considered to be bank deposits and are not insured or guaranteed by the federal deposit insurance company or other government agency. These money market funds seek to preserve the value of the investment at $1.00 per share; however, it is possible to lose money investing in these funds. Cash in excess of immediate requirements is invested in accordance with our investment policy, primarily with a view to liquidity and capital preservation. At times, such deposits may be in excess of insured limits. We have not experienced any losses on our deposits of cash and cash equivalents. We believe that our cash, cash equivalents, restricted cash and short-term investments balance of approximately $27.8 million as of June 30, 2012, and any interest income we earn on these balances, will be sufficient to meet our anticipated cash requirements well into 2013, assuming our planned commercialization and we do not receive any other additional funds.

On April 16, 2012 we entered into a new loan agreement with SVB pursuant to which SVB agreed to make term loans to us in an aggregate principal amount of up to $20.0 million. Pursuant to the loan agreement, a term loan was funded in the aggregate principal amount of $10.0 million on April 23, 2012, a portion of which was used to repay in full the outstanding debt of approximately $4.7 million. The new term loan requires interest only payments monthly through March 31, 2013 followed by 30 equal payments of principal in the amount of $333,333 plus accrued interest beginning on April 1, 2013 and ending on September 1, 2015, payable monthly. Amounts borrowed under the new loan agreement bear interest at a fixed annual rate equal to 8.0%. The additional $10.0 million term loan available under the loan agreement will be funded if we meet the primary endpoints of the ReCharge trial as well as certain financial objectives for 2012 prior to February 15, 2013. See Note 5 to our condensed consolidated financial statements included in Part I, Item 1, of this Quarterly Report on Form 10-Q for a more detailed description of the new loan agreement.

Net Cash Used in Operating Activities

Net cash used in operating activities was $12.5 million and $9.3 million for the six months ended June 30, 2012 and 2011, respectively. Net cash used in operating activities primarily reflects the net loss for those periods, which was partially offset by depreciation and amortization, stock-based compensation and changes in operating assets and liabilities. The increase of $3.2 million is primarily due to a decrease in accrued expenses as payments related to 2011 ReCharge trial activity began to be paid during the six months ended June 30, 2012.

Net Cash (Used in) Provided by Investing Activities

Net cash used in investing activities was $52,000 for the six months ended June 30, 2012 compared to net cash provided by investing activities of $6.1 million for the six months ended June 30, 2011. Net cash used in investing activities for the six months ended June 30, 2012 is primarily attributable to the purchases of property and equipment. Net cash provided by investing activities for the six months ended June 30, 2011 is primarily attributable to a $6.3 million decrease in the restricted cash balance as a result of the Fourth Amendment to the SVB loan agreement offset by purchases of $221,000 of property and equipment.

Net Cash Provided by (Used in) Financing Activities

Net cash provided by financing activities was $10.6 million for the six months ended June 30, 2012 compared to net cash used in financing activities of $400,000 for the six months ended June 30, 2011. Net cash provided by financing activities for the six months ended June 30, 2012 was primarily the result of $5.3 million in net proceeds from the initial term loan funded pursuant to the new loan agreement entered into on April 16, 2012 with SVB, net proceeds of $4.7 million from the April 16, 2012 registered direct offering and $1.4 million from the exercise of common stock warrants. These increases were partially offset by principal repayments of $753,000 on our long-term debt. Net cash used in financing activities for the six months ended June 30, 2011 was due to $367,000 in principal repayments on our long-term debt and common stock financing costs of $46,000.

Operating Capital and Capital Expenditure Requirements

We have only recently begun to generate revenue from the sale of products. We obtained European CE Mark approval for our Maestro Rechargeable System in March 2011. In January 2012, the final Maestro Rechargeable System components were listed on the ARTG by the TGA. We have been working closely with our Australian distributor, Device Technologies Australia Pty Limited, to bring the Maestro Rechargeable System to the Australian market through a controlled commercial launch and made our first commercial shipment of the Maestro ReChargeable System to Device Technologies Australia Pty Limited in March 2012. We also recently entered into an exclusive, multi-year agreement with Bader Sultan & Brothers Co. W.L.L. for commercialization and distribution of the Maestro ReChargeable System in the Gulf Coast Countries, including Saudi Arabia, Kuwait, Bahrain, Qatar and the United Arab Emirates and began commercial shipments to Bader Sultan & Brothers Co. W.L.L. during the second quarter of 2012. We continue to explore additional select international markets to commercialize the Maestro Rechargeable System, including Europe. In the United States, we completed enrollment and device implantation in our ReCharge pivotal trial for obesity in December 2011. The primary endpoints of efficacy and safety will be evaluated at 12 months, or around December 2012. Assuming we achieve favorable results, we plan to use data from that trial to pursue a PMA from the FDA to allow us to commence sales in the United States. If the FDA grants us approval, we anticipate we will be able to commercialize the Maestro Rechargeable System in the United States in 2014. We anticipate that we will continue to incur substantial net losses for the next several years as we develop our products, prepare for the potential commercial launch of our Maestro Rechargeable System, develop the corporate infrastructure required to sell our products, operate as a publicly-traded company and pursue additional applications for our technology platform.

We believe that our cash, cash equivalents, restricted cash and short-term investments balance of approximately $27.8 million as of June 30, 2012, and any interest income we earn on these balances, will be sufficient to meet our anticipated cash requirements well into 2013, assuming our planned commercialization and we do not receive any other additional funds. If our available cash, cash equivalents, restricted cash and investment balances are insufficient to satisfy our liquidity requirements, we may seek to sell additional equity or debt securities or enter into a credit facility. The sale of additional equity and debt securities may result in dilution to our stockholders. If we raise additional funds through the issuance of debt securities, these securities could have rights senior to those of our common stock and could contain covenants that would restrict our operations. We may require additional capital beyond our currently forecasted amounts. Any such required additional capital may not be available on reasonable terms, if at all. If we are unable to obtain additional financing, we may be required to reduce the scope of, delay, or eliminate some or all of, our planned research, development and commercialization activities, which could materially harm our business.

Our forecast of the period of time through which our financial resources will be adequate to support our operations, the costs to complete development of products and the cost to commercialize our products are forward-looking statements and involve risks and uncertainties, and actual results could vary materially and negatively as a result of a number of factors, including the factors discussed in Part I, Item 1A, *Risk Factors*, of our Annual Report on Form 10-K for the year ended December 31, 2011. We have based these estimates on assumptions that may prove to be wrong, and we could utilize our available capital resources sooner than we currently expect.

Because of the numerous risks and uncertainties associated with the development of medical devices, such as our Maestro System, we are unable to estimate the exact amounts of capital outlays and operating expenditures necessary to complete the development of the products and successfully deliver a commercial product to the market. Our future capital requirements will depend on many factors, including but not limited to the following:

- the scope, rate of progress, results and cost of our clinical trials and other research and development activities;
- the cost and timing of regulatory approvals;
- the cost and timing of establishing sales, marketing and distribution capabilities;
- the cost of any recalls or other field actions required either by us or by regulatory bodies in those countries in which we market our products;
- the cost of establishing clinical and commercial supplies of our Maestro System and any products that we may develop;
- the rate of market acceptance of our Maestro System and VBLOC therapy and any other product candidates;
- the cost of filing and prosecuting patent applications and defending and enforcing our patent and other intellectual property rights;
- the cost of defending, in litigation or otherwise, any claims that we infringe third-party patent or other intellectual property rights;
- the effect of competing products and market developments;

- the cost of explanting clinical devices;
- the terms and timing of any collaborative, licensing or other arrangements that we may establish;
- any revenue generated by sales of our Maestro System or our future products; and
- the extent to which we invest in products and technologies, although we currently have no commitments or agreements relating to any of these types of transactions.

Critical Accounting Policies and Estimates

We prepare our consolidated financial statements in accordance with accounting principles generally accepted in the United States. In doing so, we have to make estimates and assumptions that affect our reported amounts of assets, liabilities and expenses, as well as related disclosure of contingent assets and liabilities. In many cases, we could reasonably have used different accounting policies and estimates. In some cases, changes in the accounting estimates are reasonably likely to occur from period to period. Accordingly, actual results could differ materially from our estimates. To the extent that there are material differences between these estimates and actual results, our financial condition or results of operations will be affected. We base our estimates on past experiences and other assumptions that we believe are reasonable under the circumstances, and we evaluate these estimates on an ongoing basis.

Our significant accounting policies are fully described in Note 2 to our consolidated financial statements included in our Annual Report on Form 10-K for the year ended December 31, 2011 filed with the U.S. Securities and Exchange Commission (SEC).

Contractual Obligations

During the six months ended June 30, 2012, there were no material changes to our contractual obligation disclosures as set forth under the caption, "Contractual Obligations" in Part II, Item 7, *Management's Discussion and Analysis of Financial Condition and Results of Operations*, of our Annual Report on Form 10-K for the year ended December 31, 2011.

The following table summarizes our contractual obligations as of June 30, 2012 and the effect those obligations are expected to have on our financial condition and liquidity position in future periods:

	Payments Due By Period				
Contractual Obligations	Total	Less Than 1 Year	1-3 Years	3-5 Years	More than 5 Years
Operating lease	$ 939,538	$ 282,841	$ 582,767	$ 73,930	$ —
Long-term debt, including interest	12,156,519	1,804,296	8,838,667	1,513,556	—
Total contractual cash obligations	$13,096,057	$2,087,137	$9,421,434	$1,587,486	$ —

The table above reflects only payment obligations that are fixed and determinable. Our operating lease commitments relate to our corporate headquarters in St. Paul, Minnesota.

Off-Balance Sheet Arrangements

As of June 30, 2012, we did not have any off-balance sheet arrangements.

Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board issued guidance on the presentation of comprehensive income in financial statements. Entities are required to present total comprehensive income either in a single, continuous statement of comprehensive income or in two separate, but consecutive, statements. We adopted this standard during the first quarter of 2012 and present net loss and other comprehensive loss in two separate, but consecutive, statements. The adoption of this standard did not have a material effect on our financial statement disclosures.

There were no other significant changes in recent accounting pronouncements during the six months ended June 30, 2012 as compared to the recent accounting pronouncements described in our Annual Report on Form 10-K for the year ended December 31, 2011.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our exposure to market risk is confined to our cash, cash equivalents, restricted cash and short-term investments. As of June 30, 2012, we had approximately $27.8 million in cash, cash equivalents, restricted cash and short-term investments. The goals of our investment policy are preservation of capital, fulfillment of liquidity needs and fiduciary control of cash and investments. We also seek to maximize income from our investments without assuming significant risk. To achieve our goals, we may maintain a portfolio of cash equivalents and investments in a variety of securities of high credit quality. The securities in our investment portfolio, if any, are not leveraged, are classified as either available for sale or held-to-maturity and are, due to their very short-term nature, subject to minimal interest rate risk. We currently do not hedge interest rate exposure. Because of the short-term maturities of our cash equivalents and investments, we do not believe that an increase in market rates would have any material negative impact on the value of our investment portfolio. We have no investments denominated in foreign currencies and therefore our investments are not subject to foreign currency exchange risk.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Rule 13a-15(e) under the Securities Exchange Act of 1934, as amended (the Exchange Act), defines the term “disclosure controls and procedures” as those controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms and that such information is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, or persons performing similar functions, as appropriate to allow timely decisions regarding required disclosure. Based on their evaluation as of June 30, 2012, our Chief Executive Officer and Chief Financial Officer have concluded that our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act) were effective to ensure that information required to be disclosed by us in reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC’s rules and forms.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the quarter ended June 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II – OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

We are not currently a party to any litigation and we are not aware of any pending or threatened litigation against us that could have a material adverse effect on our business, operating results or financial condition. The medical device industry in which we operate is characterized by frequent claims and litigation, including claims regarding patent and other intellectual property rights as well as improper hiring practices. As a result, we may be involved in various legal proceedings from time to time.

ITEM 1A. RISK FACTORS

There have been no material changes during the six months ended June 30, 2012 to the risk factors set forth in Part I, Item 1A, *Risk Factors*, of our Annual Report on Form 10-K for the year ended December 31, 2011.

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

Unregistered Sales of Equity Securities

As previously described in our Current Report on Form 8-K filed April 17, 2012, on April 16, 2012 we entered into a new Loan and Security Agreement with Silicon Valley Bank. As required by the new agreement, on April 16, 2012 we issued a warrant to Silicon Valley Bank to purchase 106,746 shares of our common stock with an exercise price of $2.34 per share and a ten year life. See Note 5 to our condensed consolidated financial statements included in Part I, Item 1, of this Quarterly Report on Form 10-Q for more detail about the loan agreement. The sale and issuance of this warrant was deemed to be exempt from registration under the Securities Act of 1933 (the Securities Act) by virtue of Section 4(2) of the Securities Act, as a transaction by an issuer not involving any public offering.

Uses of Proceeds from Sale of Registered Securities

None.

Purchases of Equity Securities

None.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

None.

ITEM 6. EXHIBITS

The list of exhibits on the accompanying Exhibit Index are filed or incorporated by reference (as stated therein) as part of this Quarterly Report on Form 10-Q.

SIGNATURES

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

ENTEROMEDICS INC.

BY: /S/ MARK B. KNUDSON, PH.D.

Mark B. Knudson, Ph.D.
President and Chief Executive Officer
(Principal Executive Officer)

BY: /S/ GREG S. LEA

Greg S. Lea
Senior Vice President and Chief Financial Officer
(Principal Financial and Accounting Officer)

Dated: August 8, 2012

EXHIBIT INDEX

Exhibit Number	Description of Document
3.1	Fifth Amended and Restated Certificate of Incorporation of the Company. (Incorporated herein by reference to Exhibit 3.2 to Amendment No. 6 to the Company's Registration Statement on Form S-1 filed on November 9, 2007 (File No. 333-143265)).
3.2	Certificate of Amendment to the Fifth Amended and Restated Certificate of Incorporation of the Company. (Incorporated herein by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q filed on August 7, 2009 (File No. 1-33818)).
3.3	Certificate of Amendment to the Fifth Amended and Restated Certificate of Incorporation of the Company. (Incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K filed on July 13, 2010 (File No. 1-33818)).
3.4*	Certificate of Amendment to the Fifth Amended and Restated Certificate of Incorporation of the Company.
3.5	Amended and Restated Bylaws of the Company, as currently in effect. (Incorporated herein by reference to Exhibit 3.4 to Amendment No. 1 to the Company's Registration Statement on Form S-1 filed on July 6, 2007 (File No. 333-143265)).
4.1	Amended and Restated Investors' Rights Agreement, dated as of July 6, 2006, by and between the Company and the parties named therein. (Incorporated herein by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).
10.1	Distribution Agreement, dated as of February 21, 2012, by and between Bader Sultan & Brothers Co. W.L.L. and the Company. (Incorporated herein by reference to Exhibit 10.1 to the Company's Quarterly Report on Form 10-Q filed on May 10, 2012 (File No. 1-33818)).
10.2	Securities Purchase Agreement, dated as of April 16, 2012, between the Company and the purchasers identified on Schedule A thereto. (Incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on April 17, 2012 (File No. 1-33818)).
10.3	Loan and Security Agreement, dated April 16, 2012, between the Company and Silicon Valley Bank. (Incorporated herein by reference to Exhibit 10.3 to the Company's Quarterly Report on Form 10-Q/A filed on August 3, 2012 (File No. 1-33818)).
10.4	Form of Warrant to purchase stock under Loan and Security Agreement, dated April 16, 2012, between the Company and Silicon Valley Bank. (Incorporated herein by reference to Exhibit 10.4 to the Company's Quarterly Report on Form 10-Q filed on May 10, 2012 (File No. 1-33818)).
10.5*	Amendment No. 3, effective as of February 3, 2012, to License Agreement between Mayo Foundation for Medical Education and Research and the Company.
10.6*	Amendment No. 1, effective as of July 10, 2012, to Distribution Agreement by and between Device Technologies Australia Pty Limited and the Company.
10.7†	Form of 2012 Senior Management Non-Incentive Stock Option Agreement pursuant to the 2003 Stock Incentive Plan. (Incorporated herein by reference to Exhibit 10.1 to the Company's Current Report on Form 8-K filed on July 13, 2012 (File No. 1-33818)).
31.1*	Certification of 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 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.
101*	Financial statements from the Quarterly Report on Form 10-Q of the Company for the quarter ended June 30, 2012, formatted in Extensible Business Reporting Language: (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Comprehensive Loss, (iv) the Condensed Consolidated Statements of Cash flows and (v) the Notes to Condensed Consolidated Financial Statements.

* Filed herewith.
† Indicates management contract or compensation plan or agreement.

Exhibit 3.4

CERTIFICATE OF AMENDMENT
TO THE
FIFTH AMENDED AND RESTATED
CERTIFICATE OF INCORPORATION
OF
ENTEROMEDICS INC.

I, Greg S. Lea, certify that:

1. The following resolution was duly adopted and approved by the board of directors of EnteroMedics Inc. (the "Corporation") at a meeting of the board of directors held on February 15, 2012, in accordance with the applicable provisions of Section 242 of the General Corporation Law of the State of Delaware:

RESOLVED, that Article IV, Section 1 of the Fifth Amended and Restated Certificate of Incorporation of EnteroMedics Inc. is hereby amended and restated to read in full as follows:

"1. Authorized Stock. The Corporation is authorized to issue two classes of shares to be designated respectively Preferred Stock, par value $0.01 per share, and Common Stock, par value $0.01 per share. The total number of shares of Preferred Stock authorized is 5,000,000. The total number of shares of Common Stock authorized is 125,000,000."

2. The foregoing amendment was duly adopted by the stockholders of the Corporation in accordance with Section 242 of the General Corporation Law of the State of Delaware on May 9, 2012 at an Annual Meeting of the Stockholders of the Corporation, and such resolution has not been subsequently modified or rescinded.

Dated: May 9, 2012

/s/ Greg S. Lea
Greg S. Lea
Senior Vice President,
Chief Financial Officer and Secretary

AMENDMENT NO. 3
TO
LICENSE AGREEMENT
BETWEEN
MAYO FOUNDATION FOR MEDICAL EDUCATION AND RESEARCH
AND
ENTEROMEDICS, INC.

This Amendment No. 3 (the "Amendment No. 3") is entered into as of Feb 3rd, 2012 (the "Execution Date of Amendment No. 3") by and between Mayo Foundation for Medical Education and Research, a Minnesota charitable corporation, located at 200 First Street SW, Rochester, Minnesota 55905-0001 ("MAYO"), and EnteroMedics, Inc., a private for-profit corporation located at 2800 Patton Road, Roseville, Minnesota 55113 ("COMPANY") and amends that certain License Agreement by and between MAYO and COMPANY with an Effective Date as of February 3, 2005 (the "License Agreement") and Amendment No. 1 to the License Agreement with an Execution Date of February 3rd, 2010 ("Amendment No. 1") and Amendment No. 2 to the License Agreement with an Execution Date of January 4th, 2011 ("Amendment No. 2") with the effect of amending, restating and replacing the following provisions in their entirety with the text set forth below:

2.02 MAYO KNOW-HOW COMMITMENT. For a period of five (5) years from the Effective Date for the Obesity Device Group and the Vagal Blocking Device Group and for a period of three (3) years from the Execution Date of Amendment No. 1 for Michael Camilleri, M.D., Michael Sarr, M.D. and Michael Kendrick of the Phase II Mayo Group and until December 31st, 2010 for William Sandborn, M.D. of the Phase II Mayo Group, unless terminated earlier by either COMPANY or MAYO as provided for in this Agreement, MAYO commits to the following:

(a) Subject to existing obligations to third parties, MAYO policies and for so long as its members are employees of MAYO, the Obesity Device Group shall confer with the COMPANY in the Field as follows: (i) exclusively for Product Development for devices to treat obesity and nonexclusively for Product Testing; and (ii) non-exclusively for Product Development and Product Testing with COMPANY for Vagal Devices to treat gastrointestinal disorders other than obesity (for example, pancreatitis and irritable bowel syndrome) and excluding obesity.

(b) Subject to existing obligations to third parties, MAYO policies and for so long as its members are employees of MAYO, the Vagal Blocking Device Group shall confer exclusively with the COMPANY for Product Development and nonexclusively for Product Testing, all for Vagal Devices.

(c) Subject to existing obligations to third parties, MAYO policies and for so long as its members are employees of MAYO, the Phase II Mayo Group shall confer with the COMPANY in the Field as follows: (i) exclusively for Product Development for Vagal Devices and nonexclusively for Product Development of other devices

to treat obesity and nonexclusively for Product Testing; and (ii) non-exclusively for Product Development and Product Testing with COMPANY for Vagal Devices to treat gastrointestinal disorders other than obesity.

(d) Subject to existing obligations to third parties, MAYO hereby grants COMPANY a royalty-bearing, worldwide license to use the Know-How in the Field to develop, make, use and sell COMPANY Products as provided below:

1. With respect to Obesity Device Group Know-How for:

(a) Product Development, such license shall be exclusive for obesity devices and non-exclusive for Vagal Devices for treating conditions other than obesity; and

(b) Product Testing, such license shall be non-exclusive.

2. With respect to the Vagal Blocking Device Group Know-How for:

(a) Product Development, such license shall be exclusive; and

(b) Product Testing, such license shall be non-exclusive.

3. With respect to the Phase II Mayo Group Know-How for:

(a) Product Development, such license shall be exclusive for Vagal Devices to treat obesity and nonexclusive for Vagal Devices for treating other conditions other than obesity; and

(b) Product Testing, such license shall be non-exclusive.

COMPANY shall have the right to sublicense such know-how, but not any obligation of MAYO to confer, on the same terms and conditions as set forth above with respect to Licensed Patents.

(e) MAYO represents and warrants that to the best of internal patent counsel's knowledge as of the Effective Date and without a duty to inquire, MAYO is not aware of any existing third party obligations that will materially interfere with the Obesity Device Group, the Vagal Blocking Device Group or the Phase II Mayo Group from conferring with COMPANY under Section 2.02, in accordance the terms and conditions of this Agreement.

Each member of the Obesity Device Group, the Vagal Blocking Device Group and the Phase II Mayo Group shall use reasonable efforts to attend meetings, achieve specific Product Development objectives and milestones, and conduct Product Testing, contributing on average among the individuals of the groups between 3-6 person hours per month as requested by COMPANY. Any time credited under this Section shall not also be subject to compensation under any other agreement including any agreement referenced under Section 3.14 of this Agreement.

3.06 KNOW-HOW RETAINER FEES: The COMPANY shall pay MAYO a minimum annual retainer fee of One Hundred and Seventy-Five Thousand Dollars (US$175,000) for the Obesity Device Group as partial compensation for its Know-How as specified in the payment schedule below. The COMPANY shall also pay MAYO an additional minimum annual retainer fee of Seventy-Five Thousand Dollars (US$75,000) for the Vagal Blocking Device Group as partial compensation for its Know-How as specified in the payment schedule below. In 2010, the COMPANY shall pay MAYO a minimum retainer fee of One Hundred Thousand Dollars (US$100,000) and in 2011 Seventy-Five Thousand Dollars (US$75,000) for the Phase II Mayo Group as partial compensation for its Know-How as specified in the payment schedule below. The following payments shall be made within ten (10) days of the dates listed:

Date	Retainer fee payment due MAYO
a) The Effective Date	One Hundred Twenty-Five Thousand Dollars (US$125,000);
b) November 1, 2005	One Hundred Twenty-Five Thousand Dollars (US$125,000);
c) January 1, 2006	One Hundred Twenty-Five Thousand Dollars (US$125,000);
d) July 1, 2006	One Hundred Twenty-Five Thousand Dollars (US$125,000);
f) January 1, 2007	Two Hundred Fifty Thousand Dollars (US$250,000);
g) January 1, 2008	Two Hundred Fifty Thousand Dollars (US$250,000);
h) January 1, 2009	Two Hundred Fifty Thousand Dollars (US$250,000);
i) February 15, 2010	One Hundred Thousand Dollars (US$100,000);
j) January 1, 2011	Seventy-Five Thousand Dollars (US$75,000); and
k) February 3, 2012	Five Hundred Dollars per Hour (US$500/hour) as follows,

The COMPANY shall pay MAYO a payment of five hundred dollars ($500) per hour in exchange for the Phase II Mayo Group's actual time used in providing the Phase II Mayo Group Know-How as requested by the COMPANY. The parties agree that the payment is a good faith estimate of the fair market value for the Phase II Mayo Group's time used in providing the Phase II Mayo Group Know-How and, if during performance of providing the Phase II Mayo Group Know-How, in COMPANY'S good faith opinion, the agreed-upon hourly payment for providing such Phase II Mayo Group Know-How to the COMPANY exceeds the fair market value of the time provided by MAYO, the parties shall negotiate in good faith to reduce the payment for time used to provide the Phase II Mayo Group Know-How to be at fair market value or, in the event the parties do not agree, COMPANY may terminate the Agreement immediately. The Phase II Group agrees to keep accurate written records (personal records and notes) sufficient in detail to enable COMPANY to determine and verify the fair market value in time used in providing the Phase II Mayo Group Know-How. Such records for a particular quarter shall be retained by Phase II Mayo Group for a period of not less than one calendar year after the end of such quarter. COMPANY shall have the right, at its own expense and on a confidential basis, to review such records (or have such records reviewed), at the Phase II Mayo Group members' offices upon reasonable notice and during reasonable business hours, for the purposes of verifying the payment due Mayo hereunder. COMPANY or its reviewing designee shall not disclose MAYO's confidential information without their prior written consent. The Phase II Mayo Group shall provide the Mayo Clinic Ventures a listing of time they contributed to providing Phase II Mayo Group Know-How to the COMPANY with a brief description of the Phase II Mayo Group Know-How provided.

MAYO shall invoice COMPANY for the hours of time incurred by the Phase II Mayo Group in providing the Phase II Mayo Group Know-How on an individual basis. COMPANY agrees to pay Mayo within thirty (30) days of receiving each such invoice. The payments due under this Agreement shall be nonrefundable.

Except as expressly amended by this Amendment No. 3, all terms and conditions of the License Agreement as previously amended by Amendment No. 1 and Amendment No. 2 shall remain in full force and effect.

MAYO FOUNDATION FOR MEDICAL EDUCATION AND RESEARCH

By: /s/ Steven P. Van Nurden
Name: Steven P. Van Nurden
Title: Assistant Treasurer
Date: May 3, 2012

ENTEROMEDICS, INC.

By: /s/ Mark B. Knudson
Name: Mark B. Knudson
Title: President and CEO
Date: May 1, 2012

Exhibit 10.6

FIRST AMENDMENT
TO
DISTRIBUTION AGREEMENT

This First Amendment (the "First Amendment"), effective as of July 10, 2012 (the "First Amendment Effective Date") is by and between EnteroMedics, Inc., a Minnesota corporation located at 2800 Patton Road, St. Paul MN 55113 ("Supplier"), and Device Technologies Australia Pty Limited, located at Unit 8, 25 Frenchs Forest Road, Frenchs Forest, New South Wales 2086 Australia, with ABN 40 058 091 973 ("Distributor").

RECITALS

WHEREAS, Supplier and Distributor are Parties to the Distribution Agreement effective as of March 28, 2011 (the "Agreement"); and

WHEREAS, the Parties desire to amend the Agreement as set forth below.

NOW THEREFORE, in consideration of the foregoing, and for other good and valuable consideration, the receipt and sufficiency of which is hereby acknowledged, the parties hereto agree as follows:

1. Capitalized terms not otherwise defined herein shall have the same meanings ascribed to them in the Agreement and references to Clauses and Exhibits are to those Clauses and Exhibits that appear in the Agreement.

2. Clause 5.1 is hereby amended and restated in its entirety as follows, with effect as of the earlier of the First Amendment Effective Date or the date of any separate written agreement of the Parties providing for the same amended terms:

5.1 Delivery

All deliveries of Products shall be Ex Works (EXW) Supplier's facility. The term "Ex Works" shall be construed in accordance with INCOTERMS 2010 of the International Chamber of Commerce. Shipping, insurance, customs duties, etc. are the responsibility of Distributor. Supplier shall have no further responsibility for the Products, and all risk of damage to or loss or delay of the Products shall pass to Distributor, upon their delivery at the Ex Works delivery point to a common carrier specified by Distributor or, in the event no carrier shall have been specified by Distributor on or before the date fifteen (15) days prior to the requested shipment date, a common carrier selected by Supplier. Supplier reserves all rights with respect to delivered Products permitted by applicable law until the full amount due from Distributor in respect of all delivered Products has been paid. Title to the Products shall pass to Distributor upon payment in full in accordance with **Clause 6.2** of the Agreement.

3. Clause 5.2(b) is hereby amended and restated in its entirety as follows:

(b) Distributor will provide Supplier with written notice of any Products which Distributor believes to be defective within 30 days of receipt of the Products from

Supplier. If Distributor receives notice from any customer or other third party that a Product that is not in Distributor's possession is believed to be defective, which may be at a time later than thirty (30) days of receipt of the Products from the Supplier, Distributor will retrieve the Product from the customer or other third party promptly upon receiving such notice. Distributor shall hold all Products which are believed to be defective for Supplier's instructions for a reasonable period (not exceeding 60 days). If Supplier's instructions are not received within such period, Distributor may return the defective Products accompanied by a description of the defect to Supplier's premises at Supplier's expense, and any expense incurred by Distributor in such return will be payable forthwith by Supplier and may be set off by Distributor against any moneys otherwise due by Distributor to Supplier.

4. Clause 6.1 is hereby amended and restated in its entirety as follows:

The Products are at Distributor's risk from the time of delivery at the Ex Works delivery point as provided in **Clause 5.1** above.

5. Clause 7.1(b) is hereby amended and restated in its entirety as follows:

(b) Distributor shall maintain a database containing details of customers to whom it sells Products during the Term (including the type, quantity and serial numbers of Products purchased by each customer), and Distributor shall grant Supplier reasonable access to this database upon Supplier's request. The database shall contain all information which Supplier reasonably determines is necessary to assist Distributor in recall efforts with regard to the Products in accordance with its obligation under **Clause 19** of the Agreement.

6. Clause 7.9 is hereby amended and restated in its entirety as follows:

7.9 Sub-Distributors

Distributor shall not, without the prior written consent of Supplier, appoint any Sub-Distributors, intermediaries or agents (collectively "Sub-Distributors") to perform Distributor's obligations under this Agreement. Distributor shall at all times remain fully liable for any act or omission of its Sub-Distributors, and Distributor hereby agrees to indemnify, defend and hold harmless Supplier from all damages, losses, liabilities or expenses arising in any manner from any act or omission on the part of any Sub-Distributor.

7. Clause 7.12(f) is hereby amended and restated in its entirety as follows:

(f) comply with Supplier's policies for business conduct as provided by Supplier from time to time and/or as posted on Supplier's website;

8. Clause 7.12(i) is hereby amended and restated in its entirety as follows:

(i) follow the same quality control standards with respect to the storage, preservation, sale and use of the Products as followed by Supplier and communicated to Distributor by Supplier; store Products according to requirements of Product packaging to ensure maintenance of sterility (when applicable), integrity of packaging and storage in accordance with any environmental conditions, including but not limited to temperature and humidity requirements; and not remove Products from packages designed for delivery to end-user customers when such removal may affect the quality of the Products or destroy any trademark identity; and

9. Clause 7.14 is hereby amended by adding the following new Clause 7.14(d):

(d) Distributor shall at all times comply with all laws and regulations in the Territory applicable to the importation, sale, demonstration, use and disposition of the Products, including obtaining and maintaining all licenses and permits and satisfying all formalities as may be required under such laws and regulations.

10. Clause 8.1(c) is hereby amended and restated in its entirety as follows:

(c) Distributor shall not use, publish, broadcast or disseminate any advertising and promotional materials without Supplier's approval. When submitting the materials to Supplier for approval, Distributor shall give details of when, where and in which medium the materials will be used as well as the target audience of the material. Supplier shall take reasonable steps to promptly respond to Distributor's request for approval upon receipt of the materials.

11. Clause 9.4 is hereby amended by adding the following new heading and new Clauses 9.4(c), 9.4(d), 9.4(e) and 9.4(f):

9.4 Training, Customer Support, Certification and Product Service

(c) Distributor shall have the sole responsibility for (i) obtaining orders for Products from customers, (ii) providing First-Level Support to customers, (iii) training customers with respect to the Products sold by Distributor, which may also involve training organized by the Supplier, and (iv) handling all other interactions with customers in the Territory with respect to the Products. Without limiting Distributor's other obligations in this **Clause 9.4**, Distributor shall at all times maintain a sufficient level of understanding of the Products to enable Distributor to provide technical information to customers regarding the Products, to effectively sell and service the Products, and to obtain customer orders and provide assistance to customers in determining and fulfilling their requirements with respect to the Products. For clarity, Supplier shall have no obligation hereunder to respond to or otherwise interact with any customers in the Territory, although Distributor shall cooperate with Supplier to enable Supplier to have such contacts with customers in the Territory as Supplier reasonably determines is appropriate consistent with the objectives stated in **Clause 9.5**.

The term “First-Level Support” means a level of support at least at the level designated as required for personnel who are trained and certified in accordance with the Supplier Training Program described in **Clause 9.4(d)**.

(d) Distributor personnel shall participate in Supplier’s standard training program applicable to the Products (“Supplier Training Program”) before selling any Products. The training will be provided at a mutually agreed upon location. Distributor shall be responsible for the travel-related costs and expenses of Supplier’s personnel that attend the Supplier Training Program. Supplier and Distributor shall mutually agree to the number of Distributor personnel who must attend the Supplier Training Program.

(e) Distributor shall train all customers with respect to the use of the Products in accordance with the then-current requirements of the Supplier Training Program. Distributor shall only use training documentation provided by Supplier in performing customer training. Distributor shall create and maintain a record of training for each customer trained by Distributor with respect to the Products in accordance with a training and accreditation program to be developed and certified by Supplier, and shall provide Supplier with information about such training activities in accordance with report formats to be developed by Supplier. Distributor shall supply Products only to customers who have satisfactorily completed such Supplier-certified training and accreditation.

(f) Distributor shall perform all Product service in accordance with the requirements set forth in the Supplier Training Program and otherwise provided by Supplier to Distributor in writing from time to time during the Term, including requirements regarding customer service response times, and similar matters. Distributor shall document and maintain records of all Product service (“Service Records”) in accordance with requirements to be developed by Supplier. Distributor shall offer and provide Product service (for Products in and out of warranty) to all customers in the Territory. With respect to out-of-warranty service, Distributor shall warrant its workmanship with respect to Product service for at least ninety (90) days after completion thereof. Distributor shall, within five (5) days after Supplier’s request, provide Supplier with any or all Service Records.

12. Clause 9 is hereby amended by adding the following new Clause 9.5:

9.5 Marketing, Promotion, Clinician Training and Clinical Field Support Generally

Distributor agrees to cooperate with and follow Supplier’s directions during the Term in the development and execution of regulatory plans; marketing plans; reimbursement approval plans; the identification and accreditation of surgeons, physicians and clinics with appropriate standing to use the Products; surgeon and clinician training protocols; clinical field support; and the like. The Supplier understands

that the regulatory and reimbursement plans submitted by Distributor will take into account the regulatory and reimbursement requirements in the Territory. In order to achieve these objectives, Distributor shall use its best efforts to vigorously promote, sell and support the Products throughout the Territory in accordance with such plans, and shall at its cost and expense: (a) employ on its own behalf a sufficient number of specialized, trained, and qualified personnel to promote, sell and support the Products in the Territory; (b) maintain a professional sales and service organization as necessary to provide training and customer service for the Products in the Territory; and (c) otherwise operate its business in a professional and ethical manner, in each case in accordance with this Agreement.

13. Clause 14.3(e) is hereby amended and restated in its entirety as follows:

(e) Orders and Post-Termination Sales

Supplier shall fulfill all orders from Distributor to Supplier to the extent to which they are unfulfilled at the time of termination or expiration of this Agreement unless Distributor cancels those orders prior to Delivery of the Products or unless Supplier terminated this Agreement for cause under **Clause 14.2**. Distributor may use any labels, wraps, containers, advertising and other items bearing the Trademarks to enable it to sell Products delivered after termination of this Agreement. Distributor shall continue to be obligated to comply with the terms and conditions of this Agreement with regard to any such sales of Products after the termination or expiration of this Agreement.

14. The first lead-in clause of Clause 15 prior to the colon is hereby amended and restated in its entirety as follows:

If this Agreement is terminated for any reason (including a change of control in the ownership of Supplier or its ultimate parent company) other than as a result of a breach of this Agreement by Distributor, the occurrence of an event listed in **Clause 14.2(b)** involving Distributor, termination under **Clause 14.2(c)(iv)(A)**, a force majeure event, or an Insolvency Event involving Distributor, then Supplier shall, within 60 days of termination of this Agreement provide the following compensation:

15. Exhibit A to the Agreement is hereby amended and restated in its entirety as set forth in the attachment to this First Amendment.

16. Except as expressly revised and amended herein, the Agreement remains unchanged. Inconsistencies between the Agreement and this First Amendment shall be resolved in favor of this First Amendment.

IN WITNESS WHEREOF, the Parties have executed this First Amendment as of the First Amendment Effective Date.

ENTEROMEDICS, INC.

By: /s/ Mark B. Knudson
Name: Mark B. Knudson
Title: President & CEO

DEVICE TECHNOLOGIES AUSTRALIA PTY LIMITED (ABN 40 058 091 973)

By: /s/ Peter J. Ord
Name: Peter J. Ord
Title: CEO

Products

Model	Name	AIMD/MDD Class	Code description
2004	Implant Kit	AIMD	**Implant Kit, Neuroregulator, vagus nerve, rechargeable:** An assembly of devices intended to treat obesity through the application of electrical stimuli to the vagus nerve below the gastric junction. It is typically implanted in the abdomen and consists of a rechargeable battery-operated neuroregulator, implantable lead(s), torque wrench, and components for external charging. The battery is recharged externally.
2002	Rechargeable Neuroregulator	AIMD	**Neuroregulator, vagus nerve, rechargeable:** A device intended to treat obesity through the application of electrical stimuli to the vagus nerve below the gastric junction. It is typically implanted in the abdomen and consists of a rechargeable battery-operated neuroregulator and torque wrench. The battery is recharged externally.
2200A-47E	Anterior Lead	III	A lead, insulated with non-conductive material except at the electrode(s), that is implanted in the neurological tissue. It is used to make an electrical connection between the stimulator and the vagus nerve.
2200P-47E	Posterior Lead	III	A lead, insulated with non-conductive material except at the electrode(s), that is implanted in the neurological tissue. It is used to make an electrical connection between the stimulator and the vagus nerve.

Model	Name	AIMD/MDD Class	Code description
2403-300	Clinician transmit coil	III	**Transmit Coil -** An electronic device that provides radio-frequency connection between an implanted Vagus Nerve Electrical Blocking Neuroregulator and an external Mobile Recharger for transmission of power to charge the battery in the implanted device and to provide information transfer to and from the implant and the Mobile Recharger. This device may be operated by a clinician or patient.
2404	Patient kit	III	**Recharging Kit, Neuroregulator, vagus nerve, rechargeable -** An assembly of devices used to transcutaneously recharge the battery of a rechargeable implanted neuroregulator. Typically includes mobile charger, transmit coil, AC recharger and transmit coil belt.
2402	Mobile charger	III	**Recharger, Neuroregulator, vagus nerve, rechargeable -** A device used to transcutaneously communicate with a rechargeable implanted neuroregulator for recharging the battery of a rechargeable implanted neuroregulator, or review and modification of neuroregulator operating parameters.
2403-60	Patient transmit coil	III	**Transmit Coil -** An electronic device that provides radio-frequency connection between an implanted Vagus Nerve Electrical Blocking Neuroregulator and an external Mobile Recharger for transmission of power to charge the battery in the implanted device and to provide information transfer to and from the implant and the Mobile Recharger. This device may be operated by a clinician or patient.

Model	Name	AIMD/MDD Class	Code description
1660	Patient transmit coil belt	I	A device used for keeping electrodes in place. This is typically used for reusable electrodes which do not stick to the body surface or for electrodes that may require extra securing. This is a reusable device.
2403-60A	Patient transmit coil	III	**Transmit Coil -** An electronic device that provides radio-frequency connection between an implanted Vagus Nerve Electrical Blocking Neuroregulator and an external Mobile Recharger for transmission of power to charge the battery in the implanted device and to provide information transfer to and from the implant and the Mobile Recharger. This device may be operated by a clinician or patient.
1660A	Patient transmit coil belt	I	A device used for keeping electrodes in place. This is typically used for reusable electrodes which do not stick to the body surface or for electrodes that may require extra securing. This is a reusable device.
1620	AC recharger	I	A device designed to supply an electrical charge to rechargeable batteries, restoring the battery to an appropriate working condition. This device is typically connected to the building’s electrical power supply and can be used to either charge the batteries by themselves (removed from the device) or whilst they are still inside the parent device (in situ), e.g., a defibrillator or ophthalmoscope. This device usually has current and voltage controls to meet the charge needs of different types of batteries.
1600	Programmer cable	I	A device that provides a connection between two or more devices for the purpose of transmitting an energy that may, or may not, contain information.

Model	Name	AIMD/MDD Class	Code description
2504	Clinician Programmer Kit	III	The clinician programmer is a laptop computer with specialized software, which is connected to the mobile charger and transmit coil in order to communicate with the implanted device. The included programmer cable connects the clinician programmer to the mobile charger. The programmer and cable are intended to be used as part of the Maestro Rechargeable System to configure, monitor and change settings of the implanted neuroregulator.

Exhibit 31.1

CERTIFICATION

I, Mark B. Knudson, Ph.D., certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of EnteroMedics Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ MARK B. KNUDSON, PH.D.

Mark B. Knudson, Ph.D.
President and Chief Executive Officer

Date: August 8, 2012

Exhibit 31.2

CERTIFICATION

I, Greg S. Lea, certify that:

1. I have reviewed this Quarterly Report on Form 10-Q of EnteroMedics Inc.;

2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;

3. Based on my knowledge, the consolidated financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;

4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:

a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;

b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;

c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and

d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and

5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):

a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and

b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/S/ GREG S. LEA

Greg S. Lea
Senior Vice President and Chief Financial Officer

Date: August 8, 2012

Exhibit 32.1

CERTIFICATION

Pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act), and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350), Mark B. Knudson, Ph.D., in his capacity as Chief Executive Officer of EnteroMedics Inc., hereby certifies that, to the best of his knowledge:

1. The Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 to which this Certification is attached as Exhibit 32.1 (the Report) fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and the results of operations of EnteroMedics Inc. as of, and for, the periods covered by the Report.

By: /s/ MARK B. KNUDSON, PH.D.

Mark B. Knudson, Ph.D.
President and Chief Executive Officer

Date: August 8, 2012

Exhibit 32.2

CERTIFICATION

Pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended (the Exchange Act), and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. §1350), Greg S. Lea, in his capacity as Chief Financial Officer of EnteroMedics Inc., hereby certifies that, to the best of his knowledge:

1. The Company's Quarterly Report on Form 10-Q for the quarter ended June 30, 2012 to which this Certification is attached as Exhibit 32.2 (the Report) fully complies with the requirements of Section 13(a) or 15(d) of the Exchange Act; and
2. The information contained in the Report fairly presents, in all material respects, the financial condition and the results of operations of EnteroMedics Inc. as of, and for, the periods covered by the Report.

By: /s/ GREG S. LEA

Greg S. Lea
Senior Vice President and Chief Financial Officer

Date: August 8, 2012