UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-K/A

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

For the fiscal year ended December 31, 2007

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)

Securities registered under Section 12(b) of the Act:

Title of Class	Name of Exchange on Which Registered
Common stock, $0.01 par value per share	**The NASDAQ Global Market**

Securities registered under Section 12(g) of the Act:

None

Indicate by check mark if the registrant is a well-known seasoned issuer, as defined in Rule 405 of the Securities Act. Yes ☐ No ☑

Indicate by check mark if the registrant is not required to file reports pursuant to Section 13 or Section 15(d) of the Exchange Act. Yes ☐ No ☑

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 if disclosure of delinquent filers pursuant to Item 405 of Regulation S-K is not contained herein, and will not be contained, to the best of registrant's knowledge, in definitive proxy or information statements incorporated by reference in Part III of this Form 10-K or any amendment to this Form 10-K. ☐

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

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

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

The initial public offering of the registrant's Common stock, par value of $0.01 per share, commenced on November 15, 2007. There was no public market for the Company's common stock prior to that date.

As of March 13, 2008, 16,798,962 shares of the registrant's Common Stock were outstanding.

DOCUMENTS INCORPORATED BY REFERENCE: None

EXPLANATORY NOTE

EnteroMedics Inc. filed an Annual Report on Form 10-K with the Securities and Exchange Commission on March 13, 2008 for the fiscal year ended December 31, 2007 (the "Original Filing"). This Amendment to the Original Filing on Form 10-K/A is being filed solely to amend typographical errors in the Report of Independent Registered Public Accounting Firm dated March 7, 2008 (the "Report"). An amended Report of Independent Registered Public Accounting Firm is included in Part II, Item 8, Financial Statements and Supplementary Data of this Form 10-K/A, which amended Report supercedes the Report included in the Original Filing. This Form 10-K/A also includes new Certifications by our President and Chief Executive Officer and by our Chief Financial Officer under Item 15(b) of Part IV, as required by Rule 12b-15 of the Securities Exchange Act of 1934, as amended, for amendments to an Annual Report on Form 10-K. Except for the foregoing matters, no other information included in the Original Filing is amended by this Form 10-K/A.

ITEM 8. ***FINANCIAL STATEMENTS AND SUPPLEMENTARY DATA***

Index to Financial Statements

Report of Independent Registered Public Accounting Firm

To the Board of Directors and Stockholders of
EnteroMedics Inc.
St. Paul, Minnesota

We have audited the accompanying consolidated balance sheets of EnteroMedics Inc. and subsidiary (a development stage company) (the “Company”) as of December 31, 2007 and 2006, and the related consolidated statements of operations, stockholders’ equity (deficit), and cash flows for each of the three years in the period ended December 31, 2007, and for the period from December 19, 2002 (date of inception) to December 31, 2007. These financial statements are the responsibility of the Company’s management. Our responsibility is to express an opinion on these consolidated financial statements based on our audits.

We conducted our audits in accordance with the standards of the Public Company Accounting Oversight Board (United States). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the consolidated financial statements are free of material misstatement. The Company is not required to have, nor were we engaged to perform, an audit of its internal control over financial reporting. Our audits included consideration of internal control over financial reporting as a basis for designing audit procedures that are appropriate in the circumstances, but not for the purpose of expressing an opinion on the effectiveness of the Company’s internal control over financial reporting. Accordingly, we express no such opinion. An audit also includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements, assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, such consolidated financial statements present fairly, in all material respects, the financial position of the Company as of December 31, 2007 and 2006, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 2007, and for the period from December 19, 2002 (date of inception) to December 31, 2007, in conformity with accounting principles generally accepted in the United States of America.

As discussed in Note 2 to the consolidated financial statements, effective January 1, 2006, the Company adopted the provisions of Financial Accounting Standards Board Statement No. 123(R), “Share-Based Payment.”

/s/ DELOITTE & TOUCHE LLP
Minneapolis, MN
March 7, 2008

ENTEROMEDICS INC.
(A development stage company)

Consolidated Balance Sheets

	December 31, 2007	December 31, 2006
ASSETS		
Current assets:		
Cash and cash equivalents	$ 48,732,309	$ 17,536,472
Short-term investments available for sale	5,065,000	5,755,000
Short-term investments held-to-maturity	3,233,568	11,440,540
Interest receivable	53,177	109,401
Other receivables	43,135	46,120
Prepaid expenses and other current assets	426,718	67,646
Total current assets	57,553,907	34,955,179
Property and equipment, net	1,491,768	1,102,327
Other assets	5,000	6,395
Total assets	$ 59,050,675	$ 36,063,901
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Current portion of notes payable	$ 5,081,025	$ 2,651,336
Accounts payable	300,342	678,762
Accrued expenses	2,370,044	1,704,231
Total current liabilities	7,751,411	5,034,329
Notes payable, less current portion (net discounts of $575,889 and $90,075 at December 31, 2007 and 2006, respectively)	6,017,744	1,726,959
Convertible preferred stock warrant liability	—	728,841
Total liabilities	13,769,155	7,490,129
Stockholders' equity:		
Series C convertible preferred stock, $0.01 par value No shares authorized; 0 and 5,709,630 shares issued and outstanding at December 31, 2007 and 2006, respectively	—	57,096
Series B convertible preferred stock, $0.01 par value No shares authorized; 0 and 4,285,946 shares issued and outstanding at December 31, 2007 and 2006, respectively	—	42,859
Series A convertible preferred stock, $0.01 par value No shares authorized; 0 and 318,266 shares issued and outstanding at December 31, 2007 and 2006, respectively	—	3,183
Common stock, $0.01 par value 50,000,000 shares authorized; 16,798,962 and 579,759 shares issued and outstanding at December 31, 2007 and 2006, respectively	167,990	5,798
Additional paid-in capital	108,588,601	63,389,371
Deferred compensation	(41,667)	(66,479)
Deficit accumulated during development stage	(63,433,404)	(34,858,056)
Total stockholders' equity	45,281,520	28,573,772
Total liabilities and stockholders' equity	$ 59,050,675	$ 36,063,901

See accompanying notes to consolidated financial statements.

ENTEROMEDICS INC.
(A development stage company)

Consolidated Statements of Operations

	Years ended December 31, 2007	Years ended December 31, 2006	Years ended December 31, 2005	Period from December 19, 2002 (inception) to December 31, 2007
Operating expenses:				
Research and development	$ 21,053,395	$ 14,361,226	$ 8,832,722	$ 48,355,008
Selling, general and administrative	6,972,803	3,760,590	2,319,561	14,679,064
Total operating expenses	28,026,198	18,121,816	11,152,283	63,034,072
Other income (expense):				
Interest income	1,556,551	1,135,855	109,884	2,837,147
Interest expense	(1,648,818)	(710,108)	(181,151)	(2,793,547)
Change in value of the convertible preferred stock warrant liability	(361,504)	6,597	—	(354,907)
Other, net	(95,379)	(1,005)	8,359	(88,025)
Net loss	$ (28,575,348)	$ (17,690,477)	$ (11,215,191)	$ (63,433,404)
Net loss per share—basic and diluted	$ (11.69)	$ (34.19)	$ (28.82)	
Shares used to compute basic and diluted net loss per share	2,445,001	517,462	389,101	

See accompanying notes to consolidated financial statements.

ENTEROMEDICS INC.
(A development stage company)

Consolidated Statements of Stockholders' Equity (Deficit)
Period from December 19, 2002 (inception) to December 31, 2007

	Series C Convertible Preferred Stock		Series B Convertible Preferred Stock		Series A Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount				
Common stock issued at inception of Alpha Medical, Inc. on December 19, 2002 at $0.09 per share for cash	—	$ —	—	$ —	—	$ —	109,890	$ 1,099	$ 8,901	$ —	$ —	$ 10,000
Common stock issued at inception of Beta Medical, Inc. on December 19, 2002 at $0.09 per share for cash	—	—	—	—	—	—	109,890	1,099	8,901	—	—	10,000
Alpha Medical, Inc. Series A convertible preferred stock issued on December 31, 2002 at $9.10 per share for cash	—	—	—	—	33,150	332	—	—	301,342	—	—	301,674
Beta Medical, Inc. Series A convertible preferred stock issued on December 31, 2002 at $9.10 per share for cash	—	—	—	—	33,150	332	—	—	301,342	—	—	301,674
Net loss for the period ended December 31, 2002	—	—	—	—	—	—	—	—	—	—	(603,348)	(603,348)
Alpha Medical, Inc. Series A convertible preferred stock issued on October 1, 2003 at $9.10 per share for cash	—	—	—	—	38,461	384	—	—	349,616	—	—	350,000
Beta Medical, Inc. Series A convertible preferred stock issued on October 1, 2003 at $9.10 per share for cash	—	—	—	—	93,406	934	—	—	849,066	—	—	850,000
Cancellation of Alpha Medical, Inc. Series A convertible preferred stock and common stock upon merger with Beta Medical, Inc. effective October 1, 2003	—	—	—	—	(71,613)	(716)	(109,890)	(1,099)	(659,859)	—	—	(661,674)
Issuance of Series A convertible preferred stock upon merger of Alpha Medical, Inc. and Beta Medical, Inc. effective October 1, 2003	—	—	—	—	65,934	659	—	—	661,015	—	—	661,674
Common stock issued in October 2003 at $0.09 per share for cash	—	—	—	—	—	—	115,376	1,154	9,346	—	—	10,500
Warrants issued for the purchase of 23,516 shares of Series B convertible preferred stock for cash at $0.00455 per share in connection with the November 13, 2003 convertible bridge notes	—	—	—	—	—	—	—	—	107	—	—	107
Net loss for the year ended December 31, 2003	—	—	—	—	—	—	—	—	—	—	(1,900,288)	(1,900,288)
Balance, December 31, 2003	—	$ —	—	$ —	192,488	$ 1,925	225,266	$ 2,253	$ 1,829,777	$ —	$ (2,503,636)	$ (669,681)

See accompanying notes to consolidated financial statements.

ENTEROMEDICS INC.
(A development stage company)

Consolidated Statements of Stockholders' Equity (Deficit) (Continued)
Period from December 19, 2002 (inception) to December 31, 2007

	Series C Convertible Preferred Stock		Series B Convertible Preferred Stock		Series A Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount				
Balance, December 31, 2003	—	$ —	—	$ —	192,488	$ 1,925	225,266	$ 2,253	$ 1,829,777	$ —	$ (2,503,636)	$ (669,681)
Warrants issued for the purchase of 6,484 shares of Series B convertible preferred stock for cash at $0.00455 per share in connection with the April 23, 2004 convertible bridge notes	—	—	—	—	—	—	—	—	30	—	—	30
Exercise of 125,778 Series A convertible preferred stock warrants on April 23, 2004 for cash at $1.4919359 per share	—	—	—	—	125,778	1,258	—	—	186,394	—	—	187,652
Warrants issued for the purchase of 4,396 shares of Series B convertible preferred stock for cash at $0.00455 per share in connection with the June 30, 2004 convertible bridge notes	—	—	—	—	—	—	—	—	20	—	—	20
Fair value of warrants related to convertible bridge notes	—	—	—	—	—	—	—	—	153,722	—	—	153,722
Series B convertible preferred stock issued upon conversion of $1,564,843 of convertible bridge notes and $34,809 of accrued interest payable on July 30, 2004 at $3.9430 per share	—	—	405,690	4,057	—	—	—	—	1,595,595	—	—	1,599,652
Series B convertible preferred stock issued on July 30, 2004 for cash at $3.9430 per share, net of financing costs of $94,776	—	—	1,914,767	19,148	—	—	—	—	7,436,077	—	—	7,455,225
Warrants issued for the purchase of 45,333 shares of Series B convertible preferred stock on December 1, 2004 valued at $1.0747 per warrant for debt commitment	—	—	—	—	—	—	—	—	48,720	—	—	48,720
Issuance of 22,912 common stock options to nonemployees in 2004 valued at $0.1574 per option	—	—	—	—	—	—	—	—	3,610	(3,610)	—	—
Amortization of deferred compensation	—	—	—	—	—	—	—	—	—	830	—	830
Net loss	—	—	—	—	—	—	—	—	—	—	(3,448,752)	(3,448,752)
Balance, December 31, 2004	—	$ —	2,320,457	$ 23,205	318,266	$ 3,183	225,266	$ 2,253	$11,253,945	$ (2,780)	$ (5,952,388)	$ 5,327,418

See accompanying notes to consolidated financial statements.

Consolidated Statements of Stockholders' Equity (Deficit) (Continued)
Period from December 19, 2002 (inception) to December 31, 2007

	Series C Convertible Preferred Stock		Series B Convertible Preferred Stock		Series A Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount				
Balance, December 31, 2004	—	$ —	2,320,457	$23,205	318,266	$3,183	225,266	$2,253	$11,253,945	$ (2,780)	$ (5,952,388)	$ 5,327,418
Series B convertible preferred stock issued on June 17, 2005 for cash at $3.9430 per share, net of financing costs of $5,218	—	—	760,834	7,608	—	—	—	—	2,987,174	—	—	2,994,782
Warrants issued for the purchase of 69,744 shares of Series B convertible preferred stock in September 2005 valued at $1.0702 per warrant for debt commitment and funding	—	—	—	—	—	—	—	—	74,636	—	—	74,636
Warrants issued for the purchase of 170,336 shares of common stock on December 12, 2005 for cash at $0.09 per warrant	—	—	—	—	—	—	—	—	15,500	—	—	15,500
Series B convertible preferred stock issued on December 12, 2005 at $3.9430 per share, net of financing costs of $11,085	—	—	1,204,655	12,046	—	—	—	—	4,726,870	—	—	4,738,916
Common stock issued to nonemployees in 2005 valued at $0.46 per share	—	—	—	—	—	—	225,274	2,252	100,248	(102,500)	—	—
Issuance of 46,543 common stock options to nonemployees in 2005 valued at $0.1565 per option	—	—	—	—	—	—	—	—	7,288	(7,288)	—	—
Exercise of 29,561 common stock options in 2005 for cash at $0.46 per share	—	—	—	—	—	—	29,561	296	13,154	—	—	13,450
Amortization of deferred compensation	—	—	—	—	—	—	—	—	—	25,041	—	25,041
Net loss	—	—	—	—	—	—	—	—	—	—	(11,215,191)	(11,215,191)
Balance, December 31, 2005	—	$ —	4,285,946	$42,859	318,266	$3,183	480,101	$4,801	$19,178,815	$ (87,527)	$(17,167,579)	$ 1,974,552

See accompanying notes to consolidated financial statements.

ENTEROMEDICS INC.
(A development stage company)

Consolidated Statements of Stockholders' Equity (Deficit) (Continued)
Period from December 19, 2002 (inception) to December 31, 2007

	Series C Convertible Preferred Stock		Series B Convertible Preferred Stock		Series A Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount				
Balance, December 31, 2005	—	$ —	4,285,946	$ 42,859	318,266	$ 3,183	480,101	$ 4,801	$19,178,815	$ (87,527)	$ (17,167,579)	$ 1,974,552
Warrants issued for the purchase of 34,872 shares of Series B convertible preferred stock in March 2006 valued at $2.9257 per warrant for debt funding	—	—	—	—	—	—	—	—	102,022	—	—	102,022
Series C convertible preferred stock issued upon conversion of $5,250,003 of convertible bridge notes and $131,013 of accrued interest payable on July 6, 2006 at $8.0926 per share	664,919	6,649	—	—	—	—	—	—	5,374,367	—	—	5,381,016
Series C convertible preferred stock issued on July 6, 2006 for cash at $8.0926 per share, net of financing costs of $2,222,342	4,921,142	49,211	—	—	—	—	—	—	37,553,450	—	—	37,602,661
Warrants issued for the purchase of 147,635 shares of Series C convertible preferred stock on July 6, 2006 valued at $4.9813 per warrant for equity financing	—	—	—	—	—	—	—	—	735,438	—	—	735,438
Series C convertible preferred stock issued on December 11, 2006 for cash at $8.0926 per share	123,569	1,236	—	—	—	—	—	—	998,764	—	—	1,000,000
Series C convertible preferred stock warrants reclassified to convertible preferred stock warrant liability on December 11, 2006	—	—	—	—	—	—	—	—	(735,438)	—	—	(735,438)
Common stock issued to nonemployees in 2006 valued at $0.46 per share	—	—	—	—	—	—	9,889	100	4,400	(4,500)	—	—
Common stock issued to nonemployees in 2006 valued at $1.91 per share	—	—	—	—	—	—	2,747	27	5,223	(5,250)	—	—
Employee stock-based compensation expense	—	—	—	—	—	—	—	—	47,479	—	—	47,479
Nonemployee stock-based compensation expense	—	—	—	—	—	—	—	—	86,125	—	—	86,125
Exercise of 87,022 common stock options in 2006 for cash at $0.46 per share	—	—	—	—	—	—	87,022	870	38,726	—	—	39,596
Amortization of deferred compensation	—	—	—	—	—	—	—	—	—	30,798	—	30,798
Net loss	—	—	—	—	—	—	—	—	—	—	(17,690,477)	(17,690,477)
Balance, December 31, 2006	5,709,630	$ 57,096	4,285,946	$ 42,859	318,266	$ 3,183	579,759	$ 5,798	$63,389,371	$ (66,479)	$ (34,858,056)	$ 28,573,772

See accompanying notes to consolidated financial statements.

ENTEROMEDICS INC.
(A development stage company)
Consolidated Statements of Stockholders' Equity (Deficit) (Continued)
Period from December 19, 2002 (inception) to December 31, 2007

	Series C Convertible Preferred Stock		Series B Convertible Preferred Stock		Series A Convertible Preferred Stock		Common Stock		Additional Paid-in Capital	Deferred Compensation	Deficit Accumulated During the Development Stage	Total Stockholders' Equity (Deficit)
	Shares	Amount	Shares	Amount	Shares	Amount	Shares	Amount				
Balance, December 31, 2006	5,709,630	$ 57,096	4,285,946	$ 42,859	318,266	$ 3,183	579,759	$ 5,798	$ 63,389,371	$ (66,479)	$ (34,858,056)	$ 28,573,772
Employee stock-based compensation expense	—	—	—	—	—	—	—	—	883,310	—	—	883,310
Nonemployee stock-based compensation expense	—	—	—	—	—	—	—	—	1,289,349	—	—	1,289,349
Warrants issued for the purchase of 67,963 shares of Series C convertible preferred stock in May 2007 valued at $8.0926 per warrant for debt facility commitment	—	—	—	—	—	—	—	—	550,212	—	—	550,212
Warrants issued for the purchase of 33,982 shares of Series C convertible preferred stock in May 2007 valued at $8.2783 per warrant for debt funding	—	—	—	—	—	—	—	—	281,321	—	—	281,321
Warrants issued for the purchase of 16,991 shares of Series C convertible preferred stock in August 2007 valued at $11.6377 per warrant for debt funding	—	—	—	—	—	—	—	—	197,731	—	—	197,731
Warrants issued for the purchase of 16,991 shares of Series C convertible preferred stock in October 2007 valued at $11.4599 per warrant for debt funding	—	—	—	—	—	—	—	—	194,716	—	—	194,716
Series C convertible preferred stock warrants reclassified from convertible preferred stock warrant liability	—	—	—	—	—	—	—	—	1,090,345	—	—	1,090,345
Issuance of common stock in initial public offering ("IPO") in November 2007 for cash at $8.00 per share, net of financing costs of $4,552,663	—	—	—	—	—	—	5,000,000	50,000	35,397,337	—	—	35,447,337
Conversion of preferred stock to common stock in November 2007 in connection with the IPO	(5,709,630)	(57,096)	(4,285,946)	(42,859)	(318,266)	(3,183)	10,488,178	104,882	(1,744)	—	—	—
Reclassification of amounts due to shareholders for fractional shares upon reverse stock split	—	—	—	—	—	—	—	—	(355)	—	—	(355)
Common stock issued to Mayo Foundation upon closing the IPO in November 2007 with a fair value of $8.05 per share	—	—	—	—	—	—	206,044	2,060	1,656,594	—	—	1,658,654
Exercise of over-allotment option by underwriters in December 2007 in connection with the IPO for cash at $8.00 per share, net of financing costs of $274,315	—	—	—	—	—	—	489,849	4,899	3,639,578	—	—	3,644,477
Exercise of 35,132 common stock options in 2007 for cash at $0.60 per share	—	—	—	—	—	—	35,132	351	20,836	—	—	21,187
Amortization of deferred compensation	—	—	—	—	—	—	—	—	—	24,812	—	24,812
Net loss	—	—	—	—	—	—	—	—	—	—	(28,575,348)	(28,575,348)
Balance, December 31, 2007	—	$ —	—	$ —	—	$ —	16,798,962	$167,990	$108,588,601	$ (41,667)	$ (63,433,404)	$ 45,281,520

See accompanying notes to consolidated financial statements.

ENTEROMEDICS INC.
(A development stage company)
Consolidated Statements of Cash Flows

	Years ended December 31, 2007	2006	2005	Period from December 19, 2002 (inception) to December 31, 2007
Cash flows from operating activities:				
Net loss	$ (28,575,348)	$ (17,690,477)	$ (11,215,191)	$ (63,433,404)
Adjustments to reconcile net loss to net cash used in operating activities:				
Depreciation	403,041	175,194	58,407	642,896
Loss on sale of equipment	7,911	—	—	10,272
Employee stock-based compensation	883,310	47,479	—	930,789
Nonemployee stock-based compensation	2,972,815	116,923	25,041	3,115,609
Amortization of commitment fees, debt issuance costs and original issue discount	738,166	77,097	84,824	1,118,749
Amortization of short-term investment discount	(148,834)	(156,442)	—	(305,276)
Change in carrying value of warrant liability	361,504	(6,597)	—	354,907
Change in operating assets and liabilities:				
Interest receivable	56,224	(109,401)	—	(53,177)
Other receivables	2,985	(24,519)	(9,570)	(43,135)
Prepaid expenses and other current assets	(359,072)	73,990	(88,625)	(426,718)
Other assets	1,395	(1,395)	(5,000)	(5,000)
Accounts payable	(378,420)	361,912	159,311	300,342
Accrued expenses	665,813	789,758	700,055	2,370,044
Accrued interest payable	—	118,355	12,658	165,822
Net cash used in operating activities	(23,368,510)	(16,228,123)	(10,278,090)	(55,257,280)
Cash flows from investing activities:				
Purchases of short-term investments available for sale	—	(5,755,000)	—	(5,755,000)
Maturities of short-term investments available for sale	690,000	—	—	690,000
Purchases of short-term investments held to maturity	(6,944,194)	(14,284,098)	—	(21,228,292)
Maturities of short-term investments held to maturity	15,300,000	3,000,000	—	18,300,000
Purchases of property and equipment	(800,393)	(634,973)	(449,811)	(2,144,936)
Net cash provided by (used in) investing activities	8,245,413	(17,674,071)	(449,811)	(10,138,228)
Cash flows from financing activities:				
Proceeds from stock options exercised	21,187	39,596	13,450	74,233
Proceeds from warrants issued	—	—	15,500	15,657
Proceeds from warrants exercised	—	—	—	187,652
Proceeds from sale of common stock, net of underwriting fees of $3,074,315	40,844,477	—	—	40,844,477
Common stock financing costs	(1,752,663)	—	—	(1,752,663)
Payment to shareholders for fractional shares upon reverse stock split	(355)	—	—	(355)
Proceeds from sale of Series A convertible preferred stock	—	—	—	1,803,348
Proceeds from sale of Series B convertible preferred stock	—	—	7,750,001	15,300,002
Series B convertible preferred stock financing costs	—	—	(16,303)	(111,079)
Proceeds from sale of Series C convertible preferred stock	—	40,825,003	—	40,825,003
Series C convertible preferred stock financing costs	—	(1,486,904)	—	(1,486,904)
Proceeds from convertible notes payable	—	—	5,250,003	6,814,846
Proceeds from notes payable	10,000,000	2,620,221	3,125,900	15,831,121
Repayments on notes payable	(2,793,712)	(1,277,751)	—	(4,156,463)
Debt issuance costs	—	—	(23,748)	(91,558)
Net cash provided by financing activities	46,318,934	40,720,165	16,114,803	114,127,817
Net increase in cash and cash equivalents	31,195,837	6,817,971	5,386,902	48,732,309
Cash and cash equivalents:				
Beginning of period	17,536,472	10,718,501	5,331,599	—
End of period	$ 48,732,309	$ 17,536,472	$ 10,718,501	$ 48,732,309
Supplemental disclosure:				
Interest paid	$ 935,433	$ 514,655	$ 83,669	$ 1,533,757
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	673,768	102,022	37,318	966,830
Value of warrants issued for debt commitment	550,212	—	37,318	636,250
Value of warrants issued with Series C financing	—	735,438	—	735,438
Conversion of notes payable to Series B convertible preferred shares	—	—	—	1,564,843
Conversion of interest payable to Series B convertible preferred shares	—	—	—	34,809
Conversion of notes payable to Series C convertible preferred shares	—	5,250,003	—	5,250,003
Conversion of interest payable to Series C convertible preferred shares	—	131,013	—	131,013
Options issued for deferred compensation	—	—	7,288	10,898
Common stock issued to Mayo Foundation and for deferred compensation	1,658,654	9,750	102,500	1,770,904
Reclassification of convertible preferred stock warrant liability	1,090,345	—	—	1,090,345
Conversion of convertible preferred stock to common stock	103,138	—	—	103,138

See accompanying notes to consolidated financial statements.

Notes to Consolidated Financial Statements

(1) Formation and Business of the Company

EnteroMedics Inc. (EnteroMedics or the Company) is developing implantable systems to treat obesity and other gastrointestinal disorders. The Company was incorporated in the state of Minnesota on December 19, 2002, originally as two separate legal entities, Alpha Medical, Inc. (Alpha) and Beta Medical, Inc. (Beta), both of which were owned 100% by a common stockholder. Effective October 1, 2003, the two entities were combined and changed its name to EnteroMedics Inc. The Company changed its state of incorporation to 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 has not derived revenues from its primary business activity. Accordingly, the Company is in the development stage, as defined by Statement of Financial Accounting Standards No. 7, *Accounting and Reporting by Development Stage Enterprises.* The Company is headquartered in St. Paul, Minnesota.

EnteroMedics Europe Sárl (EnteroMedics Europe), a wholly-owned subsidiary of the Company, was formed in January 2006. EnteroMedics Europe is a Switzerland entity established as a means to conduct clinical trials in Switzerland. Upon establishment there were 20 shares of EnteroMedics Europe issued and outstanding with a par value of 1,000 Swiss Francs. EnteroMedics purchased 100% of the shares and then issued one share to a fiduciary agent. The one share is the property of EnteroMedics and is held by the fiduciary in a fiduciary capacity under terms of the Fiduciary Agreement. Pursuant to Statement of Financial Accounting Standards No. 52, *Foreign Currency Translation*, the functional currency of EnteroMedics Europe has been determined to be the U.S. Dollar.

In November 2007, the Company effected a 1-for-9.1 reverse split of its common stock and convertible preferred stock which has been retroactively applied to these consolidated financial statements. Also, in November 2007, the Company completed its initial public offering of common stock (IPO), issuing a total of 5,489,849 shares for net proceeds of approximately $39.1 million after expenses and underwriters’ discounts and commissions, and including the exercise of the underwriters’ over-allotment option.

Since inception, EnteroMedics has incurred losses through December 31, 2007 totaling approximately $63.4 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.

(2) Summary of Significant Accounting Policies

Basis of Presentation

The Company has prepared the accompanying 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.

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 consolidated financial statements include the accounts of the Company and its wholly owned subsidiary. All intercompany transactions and accounts have been eliminated in consolidation.

Concentration of Credit Risk and Other Risks and Uncertainties

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash and cash equivalents and short-term investments. Cash and cash equivalents are deposited in demand and money market accounts at two financial institutions. At times, such deposits may be in excess of insured limits. Investments in short-term money market funds 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. The Company has not experienced any losses on its deposits of cash and cash equivalents.

Most of the products developed by the Company will require clearance from the U.S. Food and Drug Administration (FDA) or corresponding foreign regulatory agencies prior to commercial sales. There can be no assurance the Company's products will receive the necessary clearances. If the Company is denied clearance or clearance is delayed, it will have a material adverse impact on the Company.

The medical device industry is characterized by frequent and extensive litigation and administrative proceedings over patent and other intellectual property rights. Whether a product infringes a patent involves complex legal and factual issues, the determination of which is often difficult to predict, and the outcome may be uncertain until the court has entered final judgment and all appeals are exhausted. The Company's competitors may assert that its products or the use of the Company's products are covered by U.S. or foreign patents held by them.

Fair Value of Financial Instruments

Carrying amounts of certain of the Company's financial instruments, including cash and cash equivalents, 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 3. The fair value of the Company's long-term debt is approximately $12,125,000 as of December 31, 2007 based on the present value of estimated future cash flows using a discount rate commensurate with borrowing rates available to the Company.

Cash and Cash Equivalents

The Company considers highly liquid investments with maturities of 90 days or less when purchased to be cash equivalents. Cash equivalents are stated at cost, which approximates market value. The Company's cash equivalents are primarily in money market funds and commercial paper. The Company deposits its cash and cash equivalents in high-quality credit institutions. Under terms of the Company's notes payable agreements (see Note 6), in the event of default, the lender has the right to enforce account control agreements and restrict the Company's access to their cash and investment accounts.

Short-Term Investments

The Company considers all investments with maturities greater than three months and less than one year at the time of purchase as short-term investments and classifies them as either available for sale or held to maturity.

Available-for-sale securities are carried at fair value based on quoted market prices, with the unrealized gains and losses included in other comprehensive income within stockholders' equity (deficit) in the consolidated balance sheets. Realized gains and losses and declines in value judged to be other than temporary on available-for-sale securities are included in interest and other income. Interest and dividends on securities classified as available for sale are included in interest income. The cost of securities sold is based on the specific identification method.

Short-term investments in debt securities which the Company has the positive intent and ability to hold to maturity are reported at cost, adjusted for premiums and discounts that are recognized in interest income, using the interest method, over the period to maturity. Unrealized losses on held-to-maturity securities reflecting a decline in value determined to be other than temporary are charged to income.

Property and Equipment, Net

Property and equipment are stated at cost less accumulated depreciation and amortization. Depreciation of property and equipment is computed using the straight-line method over their estimated useful lives of three to seven years. Leasehold improvements are amortized on a straight-line basis over the lesser of their useful life or the term of the lease. Upon retirement or sale, the cost and related accumulated depreciation are removed from the consolidated balance sheets and the resulting gain or loss is reflected in the consolidated statements of operations. Repairs and maintenance are expensed as incurred.

Impairment of Long-Lived Assets

The Company evaluates its long-lived assets for impairment by comparison of the carrying amounts to future net undiscounted cash flows expected to be generated by such assets when events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Should an impairment exist, the impairment loss would be measured based on the excess carrying value of the asset over the asset’s fair value or estimates of future discounted cash flows. The Company has not identified any such impairment losses to date.

Income Taxes

Income taxes are accounted for under the asset and liability method. Deferred tax assets and liabilities are recognized for the future tax consequences attributable to differences between the financial statement carrying amounts of existing assets and liabilities and their respective tax bases and operating loss and tax credit carry-forwards. Deferred tax assets and liabilities are measured using enacted tax rates expected to apply to taxable income in the years in which those temporary differences are expected to be recovered or settled. The effect on deferred tax assets and liabilities of a change in tax rates is recognized in income in the period that includes the enactment date. A valuation allowance for deferred income tax assets is recorded when it is more likely than not that some portion or all of the deferred income tax assets will not be realized. The Company has provided a full valuation allowance against the gross deferred tax assets as of December 31, 2007 and 2006 (see Note 9). The Company’s policy is to classify interest and penalties related to income taxes as income tax expense in the consolidated statements of operations.

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 and regulatory expenses, payroll and other personnel expenses, materials, supplies, and consulting costs.

Patent Costs

Costs associated with the submission of a patent application are expensed as incurred given the uncertainty of the patents resulting in probable future economic benefits to the Company. Patent-related legal expenses included in general and administrative costs were $378,362, $274,665 and $214,300 for the years ended December 31, 2007, 2006 and 2005, respectively, and $1,009,586 for the period from December 19, 2002 (inception) to December 31, 2007.

Derivative Instruments

The Company accounts for the Series C preferred stock warrants as derivatives under Statement of Financial Accounting Standards No. 133, *Accounting for Derivative Instruments and Hedging Activities*, and related Emerging Issues Task Force (EITF) interpretations and Securities and Exchange Commission (SEC) rules, which require that the warrants be classified as a liability and measured at fair value with changes in fair value recognized currently in earnings, when there are not enough authorized shares to be issued upon exercise of the warrants. The Company has recorded changes in fair value as an other expense in the consolidated statements of operations.

Stock-Based Compensation

Prior to January 1, 2006, the Company accounted for stock-based employee compensation arrangements in accordance with the provisions of Accounting Principles Board Opinion No. 25 (APB 25), *Accounting for Stock Issued to Employees*, and related interpretations, and followed the minimum value disclosure provisions of Statement of Financial Accounting Standards No. 123 (SFAS 123), *Accounting for Stock-Based Compensation*. Under APB 25, compensation expense is based on the difference, if any, on the date of the grant, between the fair value of the Company's stock and the exercise price. Employee stock-based compensation determined under APB 25 is recognized over the option vesting period.

Effective January 1, 2006, the Company adopted the fair value provisions of Statement of Financial Accounting Standards No. 123R (SFAS 123R), *Share-Based Payment*, which supersedes its previous accounting under APB 25. SFAS 123R requires the recognition of compensation expense, using a fair-value-based method, for costs related to all share-based payments including stock options. SFAS 123R requires companies to estimate the fair value of share-based payment awards on the date of grant using an option-pricing model. The Company adopted SFAS 123R using the prospective transition method, which requires that for nonpublic entities that used the minimum value method for either pro forma or financial statement recognition purposes, SFAS 123R shall be applied to option grants or modifications to existing options after the required effective date. For options granted prior to the new SFAS 123R effective date and for which the requisite service period has not been performed as of January 1, 2006, the Company will continue to apply the intrinsic value provisions of APB 25 on the remaining unvested awards. All option grants valued after January 1, 2006 will be expensed on a straight-line basis over the vesting period.

The Company accounts for stock-based compensation arrangements with nonemployees in accordance with the Emerging Issues Task Force Abstract No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services.* The Company records the expense of such services based on the estimated fair value of the equity instrument using the Black-Scholes pricing model. The value of the equity instrument is charged to earnings over the term of the service agreement.

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.

The following table sets forth the computation of basic and diluted net loss per share for the years ended December 31, 2007, 2006 and 2005:

	Year ended December 31,		
	2007	2006	2005
Numerator:			
Net loss	$ (28,575,348)	$ (17,690,477)	$ (11,215,191)
Denominator for historical and basic and diluted net loss per share:			
Weighted-average common shares outstanding	2,447,515	543,442	443,927
Weighted-average unvested common shares subject to repurchase	(2,514)	(25,980)	(54,826)
Denominator for net loss per common share—basic and diluted	2,445,001	517,462	389,101
Net loss per share—basic and diluted	$ (11.69)	$ (34.19)	$ (28.82)

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:

	December 31,		
	2007	2006	2005
Convertible preferred stock	—	10,313,842	4,604,212
Stock options outstanding	2,101,926	1,261,871	772,418
Warrants to purchase convertible preferred stock	—	376,972	194,465
Warrants to purchase common stock	683,235	170,336	170,336

Recently Issued Accounting Standards

In September 2006, the FASB issued Statement of Financial Accounting Standards No. 157 (SFAS 157), *Fair Value Measurements*, which defines fair value, establishes guidelines for measuring fair value and expands disclosures regarding fair value measurements. SFAS 157 does not require any new fair value measurements but rather eliminates inconsistencies in guidance found in various prior accounting pronouncements. SFAS 157 is effective for fiscal years beginning after November 15, 2007. Earlier adoption is permitted, provided the company has not yet issued financial statements, including for interim periods, for that fiscal year. The Company is currently evaluating the impact of SFAS 157.

In February 2007, the FASB issued Statement of Financial Accounting Standards No. 159 (SFAS 159), *The Fair Value Option for Financial Assets and Financial Liabilities—Including an amendment of FASB Statement No. 115*. SFAS 159 permits entities to choose to measure many financial instruments and certain other items at fair value. The amendment to SFAS 115 applies to all entities with investments in available-for-sale or trading securities. The statement is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the impact of SFAS 159.

In June 2007, the FASB issued Emerging Issues Task Force No. 07-3 (EITF 07-3), *Accounting for Nonrefundable Advance Payments for Goods or Services Received for Use in Future Research and Development Activities*. EITF 07-3 requires nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities to be deferred and capitalized. The expense should be recognized as the related goods are delivered or the related services are performed. The statement is effective prospectively for new contracts entered into during fiscal years beginning after December 15, 2007.

In December 2007, the Securities and Exchange Commission issued Staff Accounting Bulletin No. 110 (SAB 110). SAB 110 permits, under certain circumstances, the continued use of the "simplified" method in developing an estimate of the expected term of "plain vanilla" share options in accordance with Statement of Financial Accounting Standards No. 123R, *Share-Based Payment*, beyond December 31, 2007. The Company currently uses the "simplified" method as there is not enough historical experience to provide a reasonable estimate of the expected term and will continue to do so until there is enough historical experience in accordance with SAB110. The Company does not expect SAB 110 to have a material impact on the consolidated financial statements.

(3) Short-term Investments

The amortized cost and fair value of short-term investments available for sale, and the related gross unrealized gains and losses, were as follows:

As of December 31, 2007

		Gross Unrealized		
	Cost	Gains	Losses	Fair value
State and municipal tax-exempt bonds	$ 900,000	$ —	$ —	$ 900,000
Corporate debt	4,165,000	—	—	4,165,000
Total investment securities available for sale	$5,065,000	$ —	$ —	$5,065,000

As of December 31, 2006

		Gross Unrealized		
	Cost	Gains	Losses	Fair value
State and municipal tax-exempt bonds	$1,000,000	$ —	$ —	$1,000,000
Corporate debt	4,755,000	—	—	4,755,000
Total investment securities available for sale	$5,755,000	$ —	$ —	$5,755,000

Short-term investments available for sale at December 31, 2007 and December 31, 2006 consist solely of variable rate demand notes with a seven-day put option and interest rates that reset on a weekly basis.

The amortized cost and fair value of short-term investments held to maturity, and the related gross unrealized gains and losses, were as follows:

As of December 31, 2007

		Gross Unrealized		
	Cost	Gains	Losses	Fair value
Commercial paper	$ 3,233,568	$ 1,095	$ —	$ 3,234,663
Total investment securities held to maturity	$ 3,233,568	$ 1,095	$ —	$ 3,234,663

As of December 31, 2006

		Gross unrealized		
	Cost	Gains	Losses	Fair value
Corporate debt	$ 6,998,355	$ 1,572	$ (606)	$ 6,999,321
U.S. Treasury and agencies	2,945,510	2,289	—	2,947,799
Commercial paper	1,496,675	—	—	1,496,675
Total investment securities held to maturity	$ 11,440,540	$ 3,861	$ (606)	$ 11,443,795

(4) Property and Equipment

Property and equipment consist of the following as of:

	December 31,	
	2007	2006
Furniture and equipment	$1,387,513	$ 943,159
Computer hardware and software	430,098	255,609
Leasehold improvements	301,181	142,821
	2,118,792	1,341,589
Less accumulated depreciation and amortization	(627,024)	(239,262)
Property and equipment, net	$1,491,768	$1,102,327

Depreciation expense included in general and administrative costs was $403,041, $175,194 and $58,407 for the years ended December 31, 2007, 2006 and 2005, respectively, and $642,896 for the period from December 19, 2002 (inception) to December 31, 2007.

(5) Accrued Expenses

Accrued expenses consist of the following as of:

	December 31,	
	2007	2006
Professional service related expenses	$ 869,563	$ 694,953
Payroll related expenses	815,871	601,733
Other expenses	684,610	407,545
Accrued expenses	$ 2,370,044	$ 1,704,231

(6) Notes payable

Notes payable consists of the following as of:

	December 31, 2007	December 31, 2006
Equipment loan dated June 7, 2005	$ 50,957	$ 128,170
Equipment loan dated June 7, 2005	10,437	29,607
Growth capital loan dated September 30, 2005 (net discounts of $3,732 and $18,659 at December 31, 2007 and 2006, respectively)	440,567	1,637,427
Equipment loan dated December 30, 2005	153,851	278,763
Equipment loan dated December 30, 2005	18,721	35,219
Growth capital loan dated March 31, 2006 (net discounts of $6,121 and $14,283 at December 31, 2007 and 2006, respectively)	207,604	431,136
Growth capital loan dated March 31, 2006 (net discounts of $24,486 and $57,133 at December 31, 2007 and 2006, respectively)	830,414	1,724,543
Equipment loan dated April 28, 2006	58,846	94,867
Equipment loan dated April 28, 2006	11,298	18,563
Growth capital loan dated May 22, 2007 (net discounts of $99,056 at December 31, 2007)	2,329,756	—
Growth capital loan dated May 22, 2007 (net discounts of $99,056 at December 31, 2007)	2,329,756	—
Growth capital loan dated August 31, 2007 (net discounts of $83,007 at December 31, 2007)	1,166,993	—
Growth capital loan dated August 31, 2007 (net discounts of $83,007 at December 31, 2007)	1,166,993	—
Growth capital loan dated October 31, 2007 (net discounts of $88,712 at December 31, 2007)	1,161,288	—
Growth capital loan dated October 31, 2007 (net discounts of $88,712 at December 31, 2007)	1,161,288	—
Total debt	11,098,769	4,378,295
Less current portion	(5,081,025)	(2,651,336)
Total long-term debt	$ 6,017,744	$ 1,726,959

The Company entered into a loan agreement on December 1, 2004 that provided for equipment loans and growth capital loans up to an aggregate original principal amount of $250,000 and $3,000,000, respectively, through June 30, 2005. In conjunction with this loan agreement, the Company issued detachable warrants to acquire 45,333 shares of Series B convertible preferred stock (Series B) at $3.9430 per share. The warrants have a seven and a half year life. The fair value of the warrants at the time of issuance was determined to be $48,720 and was recorded as interest expense over the term of the commitment. $41,760 and $6,960 was recorded in 2005 and 2004, respectively. This fair value was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 60%, dividend rate of 0%, risk-free interest rate of 4.38% and the seven and a half year warrant life. In accordance with the agreement, upon the closing of the IPO, the warrants were converted into warrants to purchase common stock, with all other terms unchanged.

The above December 1, 2004 loan agreement was amended on September 29, 2005. The amendment provided for additional lender commitments for equipment loans and growth capital loans to the Company up to an aggregate original principal amount of $500,000 and $2,000,000, respectively. The termination date of the original growth capital loan commitment was amended to September 30, 2005 and the termination date for the additional equipment loans and growth capital loans was March 31, 2006 (see below). In conjunction with the amendment, the Company issued detachable warrants to acquire 34,872 shares of Series B stock at $3.9430 per share or shares of Series C convertible preferred stock (Series C) having an aggregate exercise price of $137,500. On June 21, 2006, prior to the close of the Series C stock financing round, the lender informed the Company of its intent to have the warrants be for Series B stock. The warrants have a seven and a half year life. The fair value of the warrants at the time of issuance was determined to be $37,318 and was recorded as interest expense over the term of the commitment, with $18,659 being recorded in both 2006 and 2005. This fair value was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 55%, dividend rate of 0%, risk-free interest rate of 4.29% and the seven and a half year warrant life. In accordance with the agreement, upon the closing of the IPO, the warrants were converted into warrants to purchase common stock, with all other terms unchanged.

The Company entered into two separate equipment loans (aggregate of $120,221) during 2006 and four separate equipment loans (aggregate of $625,900) during 2005 with the below terms:

1. *Equipment Loan Dated June 7, 2005*—Face amount of $199,450 payable in 30 equal principal and interest installments beginning January 1, 2006 through May 2008 with a final payment of $17,283 on June 1, 2008 at an annual percentage rate of 8.023%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10%.
2. *Equipment Loan Dated June 7, 2005*—Face amount of $46,710 payable in 30 equal principal and interest installments beginning January 1, 2006 through June 1, 2008 at an annual percentage rate of 11.461%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10%.
3. *Equipment Loan Dated December 30, 2005*—Face amount of $337,023 payable in 30 equal principal and interest installments beginning July 1, 2006 through November 2008 with a final payment of $29,384 on December 1, 2008 at an annual percentage rate of 9.273%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10%.
4. *Equipment Loan Dated December 30, 2005*—Face amount of $42,717 payable in 30 equal principal and interest installments beginning July 1, 2006 through December 1, 2008 at an annual percentage rate of 12.71%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10%.
5. *Equipment Loan Dated April 28, 2006*—Face amount of $100,537 payable in 30 equal principal and interest installments beginning November 1, 2006 through March 2009 with a final payment of $8,787 on April 1, 2009 at an annual percentage rate of 9.773%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10%.
6. *Equipment Loan Dated April 28, 2006*—Face amount of $19,684 payable in 30 equal principal and interest installments beginning November 1, 2006 through April 1, 2009 at an annual percentage rate of 13.21%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10%.

The Company entered into a growth capital loan on September 30, 2005 with a face amount of $2,500,000 payable in 23 equal principal and interest installments beginning April 1, 2006 through February 2008 with a final payment of $237,825 on March 1, 2008 at an annual percentage rate of 8.486%, an effective rate of 10.12%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10.999%. In conjunction with the funding of the growth capital loan, the Company issued detachable warrants to acquire 34,872 shares of Series B stock at $3.9430 per share or shares of Series C stock having an aggregate exercise price of $137,500. On June 21, 2006, prior to the close of the Series C stock financing round, the lender informed the Company of its intent to have the warrants be for Series B stock. The warrants have a seven and a half year life. The fair value of the warrants at the time of issuance was determined to be $37,318 and is recorded as interest expense over the term of the loan, with $14,927, $14,927 and $3,732 being recorded in 2007, 2006 and 2005, respectively. This fair value was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 55%, dividend rate of 0%, risk-free interest rate of 4.33% and the seven and a half year warrant life. In accordance with the agreement, upon the closing of the IPO, the warrants were converted into warrants to purchase common stock, with all other terms unchanged.

The Company entered into two separate growth capital loans on March 31, 2006 with a combined face amount of $2,500,000 payable in 23 equal principal and interest installments beginning October 1, 2006 through August 2008 with a final payment of $238,875 on September 1, 2008 at an annual percentage rate of 9.49%, an effective rate of 14.07%. Interest only payments for the first six months of the loan are at an annual percentage rate of 10.999%. In conjunction with the funding of the growth capital loan, the Company issued detachable warrants to acquire 34,872 shares of Series B stock at $3.9430 per share or shares of Series C stock having an aggregate exercise price of $137,500. On June 21, 2006, prior to the close of the Series C stock financing round, the lender informed the Company of its intent to have the warrants be for Series B stock. The warrants have a seven year life. The fair value of the warrants at the time of issuance was determined to be $102,022 and is recorded as interest expense over the term of the loan, with $40,809 and $30,606 being recorded in 2007 and 2006, respectively. This fair value was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 54%, dividend rate of 0%, risk-free interest rate of 4.85% and the seven year warrant life. In accordance with the agreement, upon the closing of the IPO, the warrants were converted into warrants to purchase common stock, with all other terms unchanged.

On May 17, 2007 the Company entered into a $15.0 million debt facility with the same lender of the other notes payable. The initial commitment under the debt facility is for $10.0 million and allows for two $5.0 million draw periods, the first of which was required upon closing. The loan agreement was amended to provide for two draw periods on the second $5.0 million that is available to the Company under the terms of the original agreement. As amended, $2.5 million was available to the Company through August 31, 2007 and the remaining $2.5 million was available to the Company through October 31, 2007. Upon closing of the initial commitment, the Company issued 67,963 Series C stock warrants with an exercise price of $8.0926 per share and a seven year life. The fair value of the warrants at the time of issuance was determined to be $550,212 and is recorded as interest expense in 2007. The fair value of the warrants was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 55.5%, dividend rate of 0%, risk-free interest rate of 4.76% and the seven year warrant life. In accordance with the agreement, upon the closing of the IPO, the warrants were converted into warrants to purchase common stock, with all other terms unchanged.

Under the terms of the May 17, 2007 debt facility, the Company completed the initial $5.0 million draw by entering into two separate growth capital loans on May 22, 2007 with a combined face amount of $5,000,000 payable in 29 equal principal and interest installments beginning December 1, 2007 through April 1, 2010 with a final payment of $343,050 on May 1, 2010 at an annual percentage rate of 10.25%. Interest only payments for the first six months of the loan are at an annual percentage rate of 12.48%. In conjunction with the funding of the growth capital loan, the Company issued detachable warrants to acquire 33,982 shares of Series C stock at an exercise price of $8.0926 per share. The warrants have a seven year life. The fair value of the warrants at the time of issuance was determined to be $281,321 and is being recorded as interest expense over the term of the loan, with $83,209 recorded as interest expense in 2007. This fair value was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 55.5%, dividend rate of 0%, risk-free interest rate of 4.83% and the seven year warrant life. In accordance with the agreement, upon the closing of the IPO, the warrants were converted into warrants to purchase common stock, with all other terms unchanged.

The debt facility agreement entered into on May 17, 2007 was amended on August 28, 2007 to provide for two draw periods on the second $5.0 million that was available under the terms of the original agreement. As amended, $2.5 million was available to the Company through August 31, 2007 and the remaining $2.5 million was available to the Company through October 31, 2007. On August 31, 2007, the Company completed the $2.5 million draw available through that date by entering into two separate growth capital loans with a combined face amount of $2.5 million payable in 29 equal principal and interest installments beginning March 1, 2008 through July 1, 2010 with a final payment of $171,525 on August 1, 2010 at an annual percentage rate of 10.25%. Interest only payments for the first six months of the loan are at an annual percentage rate of 12.48%. In conjunction with the funding of the growth capital loan, the Company issued detachable warrants to acquire 16,991 shares of Series C stock at an exercise price of $8.0926 per share. The warrants have a seven year life. The fair value of the warrants at the time of issuance was determined to be $197,731 and is being recorded as interest expense over the term of the loan, with $31,717 recorded as interest expense in 2007. The fair value was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 52.6%, dividend rate of 0%, risk-free interest rate of 4.54% and a seven year life. In accordance with the agreement, upon the closing of the IPO, the warrants were converted into warrants to purchase common stock, with all other terms unchanged.

On October 31, 2007, the Company completed the $2.5 million draw that was available through that date by entering into two separate growth capital loans with a combined face amount of $2.5 million payable in 29 equal principal and interest installments beginning March 1, 2008 through July 1, 2010 with a final payment of $171,525 on August 1, 2010 at an annual percentage rate of 10.25%. Interest only payments for the first four months of the loan are at an annual percentage rate of 12.48%. In conjunction with the funding of the growth capital loan, the Company issued detachable warrants to acquire 16,991 shares of Series C stock at an exercise price of $8.0926 per share. The warrants have a seven year life. The fair value of the warrants at the time of issuance was determined to be $194,716 and is being recorded as interest expense over the term of the loan, with $17,292 recorded as interest expense in 2007. The fair value was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 50.3%, dividend rate of 0%, risk-free interest rate of 4.47% and a seven year life. In accordance with the agreement, upon the closing of the IPO, the warrants were converted into warrants to purchase common stock, with all other terms unchanged.

The final $5.0 million commitment is available to the Company under the terms of the debt facility through 2008. The Company is not required to pay any additional equity consideration for this portion of the facility unless it is utilized. Should the Company utilize any portion of the remaining facility, it would be required to issue common stock warrants to the lender with an aggregate exercise price equal to 11% of the amount drawn.

The aggregate amount funded by the lender under the debt facilities noted above was $15,746,121 and $5,746,121 as of December 31, 2007 and 2006, respectively.

Each of the above loans is collateralized by a first security priority lien on all of the Company's assets, excluding intellectual property. In the event we have less than four remaining months of liquidity, we are required to grant a temporary lien on our intellectual property. The number of remaining months of liquidity is calculated by dividing cash and cash equivalents as of the end of any particular month by the sum of our total operating expenses for each of the immediately preceding four months.

The Company also entered into account control agreements for each cash and investment account held by the Company. The lender has the right to enforce the account control agreements in the event of default. If enforced, the lender has the ability to withdraw funds from the accounts and restrict the Company's access to the funds.

The Company was in compliance with all covenants related to the notes payable at December 31, 2007, and has not incurred any events of default as described in the terms of the notes payable agreements.

Scheduled debt principal payments are as follows as of December 31, 2007:

Years Ending December 31:	
2008	$ 5,081,025
2009	3,972,771
2010	2,620,862
	11,674,658
Less: Original issue discount	(575,889)
Notes payable, net	$ 11,098,769

Scheduled debt principal payments are as follows as of December 31, 2006:

Years Ending December 31:	
2007	$2,651,336
2008	1,794,877
2009	22,157
	4,468,370
Less: Original issue discount	(90,075)
Notes payable, net	$4,378,295

(7) Series C Convertible Preferred Stock Financing

On July 6, 2006, the Company closed the Series C convertible preferred stock (Series C) financing. The Company sold 4,921,142 shares of Series C stock for $8.0926 per share, or total gross proceeds of $39,825,003. In addition, $5,250,003 of Convertible Notes Payable principal and $131,013 of accrued interest payable were converted into 664,919 shares of Series C stock. The Company incurred $2,222,342 in financing costs, which were recorded as a reduction to additional paid-in capital. Included in the Series C financing costs was $735,438 of value related to 147,635 Series C warrants issued to the private placement underwriter. The fair value of the warrants was calculated using a Black-Scholes valuation model and the following assumptions: volatility of 55%, dividend rate of 0%, risk-free interest rate of 5.18%, and the maximum seven-year warrant life. The fair value of the warrants was recorded in additional paid-in capital. In accordance with the agreement, upon the closing of the IPO, the warrants were converted into warrants to purchase common stock, with all other terms unchanged.

On December 11, 2006, the Company sold an additional 123,569 shares of Series C stock for $8.0926 per share, or total gross proceeds of $1,000,000.

As of the closing date of the additional sale of 123,569 shares of Series C stock, the Company had insufficient authorized and unissued Series C stock available to share settle the Series C warrants which required the instrument to be accounted for under Statement of Financial Accounting Standards No. 133 and classified as a liability in accordance with EITF 00-19, *Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock*. The fair market value of the warrant as of December 31, 2006 was $728,841. The change in fair value is recorded separately in the consolidated statements of operations.

On May 14, 2007 the Company filed an amended certificate of incorporation to increase the number of authorized shares of Series C stock to 6,043,956. As a result of the amendment, the Company had sufficient authorized and unissued shares of Series C stock available to share settle the Series C warrants. The fair market value of the warrants on May 14, 2007 was determined to be $1,090,345. The change in fair value from December 31, 2006 to the amendment date of $361,504 was recorded as expense and the convertible preferred stock liability was reclassified to additional paid-in capital.

(8) Convertible Preferred Stock

The Company's Amended and Restated Certificate of Incorporation, currently authorizes 5,000,000 shares of $0.01 par value convertible preferred stock. As of December 31, 2007, there were no shares of convertible preferred stock issued or outstanding as all shares of Series A, Series B and Series C convertible preferred stock converted into shares of common stock upon completion of the Company's IPO utilizing the quotient obtained by dividing the original purchase price per share of $6.5593, $3.9430 and $8.0926 by $4.2379, $3.9430 and $8.0926 per share, respectively.

As of December 31, 2006, there were 318,266, 4,285,946 and 5,709,630 shares of Series A, Series B and Series C convertible preferred stock outstanding, respectively, with a liquidation preference per share of $6.5593, $3.9430 and $8.0926, respectively.

(9) Income Taxes

The Company has incurred net operating losses (NOLs) since inception. The Company has not reflected any benefit of such net operating loss carryforwards in the accompanying consolidated financial statements.

The income tax expense benefit differed from the amount computed by applying the U.S. federal income tax rate of 34% to income before income taxes as a result of the following:

	2007	2006	2005
Computed 'expected' tax benefit	34.0%	34.0%	34.0%
Other permanent adjustments	-2.7%	-0.4%	-0.4%
Research and development credit	2.2%	2.3%	3.5%
State income taxes, net of federal benefit	5.5%	6.0%	7.0%
Effect of foreign operations	0.0%	-1.5%	0.0%
Federal and state valuation allowance	-39.0%	-40.4%	-44.1%
	0.0%	0.0%	0.0%

The tax effect of temporary differences that give rise to significant portions of the deferred tax assets as of December 31 is presented below:

	2007	2006
Deferred tax assets (liabilities):		
Start-up costs	$ 5,562,000	$ 5,505,000
Reserves and accruals	875,000	157,000
Property and equipment	83,000	16,000
Research and development credit	1,584,000	1,107,000
Net operating loss carryforwards	17,671,000	7,784,000
Total gross deferred tax assets	25,775,000	14,569,000
Valuation allowance	(25,775,000)	(14,569,000)
Net deferred tax assets	$ —	$ —

In assessing the realization of deferred tax assets, management considers whether it is more likely than not that some portion or all of the deferred tax assets will not be realized. The ultimate realization of deferred tax assets is dependent upon the generation of future taxable income during periods in which those temporary differences become deductible.

Based on the level of historical taxable losses and projections of future taxable income (losses) over the periods in which the deferred tax assets can be realized, management currently believes that it is more likely than not that the Company will not realize the benefits of these deductible differences. Accordingly, the Company has provided a valuation allowance against the gross deferred tax assets as of December 31, 2007 and 2006.

As of December 31, 2007, the Company has U.S. federal net operating loss carryforwards of approximately $43,739,000. The federal net operating loss carryforwards expire in the years 2022 through 2027.

Federal tax laws impose significant restrictions on the utilization of net operating loss carryforwards and research and development credits in the event of a change in ownership of the Company, as defined by the Internal Revenue Code Section 382. The Company’s net operating loss carryforwards and research and development credits may be subject to the above limitations.

The Company adopted the provisions of FASB Interpretation No. 48 (FIN 48), *Accounting for Uncertainty in Income Taxes*, on January 1, 2007. Implementation of FIN 48 resulted in no adjustment to the Company’s liability for unrecognized tax benefits. As of both the date of adoption, and as of December 31, 2007, there were no unrecognized tax benefits. Accordingly, a tabular reconciliation from beginning to ending periods is not provided. The Company will classify any future interest and penalties as a component of income tax expense if incurred. To date, there have been no interest or penalties charged or accrued in relation to unrecognized tax benefits.

The Company is subject to federal and state examinations for the years 2004 forward. There are no tax examinations currently in progress.

(10) Stock Options

The Company has adopted the EnteroMedics Inc. 2003 Stock Incentive Plan (the Plan) that includes both incentive stock options and nonqualified stock options to be granted to employees, officers, consultants, independent contractors, directors and affiliates of the Company. At December 31, 2007 and 2006, according to the Plan, 3,901,103 shares and 1,728,007 shares, respectively, have been authorized and reserved. The board of directors establishes the terms and conditions of all stock option grants, subject to the Plan and applicable provisions of the Internal Revenue Code. Incentive stock options must be granted at an exercise price not less than the fair market value of the common stock on the grant date. The options granted to participants owning more than 10% of the Company's outstanding voting stock must be granted at an exercise price not less than 110% of fair market value of the common stock on the grant date. The options expire on the date determined by the board of directors, but may not extend more than 10 years from the grant date, while incentive stock options granted to participants owning more than 10% of the Company's outstanding voting stock expire five years from the grant date. The vesting period for employees is generally over four years. The vesting period for nonemployees is determined based on the services being provided.

Stock option activity is as follows:

	Shares Available For Grant	Outstanding Options		Aggregate Intrinsic Value
		Number of Shares	Weighted-Average Exercise Price	
Shares reserved at Plan inception	42,858	—	$ —	
Balance, December 31, 2003 (unaudited)	42,858	—	—	
Shares reserved	439,561	—	—	
Options granted	(344,796)	344,796	0.46	
Options exercised	—	—	—	
Options cancelled	3,847	(3,847)	0.46	
Balance, December 31, 2004	141,470	340,949	0.46	
Shares reserved	678,891	—	—	
Options granted	(504,285)	504,285	0.46	
Options exercised	—	(29,561)	0.46	
Options cancelled	43,255	(43,255)	0.46	
Balance, December 31, 2005	359,331	772,418	0.46	
Shares reserved	566,697	—	—	
Options granted	(679,911)	679,911	1.15	
Options exercised	—	(87,022)	0.46	
Options cancelled	103,436	(103,436)	0.46	
Balance, December 31, 2006	349,553	1,261,871	0.83	$ 1,362,935
Shares reserved	2,173,096	—	—	
Options granted	(912,805)	912,805	6.50	
Options exercised	—	(35,132)	0.60	
Options cancelled	37,618	(37,618)	3.88	
Balance, December 31, 2007	1,647,462	2,101,926	$ 3.24	$10,180,231

The options outstanding, vested and currently exercisable by exercise price at December 31, 2007:

	Outstanding Options and Expected to Vest			Options Exercisable and Vested		
Exercise Price	Number of Shares Outstanding	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value	Number of Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value
$0.46	894,411	7.5	$ 6,793,044	605,867	$ 0.46	$4,601,557
$1.91	321,886	8.8	1,976,058	107,838	$ 1.91	662,018
$5.19	471,782	9.1	1,350,712	5,689	$ 5.19	16,289
$7.46	102,750	9.3	60,417	35,029	$ 7.46	20,597
$8.16	173,734	9.7	—	6,594	$ 8.16	—
$8.46	137,363	9.4	—	27,473	$ 8.46	—
	2,101,926		$10,181,231	788,490	$ 1.34	$5,300,461

The options outstanding, vested and currently exercisable by exercise price at December 31, 2006:

	Outstanding Options and Expected to Vest			Options Exercisable and Vested		
Exercise Price	Number of Shares Outstanding	Weighted-Average Remaining Contractual Life (Years)	Aggregate Intrinsic Value	Number of Options	Weighted-Average Exercise Price	Aggregate Intrinsic Value
$ 0.46	936,138	8.6	$1,362,935	381,859	$ 0.46	$555,987
$ 1.91	325,733	9.8	—	550	$ 1.91	—
	1,261,871		$1,362,935	382,409	$ 0.46	$555,987

Stock-Based Compensation for Nonemployees

Stock-based compensation expenses related to stock options granted to nonemployees is recognized as the stock options are earned. The Company believes that the fair value of the stock options is more reliably measurable than the fair value of the services received. The fair value of the stock options granted is calculated at each reporting date, using the Black-Scholes option-pricing model, until the award vests or there is a substantial disincentive for the nonemployee not to perform the required services. The fair value for the years ended December 31, 2007, 2006 and 2005 was calculated using the following assumptions:

	Years Ended December 31,		
	2007	2006	2005
Risk-free interest rates	4.03%–5.03%	4.48%–5.14%	4.14%–4.56%
Expected life	10 years	10 years	10 years
Expected dividends	0%	0%	0%
Expected volatility	60.50%–63.25%	62.83%–66.57%	62.67%–69.60%

Stock-based compensation expense charged to operations on options granted to nonemployees for the years ended December 31, 2007, 2006 and 2005 was $1,289,349, $90,840 and $5,354, respectively, and $1,386,373 for the period from December 19, 2002 (inception) to December 31, 2007.

Employee Stock-Based Awards Granted on or Subsequent to January 1, 2006

On January 1, 2006, the Company adopted the fair value recognition provisions of SFAS 123R, using the prospective transition method. Under this transition method, beginning January 1, 2006, compensation cost recognized includes: (a) compensation cost for all stock-based awards granted prior to, but not yet vested as of December 31, 2005, based on the intrinsic value method in accordance with the provisions of APB 25, and (b) compensation cost for all stock-based payments granted or modified subsequent to December 31, 2005, based on the grant-date fair value estimated in accordance with the provisions of SFAS 123R.

Under SFAS 123R, compensation cost for employee stock-based awards is based on the estimated grant-date fair value and is recognized over the vesting period of the applicable award on a straight-line basis. The weighted average estimated fair value of the employee stock options granted for the years ended December 31, 2007 and 2006 was $4.51 and $0.68 per share, respectively.

The Company uses the Black-Scholes pricing model to determine the fair value of stock options. The determination of the fair value of stock-based payment awards on the date of grant is affected by our stock price as well as assumptions regarding a number of complex and subjective variables. These variables include our expected stock price volatility over the term of the awards, actual and projected employee stock option exercise behaviors, risk-free interest rates and expected dividends. The estimated grant-date fair values of the employee stock options were calculated using the Black-Scholes valuation model, based on the following assumptions for the years ended December 31, 2007 and 2006:

	Years Ended December 31,	
	2007	2006
Risk-free interest rates	4.15%–4.79%	4.39%–5.04%
Expected life	6 years–6.5 years	5 years–6.25 years
Expected dividends	0%	0%
Expected volatility	55.13%–58.63%	55.17%–62.86%

Expected Life. The expected life is based on the “simplified” method described in the SEC Staff Accounting Bulletin, Topic 14: *Share-Based Payment*.

Volatility. Since the Company was a private entity for most of 2007 with no historical data regarding the volatility of its common stock, the expected volatility used for 2006 and 2007 is based on volatility of similar entities, referred to as “guideline” companies. In evaluating similarity, the Company considered factors such as industry, stage of life cycle and size.

Risk-Free Interest Rate. The risk-free rate is based on U.S. Treasury zero-coupon issues with remaining terms similar to the expected term on the options.

Dividend Yield. The Company has never declared or paid any cash dividends and does not plan to pay cash dividends in the foreseeable future, and, therefore, used an expected dividend yield of zero in the valuation model.

Forfeitures. SFAS No. 123R also requires the Company to estimate forfeitures at the time of grant, and revise those estimates in subsequent periods if actual forfeitures differ from those estimates. The Company uses historical data to estimate pre-vesting option forfeitures and record stock-based compensation expense only for those awards that are expected to vest. All stock-based payment awards are amortized on a straight-line basis over the requisite service periods of the awards, which are generally the vesting periods. If the Company's actual forfeiture rate is materially different from its estimate, the stock-based compensation expense could be significantly different from what the Company has recorded in the current period.

As of December 31, 2007 there was $3,582,339 of total unrecognized compensation costs related to non-vested stock option awards granted after January 1, 2006, which are expected to be recognized over a weighted-average period of 3.60 years.

The aggregate intrinsic value of stock options (the amount by which the market price of the stock on the date of exercise exceeded the exercise price of the option) exercised during the years ended December 31, 2007, 2006 and 2005, was $184,970, $13,198 and $0, respectively.

(11) Warrants

Stock warrant activity is as follows:

	Common Shares	Price(1)	Series A Preferred Shares	Price(1)	Series B Preferred Shares	Price(1)	Series C Preferred Shares	Price(1)
Balance as of:								
December 31, 2002 (unaudited)	—		—		—		—	
Granted	—		125,778	$ 0.91	23,516	$ 3.9430	—	
Exercised	—		—		—		—	
Cancelled	—		—		—		—	
December 31, 2003 (unaudited)	—		125,778	$ 0.91	23,516	$ 3.9430	—	
Granted	—		—		101,205	$ 3.9430	—	
Exercised	—		(125,778)	$ 1.46	—		—	
Cancelled	—		—		—		—	
December 31, 2004	—		—		124,721	$ 3.9430	—	
Granted	170,336	$ 0.46	—		69,744	$ 3.9430	—	
Exercised	—		—		—		—	
Cancelled	—		—		—		—	
December 31, 2005	170,336	$ 0.46	—		194,465	$ 3.9430	—	
Granted	—		—		34,872	$ 3.9430	147,635	$ 8.0926
Exercised	—		—		—		—	
Cancelled	—		—		—		—	
December 31, 2006	170,336	$ 0.46	—		229,337	$ 3.9430	147,635	$ 8.0926
Granted	—		—		—		135,927	$ 8.0926
Exercised	—		—		—		—	
Cancelled	—		—		—		—	
Converted upon close of IPO	512,899	$ 6.24	—		(229,337)	$ 3.9430	(283,562)	$ 8.0926
December 31, 2007	683,235	$ 4.80	—		—		—	

(1) Represents weighted-average exercise price per share.

At December 31, 2007 and 2006, the weighted-average remaining contractual life of outstanding warrants was 4.71 and 5.22 years, respectively. All of the warrants outstanding are currently exercisable.

The aggregate number of common shares that could be issued if all warrants were exercised and converted to common stock at the option of the holder would be 683,235.

See Notes 6 and 7 for discussions relating to the issuance of stock warrants.

(12) Related Party Transactions

The Company shares space with Restore Medical, Inc. (Restore), a related party who has directors and stockholders that are officers of the Company. The Company reimburses Restore for various facility expenses, including property taxes, common area maintenance charges, payroll for the use of personnel, and shipping charges. Beginning in 2005 the Company also reimbursed Restore for rent expense related to the sublease agreement discussed in Note 13. Total expenses recorded were approximately $432,000, $256,000 and $75,000 for the years ended December 31, 2007, 2006 and 2005, respectively, and approximately $831,000 for the period from December 19, 2002 (inception) to December 31, 2007. The majority of expenses are included in general and administrative costs on the consolidated statements of operations. Included in accounts payable and accrued expenses are a total of $27,066 and $66,076 due to Restore as of December 31, 2007 and 2006, respectively.

The Company obtains consulting services from Venturi Development Inc. (VDI), whose stockholders and officers are investors in the Company. The consultants receive cash compensation for services provided. Total expenses recorded, including consulting expenses, were approximately $29,000, $29,000 and $46,000 for the years ended December 31, 2007, 2006 and 2005, respectively, and approximately $2,679,000 for the period from December 19, 2002 (inception) to December 31, 2007. On December 31, 2007 and 2006 the Company had no outstanding payable balance to VDI.

Effective September 21, 2006, the Company entered into a consulting agreement with Bobby I. Griffin, who is a member of the board of directors. The consulting agreement provides for the consultant to receive compensation in the form of an option to purchase common stock for services provided. Pursuant to this consulting agreement, Mr. Griffin received a one-time option grant to purchase 54,946 shares of common stock at $1.91 per share that vested 25% on the first anniversary of the date the consulting agreement was entered into and 1/36th per month each month thereafter for 36 months. The consulting agreement was for one year and does not provide for the forfeiture of any vested or unvested options if after one year Mr. Griffin stops performing services as a consultant. The Company accounted for this transaction under the guidance of Emerging Issues Task Force Abstract No. 96-18, *Accounting for Equity Instruments That Are Issued to Other Than Employees for Acquiring, or in Conjunction with Selling Goods or Services.* Under EITF 96-18, options are recorded at their fair value on the measurement date. The Company remeasured the fair value of the options granted at each reporting period until performance under the consulting agreement was completed and the measurement date was reached. The Company expensed the fair value of the options granted over the requisite service period which was the term of the consulting agreement, or one year. Total expense recorded was approximately $778,000 and $5,000 for the years ended December 31, 2007 and 2006 respectively, and approximately $783,000 for the period from December 19, 2002 (inception) to December 31, 2007. All of the expenses were included in general and administrative costs on the consolidated statements of operations.

(13) Commitments and Contingencies

In September 2005, the Company entered into a three-year noncancelable operating sublease agreement for office/warehouse space with Restore. The lease expires on September 30, 2008 with monthly base rent ranging from $7,518 to $7,676. Effective January 1, 2007, the sublease was amended to include additional square footage. Under the amended sublease agreement, the monthly base rent ranges from $11,476 to $11,596. Rent expense recognized for the years ended December 31, 2007, 2006 and 2005 was $120,256, $127,766 and $22,555, respectively. The Company also reimburses Restore for various facility and personnel related expenses discussed in Note 12. Prior to entering into the sublease agreement with Restore, the Company assumed VDI’s sublease agreement with Integ Inc. (Integ) and paid Integ directly for rent and other facility charges in the amount of $32,370 for the year ended December 31, 2005. Total rent expense recognized for the period from December 19, 2002 (inception) to December 31, 2007 was $382,530. Facility related expenses are included as general and administrative costs on the consolidated statements of operations.

The following is a schedule of total future minimum lease payments due as of December 31, 2007:

Years ending December 31:	
2008	$ 104,364
2009	—
	$ 104,364

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.

In 2005, EnteroMedics entered into an exclusive collaborative obesity device research and development agreement with the Mayo Foundation for Medical Education and Research (Mayo Foundation), Rochester, Minnesota. Through this agreement, EnteroMedics will collaborate with a group of physicians and researchers at Mayo Clinic in the field of obesity. Under the terms of this five-year agreement, EnteroMedics and this group of Mayo specialists will collectively work toward the development of new and innovative medical devices for the treatment of obesity. The agreement also includes a similar collaboration for the development of products to address a wide variety of disorders susceptible to treatment by electrically blocking neural impulses on the vagus nerve.

Under this agreement, the Company issued 219,780 shares of common stock to the Mayo Foundation in 2005 and recorded $100,000 as deferred compensation, which is being amortized over the term of the five-year agreement. Unamortized deferred compensation related to the agreement was $41,667 and $61,667 at December 31, 2007 and 2006, respectively. In accordance with the agreement, upon the closing of the IPO in November 2007, the Company was also obligated to issue 206,044 shares of common stock as consideration to the Mayo Foundation and recorded a one-time stock-based compensation expense of $1.7 million. The stock-based compensation expense is recorded on the consolidated statements of operations as research and development expense.

The Company may also be obligated to pay the Mayo Foundation, contingent upon the occurrence of certain future events, earned royalty payments, including a minimum annual royalty as defined by the agreement, for the commercial sale of products developed and patented by the Mayo Foundation, jointly patented by the Company and the Mayo Foundation, or a product where the Mayo Foundation provided know-how as defined by the agreement. If no products are patented, the minimum royalty is not due. The Mayo Foundation receives an annual $250,000 retainer fee which commenced in 2005 and continues through January 2009. The annual retainer fee paid to the Mayo Foundation is recorded on the consolidated statements of operations as research and development expense.

In December 2007, EnteroMedics entered into a second research and development agreement with the Mayo Foundation. In accordance with the three year agreement, the Mayo Foundation receives an annual $50,000 retainer fee. The annual retainer fee paid to the Mayo Foundation is recorded on the consolidated statements of operations as research and development expense. The Company may also be obligated to pay the Mayo Foundation, contingent upon the occurrence of certain future events as defined by the agreement, consideration with respect to licensed know-how regarding product development and testing of products and rights to licensed patents, where the Mayo Foundation provided know-how as defined by the agreement.

(14) Retirement Plan

The Company has a 401(k) profit-sharing plan that provides retirement benefits to employees. Eligible employees may contribute a percentage of their annual compensation, subject to Internal Revenue Service limitations. The Company's matching is at the discretion of the Company's board of directors. For the years ended December 31, 2007, 2006 and 2005 and for the period from December 19, 2002 (inception) to December 31, 2007, the Company did not provide any matching of employees' contributions.

(15) Quarterly Data (unaudited)

The following table represents certain unaudited quarterly information for each of the eight quarters in the period ended December 31, 2007. In management's opinion, this information has been prepared on the same basis as the audited financial statements and includes all the adjustments necessary to fairly state the unaudited quarterly results of operations (in thousands, except per share data).

	First Quarter	Second Quarter	Third Quarter	Fourth Quarter
2007:				
Net loss	$(5,398)	$(7,478)	$(6,953)	$(8,746)
Basic and diluted net loss per share	$ (9.16)	$(12.41)	$(11.40)	$ (1.10)
2006:				
Net loss	$(4,580)	$(4,224)	$(3,661)	$(5,225)
Basic and diluted net loss per share	$(10.12)	$ (8.27)	$ (6.69)	$ (9.37)

PART IV.

ITEM 15. *EXHIBITS AND FINANCIAL STATEMENT SCHEDULES*

(a) *Financial Statements and Schedules:* Financial Statements for the three years ended December 31, 2007 are included in Part II, Item 8. All schedules are omitted because they are not applicable or the required information is shown in the financial statements or notes thereto.

(b) *Exhibits:* The list of exhibits on the Exhibit Index on page 33 of this report is incorporated herein by reference.

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

By: /S/ GREG S. LEA
Greg S. Lea
Senior Vice President and Chief Financial Officer

Dated: November 20, 2008

EXHIBIT INDEX

Exhibit Number	Description of Document
3.1	Amended and Restated Certificate of Incorporation of the Company, as currently in effect. (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	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	Licensing Agreement, by and between Mayo Foundation for Medical Education and Research and the Company, dated February 3, 2005. (Incorporated herein by reference to Exhibit 10.1 to Amendment No. 2 to the Company’s Registration Statement on Form S-1 filed on August 14, 2007 (File No. 333-143265)).
10.2	Supply Agreement, by and between Atrotech OY and the Company, dated September 11, 2006. (Incorporated herein by reference to Exhibit 10.2 to the Company’s Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).
10.3	Loan and Security Agreement, dated December 1, 2004, between the Company and Venture Lending and Leasing IV, Inc. (Incorporated herein by reference to Exhibit 10.3 to the Company’s Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).
10.4	Supplement to the Loan and Security Agreement, dated December 1, 2004, between the Company and Venture Lending and Leasing IV, Inc. (Incorporated herein by reference to Exhibit 10.4 to the Company’s Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).
10.5	Amendment No. 1, dated as of September 29, 2005, to Supplement to the Loan and Security Agreement, dated December 1, 2004, between the Company and Venture Lending and Leasing IV, Inc. (Incorporated herein by reference to Exhibit 10.5 to the Company’s Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).
10.6	Loan and Security Agreement, dated as of May 17, 2007, between the Company, Venture Lending and Leasing IV, Inc. and Venture Lending and Leasing V, Inc. (Incorporated herein by reference to Exhibit 10.6 to the Company’s Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).
10.7	Supplement to the Loan and Security Agreement, dated as of May 17, 2007, between the Company, Venture Lending and Leasing IV, Inc. and Venture Lending and Leasing V, Inc. (Incorporated herein by reference to Exhibit 10.7 to the Company’s Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).
10.7A	Amendment No. 1 to Supplement to Loan and Security Agreement dated August 28, 2007 between the Company, Venture Lending and Leasing IV, Inc. and Venture Lending and Leasing V, Inc. (Incorporated herein by reference to Exhibit 10.7A to Amendment No. 3 to the Company’s Registration Statement on Form S-1 filed on September 11, 2007 (File No. 333-143265)).
10.8†	Executive Employment Agreement, dated June 22, 2005, by and between the Company and Mark B. Knudson. (Incorporated herein by reference to Exhibit 10.8 to the Company’s Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).
10.9†	Executive Employment, dated May 21, 2007, by and between the Company and Greg Lea. (Incorporated herein by reference to Exhibit 10.9 to the Company’s Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).

Exhibit Number	Description of Document
10.10†	Executive Employment Agreement, dated February 9, 2007, by and between the Company and Adrianus Donders. (Incorporated herein by reference to Exhibit 10.10 to the Company’s Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).
10.11†	Executive Employment Agreement, dated May 16, 2007, by and between the Company and Russell Felkey. (Incorporated herein by reference to Exhibit 10.11 to the Company’s Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).
10.12†	2003 Stock Incentive Plan. (Incorporated herein by reference to Exhibit 10.12 to the Company’s Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).
10.13†	Standard form of Incentive Stock Option Agreement pursuant to the 2003 Stock Incentive Plan. (Incorporated herein by reference to Exhibit 10.13 to the Company’s Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).
10.14†	Standard form of Non-Incentive Stock Option Agreement pursuant to the 2003 Stock Incentive Plan. (Incorporated herein by reference to Exhibit 10.12 to the Company’s Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).
10.15†	Standard form of Restricted Stock Agreement. (Incorporated herein by reference to Exhibit 10.15 to the Company’s Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).
10.16†	Management Incentive Plan (Incorporated herein by reference to Exhibit 10.1 to the Company’s Current Report on Form 8-K filed on February 12, 2007 (File No. 1-33818)).
10.17	Form of Indemnification Agreement entered into by and between the Company and each of its executive officers and directors. (Incorporated herein by reference to Exhibit 10.17 to Amendment No. 1 to the Company’s Registration Statement on Form S-1 filed on July 6, 2007 (File No. 333-143265)).
10.18	Consulting Agreement, dated April 23, 2004, by and between the Registrant and Donald C. Harrison. (Incorporated herein by reference to Exhibit 10.18 to Amendment No. 1 to the Company’s Registration Statement on Form S-1 filed on July 6, 2007 (File No. 333-143265)).
10.19	Consulting Agreement, dated September 21, 2006, by and between the Registrant and Bobby I. Griffin. (Incorporated herein by reference to Exhibit 10.19 to Amendment No. 1 to the Company’s Registration Statement on Form S-1 filed on July 6, 2007 (File No. 333-143265)).
14.1	Code of Conduct and Ethics of the Company Standard form of Restricted Stock Agreement. (Incorporated herein by reference to Exhibit 14.1 to the Company’s Registration Statement on Form S-1 filed on May 25, 2007 (File No. 333-143265)).
23.1	Consent of Deloitte & Touche LLP, Independent Registered Public Accounting Firm.
24.1	Power of Attorney (Incorporated herein by reference to the Company’s Form 10-K filed on March 13, 2008).
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 Executive Officer pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.

† Indicates management contract or compensation plan or agreement.

EXHIBIT 23.1

CONSENT OF INDEPENDENT REGISTERED PUBLIC ACCOUNTING FIRM

We consent to the incorporation by reference in Registration Statement No. 333-149662 on Form S-8 of our report dated March 7, 2008 (which report expresses an unqualified opinion and includes an explanatory paragraph relating to the January 1, 2006 adoption of the provisions of Financial Accounting Standards Board Statement No. 123(R), *Share-Based Payment*), relating to the consolidated financial statements of EnteroMedics Inc. and subsidiary (the "Company") appearing in this Amendment #1 on Form 10-K/A of the Company for the year ended December 31, 2007.

/S/ DELOITTE & TOUCHE LLP

Minneapolis, MN
November 20, 2008

EXHIBIT 31.1

CERTIFICATIONS

I, Mark B. Knudson, certify that:

1. I have reviewed this Amendment #1 on Form 10-K/A 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. The registrant's other certifying officer(s) 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)) 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) 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

c) 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

4. The registrant's other certifying officer(s) 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: November 20, 2008

EXHIBIT 31.2

CERTIFICATIONS

I, Greg S. Lea, certify that:

1. I have reviewed this Amendment #1 on Form 10-K/A 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. The registrant's other certifying officer(s) 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)) 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) 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

c) 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

4. The registrant's other certifying officer(s) 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: November 20, 2008

EXHIBIT 32.1

**CERTIFICATION PURSUANT TO
18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the Amendment #1 on Form 10-K/A of EnteroMedics Inc. (the "Company") for the period ended December 31, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Mark B. Knudson, Chief Executive Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

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

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

November 20, 2008

EXHIBIT 32.2

CERTIFICATION PURSUANT TO
18 U.S.C. §1350,
AS ADOPTED PURSUANT TO
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002

In connection with the Amendment #1 on Form 10-K/A of EnteroMedics Inc. (the "Company") for the period ended December 31, 2007 as filed with the Securities and Exchange Commission on the date hereof (the "Report"), I, Greg S. Lea, Chief Financial Officer of the Company, certify, pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that:

1. The Report fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934; and

2. The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

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

November 20, 2008