

INSULET CORP  
Form 10-Q  
November 03, 2017  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

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Form 10-Q

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QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF  
<sup>x</sup> 1934

For the quarterly period ended September 30, 2017

OR

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

Commission File Number 001-33462

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INSULET CORPORATION  
(Exact name of Registrant as specified in its charter)

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|   |   |
|---|---|
| Delaware<br>(State or Other Jurisdiction of<br>Incorporation or Organization) | 04-3523891<br>(I.R.S. Employer<br>Identification No.) |
|---|---|

|  |                     |
|--|---------------------|
| 600 Technology Park Drive, Suite 200<br>Billerica, Massachusetts<br>(Address of Principal Executive Offices) | 01821<br>(Zip Code) |
|--|---------------------|

Registrant's Telephone Number, Including Area Code: (978) 600-7000

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

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

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

Large accelerated filer  Accelerated filer

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

Emerging growth company

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act.

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

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As of November 1, 2017, the registrant had 58,187,756 shares of common stock outstanding.

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INSULET CORPORATION  
QUARTERLY REPORT ON FORM 10-Q FOR THE PERIOD ENDED  
September 30, 2017  
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## PART I - FINANCIAL INFORMATION

## Item 1. Consolidated Financial Statements (Unaudited)

## INSULET CORPORATION

## CONSOLIDATED BALANCE SHEETS

| (in thousands, except share and per share data)   | September 30,<br>2017 | December 31,<br>2016 |
|---|-----------------------|----------------------|
|   | (Unaudited)           |                      |
| <b>ASSETS</b>   |                       |                      |
| Current Assets  |                       |                      |
| Cash and cash equivalents   | \$ 102,233            | \$ 137,174           |
| Short-term investments  | 173,523               | 161,396              |
| Accounts receivable, net  | 47,173                | 28,803               |
| Inventories, net  | 35,054                | 35,514               |
| Prepaid expenses and other current assets   | 8,037                 | 7,073                |
| Total current assets  | 366,020               | 369,960              |
| Property and equipment, net   | 88,491                | 44,753               |
| Other intangible assets, net  | 4,369                 | 2,041                |
| Goodwill  | 39,854                | 39,677               |
| Other assets  | 1,614                 | 216                  |
| Total assets  | \$ 500,348            | \$ 456,647           |
| <b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>   |                       |                      |
| Current Liabilities   |                       |                      |
| Accounts payable  | \$ 28,648             | \$ 13,160            |
| Accrued expenses and other current liabilities  | 44,897                | 41,228               |
| Deferred revenue  | 1,395                 | 1,309                |
| Total current liabilities   | 74,940                | 55,697               |
| Long-term debt, net of discount   | 344,953               | 332,768              |
| Other long-term liabilities   | 6,201                 | 5,032                |
| Total liabilities   | 426,094               | 393,497              |
| Commitments and contingencies (Note 12)   |                       |                      |
| Stockholders' Equity  |                       |                      |
| Preferred stock, \$.001 par value:  |                       |                      |
| Authorized: 5,000,000 shares at September 30, 2017 and December 31, 2016.   | —                     | —                    |
| Issued and outstanding: zero shares at September 30, 2017 and December 31, 2016.                                    |                       |                      |
| Common stock, \$.001 par value:   |                       |                      |
| Authorized: 100,000,000 shares at September 30, 2017 and December 31, 2016.   |                       |                      |
| Issued and outstanding: 58,156,128 and 57,457,967 shares at September 30, 2017 and December 31, 2016, respectively. | 58                    | 57                   |
| Additional paid-in capital  | 774,714               | 744,243              |
| Accumulated other comprehensive loss  | (123                  | ) (726               |
| Accumulated deficit   | (700,395              | ) (680,424           |
| Total stockholders' equity  | 74,254                | 63,150               |
| Total liabilities and stockholders' equity  | \$ 500,348            | \$ 456,647           |

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

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CONSOLIDATED STATEMENTS OF OPERATIONS  
(UNAUDITED)

| (in thousands, except per share data)  | Three Months Ended    |            | Nine Months Ended     |             |
|--|-----------------------|------------|-----------------------|-------------|
|  | September 30,<br>2017 | 2016       | September 30,<br>2017 | 2016        |
| Revenue  | \$121,775             | \$94,871   | \$333,244             | \$263,414   |
| Cost of revenue  | 48,151                | 39,230     | 135,583               | 113,265     |
| Gross profit   | 73,624                | 55,641     | 197,661               | 150,149     |
| Operating expenses:  |                       |            |                       |             |
| Research and development   | 20,141                | 13,734     | 55,670                | 39,676      |
| Sales and marketing  | 28,718                | 22,147     | 86,288                | 69,119      |
| General and administrative   | 22,718                | 17,342     | 62,322                | 47,923      |
| Total operating expenses   | 71,577                | 53,223     | 204,280               | 156,718     |
| Operating income (loss)  | 2,047                 | 2,418      | (6,619 )              | (6,569 )    |
| Interest expense   | 4,709                 | 3,029      | 14,512                | 9,252       |
| Other income (expense), net  | 556                   | 211        | 1,478                 | 510         |
| Loss on extinguishment of long-term debt   | —                     | 2,551      | —                     | 2,551       |
| Interest expense and other income, net   | 4,153                 | 5,369      | 13,034                | 11,293      |
| Loss from continuing operations before income taxes  | (2,106 )              | (2,951 )   | (19,653 )             | (17,862 )   |
| Income tax expense   | 121                   | 66         | 318                   | 195         |
| Net loss from continuing operations  | (2,227 )              | (3,017 )   | (19,971 )             | (18,057 )   |
| Loss from discontinued operations, net of tax (\$0 for each of the three months ended September 30, 2017 and 2016 and \$0 and \$408 for the nine months ended September 30, 2017 and 2016, respectively) | —                     | (64 )      | —                     | (1,703 )    |
| Net loss   | \$(2,227 )            | \$(3,081 ) | \$(19,971 )           | \$(19,760 ) |
| Net loss per share basic and diluted:  |                       |            |                       |             |
| Net loss from continuing operations per share  | \$(0.04 )             | \$(0.05 )  | \$(0.34 )             | \$(0.32 )   |
| Net loss from discontinued operations per share  | \$—                   | \$—        | \$—                   | \$(0.03 )   |
| Weighted-average number of shares used in calculating net loss per share   | 58,100                | 57,341     | 57,925                | 57,189      |

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

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CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS  
(UNAUDITED)

| (in thousands)   | Three Months<br>Ended September<br>30, |           | Nine Months Ended<br>September 30, |            |
|--|--|-----------|------------------------------------|------------|
|  | 2017                                   | 2016      | 2017                               | 2016       |
| Net loss   | \$(2,227)                              | \$(3,081) | \$(19,971)                         | \$(19,760) |
| Other comprehensive income, net of tax                                     |  |           |                                    |            |
| Foreign currency translation adjustment, net of tax                        | 329                                    | (102 )    | 594                                | 302        |
| Unrealized gain (loss) income on available-for-sale securities, net of tax | 76                                     | (43 )     | 9                                  | (35 )      |
| Total other comprehensive income (loss), net of tax                        | 405                                    | (145 )    | 603                                | 267        |
| Total comprehensive loss   | \$(1,822)                              | \$(3,226) | \$(19,368)                         | \$(19,493) |

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

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INSULET CORPORATION  
CONSOLIDATED STATEMENTS OF CASH FLOWS  
(UNAUDITED)

| (in thousands)   | Nine Months Ended     |             |
|--|-----------------------|-------------|
|  | September 30,<br>2017 | 2016        |
| Cash flows from operating activities   |                       |             |
| Net loss   | \$(19,971 )           | \$(19,760 ) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities |                       |             |
| Depreciation and amortization  | 10,533                | 10,474      |
| Non-cash interest and other expense  | 12,185                | 6,117       |
| Stock-based compensation expense   | 23,551                | 16,850      |
| Loss on extinguishment of long-term debt   | —                     | 2,551       |
| Provision for bad debts  | 1,502                 | 1,889       |
| Other  | 519                   | 139         |
| Changes in operating assets and liabilities:   |                       |             |
| Accounts receivable  | (19,757 )             | 2,994       |
| Inventories  | 428                   | (21,287 )   |
| Prepaid expenses and other assets  | (1,290 )              | (3,268 )    |
| Accounts payable, accrued expenses and other current liabilities                         | 10,502                | (632 )      |
| Deferred revenue   | 537                   | (982 )      |
| Other long-term liabilities  | 668                   | 756         |
| Net cash provided by (used in) operating activities <sup>(1)</sup>                       | 19,407                | (4,159 )    |
| Cash flows from investing activities   |                       |             |
| Purchases of property, equipment and software <sup>(2)</sup>                             | (47,813 )             | (19,205 )   |
| Purchases of investments   | (115,056 )            | (76,241 )   |
| Receipts from the maturity or sale of investments  | 101,384               | 8,905       |
| Proceeds from divestiture of business, net   | —                     | 5,714       |
| Net cash used in investing activities  | (61,485 )             | (80,827 )   |
| Cash flows from financing activities   |                       |             |
| Principal payments of capital lease obligations  | (269 )                | (4,727 )    |
| Proceeds from issuance of convertible notes, net of issuance costs                       | —                     | 333,904     |
| Repayment of convertible notes   | —                     | (153,628 )  |
| Proceeds from exercise of stock options and issuance of common stock                     | 10,735                | 4,848       |
| Payment of withholding taxes in connection with vesting of restricted stock units        | (3,816 )              | (2,839 )    |
| Net cash provided by financing activities  | 6,650                 | 177,558     |
| Effect of exchange rate changes on cash  | 487                   | 158         |
| Net (decrease) increase in cash and cash equivalents                                     | (34,941 )             | 92,730      |
| Cash and cash equivalents, beginning of period   | 137,174               | 122,672     |
| Cash and cash equivalents, end of period   | \$102,233             | \$215,402   |

<sup>(1)</sup> 2016 includes activity related to discontinued operations. See Note 3 to the consolidated financial statements for discussion of discontinued operations.

<sup>(2)</sup> Cash outflows from purchases of property, equipment and software for the nine months ended September 30, 2017 includes \$2.0 million of purchases made in prior periods that were included in accounts payable and accrued expenses as of December 31, 2016 and excludes \$10.7 million of purchases made during the nine months ended September 30, 2017 that were included in accounts payable and accrued expenses as of September 30, 2017.

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





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INSULET CORPORATION  
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS  
(UNAUDITED)

Note 1. Nature of the Business

Insulet Corporation, the "Company," is primarily engaged in the development, manufacturing and sale of its proprietary Omnipod Insulin Management System ("Omnipod System"), an innovative, discreet and easy-to-use continuous insulin delivery system for people with insulin-dependent diabetes. The Omnipod System features a small, lightweight, self-adhesive disposable tubeless Omnipod device which is worn on the body for approximately three days at a time and its wireless companion, the handheld Personal Diabetes Manager ("PDM"). Conventional insulin pumps require people with insulin-dependent diabetes to learn to use, manage and wear a number of cumbersome components, including up to 42 inches of tubing. In contrast, the Omnipod System features only two discreet, easy-to-use devices that eliminate the need for a bulky pump, tubing and separate blood glucose meter, provides for virtually pain-free automated cannula insertion, communicates wirelessly and integrates a blood glucose meter. The Company believes that the Omnipod System's unique proprietary design and features allow people with insulin-dependent diabetes to manage their diabetes with unprecedented freedom, comfort, convenience, and ease. Commercial sales of the Omnipod System began in the United States in 2005. The Company sells the Omnipod System in the United States through direct sales to customers or through its distribution partners. The Omnipod System is currently available in multiple countries in Europe, as well as in Canada and Israel.

The Company announced on July 20, 2017 its plans to assume, on July 1, 2018, the distribution, sales, marketing, training and support activities of its Omnipod System across Europe following the expiration of its global distribution agreement with Ypsomed Distribution AG ("Ypsomed") on June 30, 2018. Until the expiration of the agreement, Ypsomed will remain the distributor of the Company's Omnipod products in Europe. The Company will be required to pay to Ypsomed a per unit fee for direct sales over the 12 month period following the expiration of the global distribution agreement of its Omnipod device to former customers of Ypsomed, as defined in the distribution agreement. The Company will recognize a liability for this fee as it sells its Omnipod device to these customers during the twelve-month period beginning July 1, 2018.

In addition to using the Omnipod System for insulin delivery, the Company also partners with global pharmaceutical and biotechnology companies to tailor the Omnipod System technology platform for the delivery of subcutaneous drugs across multiple therapeutic areas.

The Company acquired Neighborhood Holdings, Inc. and its wholly-owned subsidiaries (collectively, "Neighborhood Diabetes") in June 2011. Through Neighborhood Diabetes, the Company provided customers with blood glucose testing supplies, traditional insulin pumps, pump supplies and pharmaceuticals and had the ability to process claims as either durable medical equipment or through pharmacy benefits. In February 2016, the Company sold Neighborhood Diabetes to Liberty Medical LLC ("Liberty Medical"). Additional information regarding the disposition and treatment of the Neighborhood Diabetes business as discontinued operations is provided in Note 3 to these consolidated financial statements.

Note 2. Basis of Presentation and Summary of Significant Accounting Policies

Basis of Presentation

The unaudited consolidated financial statements in this Quarterly Report on Form 10-Q have been prepared in accordance with generally accepted accounting principles ("U.S. GAAP" or "GAAP") for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, these unaudited consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. Operating results for the three and nine months ended September 30, 2017 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2017, or for any other subsequent interim period.

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The unaudited consolidated financial statements in this Quarterly Report on Form 10-Q should be read in conjunction with the Company's consolidated financial statements and notes thereto contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2016.

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### Reclassification of Prior Period Balances

Certain reclassifications have been made to prior period amounts to conform to the current period financial statement presentation including the reclassification of capitalized internal-use software costs from property and equipment to other intangible assets for the year ended December 31, 2016 upon adoption of Accounting Standards Update ("ASU") 2016-19, Technical Corrections and Improvements.

### Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions in the application of certain of its significant accounting policies that may materially affect the reported amounts of assets, liabilities, equity, revenue and expenses. The most significant estimates used in these financial statements include the valuation of stock-based compensation expense; the fair value of intangible assets acquired in businesses combinations; the valuation of inventory; the fair value of reporting units used to calculate the potential impairment of goodwill; the valuation of deferred revenue; the calculation of gains and losses, if any, on the retirement or conversion of convertible debt; the estimated useful lives of property and equipment and intangible assets; the amount of internal use software development costs that qualify for capitalization; the estimated amount, if any, of accrued contingent liabilities as well as warranty and doubtful accounts allowance reserve calculations. Actual results may differ from those estimates.

### Principles of Consolidation

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

### Foreign Currency Translation

For foreign operations, asset and liability accounts are translated at exchange rates as of the balance sheet date; income and expenses are translated using weighted average exchange rates for the reporting period. Resulting translation adjustments are reported in accumulated other comprehensive loss, a separate component of stockholders' equity. Gains and losses arising from transactions and revaluation of period-end balances denominated in currencies other than the local entity's functional currency are included in other income (expense), net, and were not material in the three and nine months ended September 30, 2017 and 2016. Exposure to gains and losses from such transactions and revaluations are primarily related to Canadian dollar exchange rate fluctuations.

### Cash and Cash Equivalents

For the purpose of financial statement classification, the Company considers all highly-liquid investment instruments with original maturities of 90 days or less, when purchased, to be cash equivalents. Cash equivalents include money market mutual funds, corporate bonds and certificates of deposit which are carried at cost which approximates their fair value. Included in the Company's cash and cash equivalents are restricted cash amounts set aside for collateral on an outstanding letter of credit, related to a security deposit for a lease obligation, totaling \$0.5 million as of September 30, 2017 and \$1.2 million as of December 31, 2016.

### Short-term Investments

Short-term investment securities consist of available-for-sale marketable securities and are carried at fair value with unrealized gains or losses included as a component of other comprehensive loss in stockholders' equity. Investments, exclusive of cash equivalents, with a stated maturity date of one year or less from the balance sheet date or that are expected to be used in current operations, are classified as short-term investments. Short-term investments include U.S. government and agency bonds, corporate bonds, and certificates of deposit.

The Company reviews investments for other-than-temporary impairment when the fair value of an investment is less than its amortized cost. If an available-for-sale security is other than temporarily impaired, the loss is charged to earnings.

Property and Equipment

Property and equipment is stated at cost and depreciated using the straight-line method over the estimated useful life of the respective assets. Leasehold improvements are amortized over their useful life or the life of the lease, whichever is shorter. Assets acquired under capital leases are amortized in accordance with the respective class of owned assets and the amortization is included with depreciation expense. Maintenance and repair costs are expensed as incurred. Property and equipment included \$49.0 million and \$39.0 million of accumulated depreciation as of September 30, 2017 and December 31, 2016, respectively.

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### Business Combinations

The Company recognizes the assets and liabilities assumed in business combinations on the basis of their fair values at the date of acquisition. The Company assesses the fair value of assets, including intangible assets, using a variety of methods and each asset is measured at fair value from the perspective of a market participant. The method used to estimate the fair values of intangible assets incorporates significant assumptions regarding the estimates a market participant would make in order to evaluate an asset, including a market participant's use of the asset and the appropriate discount rates for a market participant. Assets recorded from the perspective of a market participant that are determined to not have economic use for the Company are expensed immediately. Any excess purchase price over the fair value of the net tangible and intangible assets acquired is allocated to goodwill. Transaction costs and restructuring costs associated with a business combination are expensed as incurred.

### Segment Reporting

Operating segments are defined as components of an enterprise about which separate financial information is available that is evaluated on a regular basis by the chief operating decision-maker ("CODM") in deciding how to allocate resources to an individual segment and in assessing performance of the segment. The Company has concluded that its Chief Executive Officer is the CODM as he is the ultimate decision maker for key operating decisions, determining the allocation of resources and assessing the financial performance of the Company. These decisions, allocations and assessments are performed by the CODM using consolidated financial information. Consolidated financial information is utilized by the CODM as the Company's current product offering primarily consists of drug delivery and the Omnipod System. The Company's products are relatively consistent and manufacturing is centralized and consistent across product offerings. Based on these factors, key operating decisions and resource allocations are made by the CODM using consolidated financial data and as such the Company has concluded that it operates as one segment.

### Goodwill

Goodwill represents the excess of the cost of acquired businesses over the fair value of identifiable net assets acquired. The Company follows the provisions of Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") 350-20, Intangibles - Goodwill and Other ("ASC 350-20"). The Company performs an assessment of its goodwill for impairment on at least an annual basis or whenever events or changes in circumstances indicate there might be impairment. The Company's annual impairment test date is October 1st.

As the Company operates in one segment, the Company has considered whether that segment contains multiple reporting units. The Company has concluded that there is a single reporting unit as the Company does not have segment managers and discrete financial information below consolidated results is not reviewed on a regular basis. Based on this conclusion, goodwill is tested for impairment at the enterprise level. The Company has the option to first assess the qualitative factors to determine whether it is more likely than not that the fair value of its sole reporting unit is less than its carrying amount. This qualitative analysis is used as a basis for determining whether it is necessary to perform the two-step goodwill impairment analysis. If the Company determines that it is more likely than not that its fair value is less than its carrying amount, then the two-step goodwill impairment test will be performed. The first step compares the carrying value of the reporting unit to its fair value using either a market approach or a discounted cash flow analysis. If the carrying value of the reporting unit, including goodwill, exceeds its fair value, the Company will record an impairment loss to the extent that the reporting unit's carrying value exceeds its implied fair value as determined in step two of the impairment test. There was no impairment of goodwill during the three and nine months ended September 30, 2017 and 2016.

### Revenue Recognition

The Company generates the majority of its revenue from sales of its Omnipod System to customers and third-party distributors who resell the products to patients with diabetes, and to a lesser extent from product sales to pharmaceutical companies who use the Company's technology as a delivery method for their pharmaceuticals.

Revenue recognition requires that persuasive evidence of a sales arrangement exists, delivery of goods occurs through transfer of title and risk and rewards of ownership, the selling price is fixed or determinable and collectibility is reasonably assured. With respect to these criteria:

The evidence of an arrangement generally consists of a physician order form, a patient information form and, if applicable, third-party insurance approval for sales directly to patients or a purchase order for sales to a third-party distributor.

Revenue is recognized when title and risk and rewards of ownership have transferred to the customer.

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The selling prices for all sales are fixed and agreed with the patient or third-party distributor and, if applicable, the patient's third-party insurance provider(s) prior to shipment and are based on established list prices or, in the case of certain third-party insurers, contractually agreed upon prices. Provisions for discounts, rebates and other adjustments to customers are established as a reduction to revenue in the same period the related sales are recorded.

The Company offers a 45-day right of return for sales of its Omnipod System in the United States, and a 90-day right of return for sales of its Omnipod System in Canada to new patients and defers revenue to reflect estimated sales returns in the same period that the related product sales are recorded. Returns are estimated through a comparison of the Company's historical return data to its related sales. Historical rates of return are adjusted for known or expected changes in the marketplace when appropriate. When doubt exists about reasonable assuredness of collectibility from specific customers, the Company defers revenue from sales of products to those customers until payment is received. As of September 30, 2017 and December 31, 2016, the Company had deferred revenue of \$2.6 million and \$1.9 million, respectively, which included \$1.2 million and \$0.6 million classified in other long-term liabilities as of September 30, 2017 and December 31, 2016, respectively. Deferred revenue primarily relates to undelivered elements within certain of the Company's developmental arrangements and other instances where the Company has not yet met the revenue recognition criteria.

**Collaborative Arrangements**

The Company enters into collaborative arrangements for ongoing initiatives to develop products. Although the Company does not consider any individual alliance to be material, certain of the more notable alliances are described below.

**Eli Lilly and Company and Concentrated Insulins:** In May 2013 and January 2016, the Company entered into agreements with Eli Lilly and Company to develop new versions of the Omnipod tubeless insulin delivery system specifically designed to deliver a concentrated form of insulin used by higher insulin-requiring patients with diabetes. Under the terms of these arrangements, the parties share the responsibility of the permissible costs that are incurred. Consideration received and payments made by the Company under the terms of the arrangements are recorded within research and development expense.

**Shipping and Handling Costs**

The Company does not typically charge its customers for shipping and handling costs associated with shipping its product to its customers unless non-standard shipping and handling services are requested. These shipping and handling costs are included in general and administrative expenses and were \$1.3 million and \$1.1 million for the three months ended September 30, 2017 and 2016, respectively, and were \$3.5 million and \$2.8 million for the nine months ended September 30, 2017 and 2016, respectively.

**Concentration of Credit Risk**

Financial instruments that subject the Company to credit risk primarily consist of cash and cash equivalents, short-term investments and accounts receivable. The Company maintains the majority of its cash and short-term investments with one financial institution. Accounts are partially insured up to various amounts mandated by the Federal Deposit Insurance Corporation or by the foreign country where the account is held.

The Company purchases Omnipod Systems from Flex Ltd., its single source contract manufacturer. As of each of September 30, 2017 and December 31, 2016, liabilities to this vendor represented approximately 21% and 16%, respectively, of the combined balance of accounts payable, accrued expenses and other current liabilities.

Revenue for customers comprising more than 10% of total revenue were as follows:

|           |           |      |      |
|-----------|-----------|------|------|
| Three     | Nine      |      |      |
| Months    | Months    |      |      |
| Ended     | Ended     |      |      |
| September | September |      |      |
| 30,       | 30,       |      |      |
| 2017      | 2016      | 2017 | 2016 |

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|                       |     |     |     |     |
|-----------------------|-----|-----|-----|-----|
| Amgen, Inc.           | 16% | 17% | 16% | 17% |
| Ypsomed               | 23% | 16% | 21% | 15% |
| RGH Enterprises, Inc. | 11% | 10% | 10% | 10% |

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## Other Significant Policies:

The following table identifies the Company's other significant accounting policies and the note and page where a detailed description of each policy can be found.

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| <u>Fair Value Measurements</u>  | Note 4 Page 14  |
| Convertible Debt  | Note 6 Page 16  |
| <u>Accounts Receivable and Allowance for Doubtful Accounts</u>          | Note 8 Page 18  |
| <u>Inventories</u>  | Note 9 Page 19  |
| Other Intangible Assets   | Note 10 Page 19 |
| Accrued Expenses and Other Current Liabilities - Product Warranty Costs | Note 11 Page 20 |
| Commitments and Contingencies   | Note 12 Page 21 |
| Equity: <u>Stock-Based Compensation</u>                                 | Note 13 Page 22 |
| <u>Income Taxes</u>   | Note 14 Page 25 |

## Recently Adopted Accounting Standards:

In December 2016, the FASB issued ASU 2016-19, Technical Corrections and Improvements ("ASU 2016-19"). ASU 2016-19 includes numerous technical corrections and clarifications to GAAP that are designed to remove inconsistencies in the board's accounting guidance. Several provisions in this accounting guidance were effective immediately and did not have an impact on the Company's consolidated financial statements. Additional provisions in this accounting guidance are effective for the Company in the current fiscal year, including the clarification that the license of internal-use software shall be accounted for as the acquisition of an intangible asset. The standard allows for prospective or retrospective adoption and the Company has elected retrospective adoption. As a result of adoption, the Company reclassified \$4.1 million of gross internal-use software costs, net of accumulated amortization of \$2.6 million, from property and equipment to other intangible assets as of December 31, 2016.

In July 2015, the FASB issued ASU 2015-11, Simplifying the Measurement of Inventory ("ASU 2015-11"). ASU 2015-11 amends existing guidance and requires entities to measure most inventory at the lower of cost and net realizable value. The guidance is effective prospectively for annual reporting periods beginning after December 15, 2016. Early adoption is permitted. Upon adoption, entities must disclose the nature of and reason for the accounting change. The Company adopted ASU 2015-11 on January 1, 2017 and its adoption did not have a material impact on the consolidated financial statements.

The Company adopted ASU 2016-09, Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09") on January 1, 2017 using the modified retrospective method. ASU 2016-09 simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The adoption of ASU 2016-09 resulted in the Company increasing its deferred tax assets (tax effected) by approximately \$23.8 million, which is offset by a full valuation allowance. Overall, adoption of the standard did not have a material impact on the Company's consolidated financial statements.

The Company adopted ASU 2016-18, Restricted Cash (a consensus of the Emerging Issues Task Force) ("ASU 2016-18") as of January 1, 2017 using the retrospective transition method. ASU 2016-18 requires the statement of cash flows to show the changes in the total of cash, cash equivalents, and restricted cash. As the Company includes restricted cash within cash and cash equivalents on the consolidated balance sheet and discloses the carrying value of

restricted cash in the notes to the consolidated financial statements, there was no impact on the statement of cash flows upon the adoption of ASU 2016-18.

Accounting Standards Issued and Not Yet Adopted:

In May 2014, the FASB issued ASU 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"). ASU 2014-09 and its related amendments (collectively known as ASC 606) requires that an entity recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. Under this guidance, an entity makes additional estimates regarding performance conditions and the allocation of variable consideration and must evaluate whether revenue derived from a

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contract should be recognized at a point in time or over time. The guidance is effective in fiscal years beginning January 1, 2018, with early adoption permitted. The Company plans to adopt the standard as of the required effective date using the modified retrospective method. Under this method, the new guidance is applied to contracts that are not yet completed as of the date of adoption with the cumulative effect of initially applying the guidance recognized through accumulated deficit at the date of initial application.

The Company continues to evaluate the potential impact of ASC 606 on its consolidated financial statements and related disclosures. As part of the Company's assessment work to date, the Company has formed an implementation work team, completed training on the ASC 606 revenue recognition model and is continuing to review and finalize its conclusions relative to its contracts with customers. For the remainder of 2017, the Company plans to finalize its evaluation and implement any required policy, process, and internal control changes required as a result of that evaluation.

While the Company continues to assess all potential impacts of the new standard on its consolidated financial statements, the Company currently expects that the adoption of ASC 606 will accelerate the timing of revenue recognition relative to a portion of its drug delivery product line whereby revenue will be recognized as the product is produced pursuant to the customer's firm purchase commitments (as opposed to at a point in time when the product is shipped to the customer) as the Company has an enforceable right to payment for performance completed to date and the inventory has no alternative use. Upon the adoption of ASC 606 using the modified retrospective method on January 1, 2018, the Company expects to record an adjustment to accumulated deficit for the amount that would have been recognized in 2017 under the new guidance and would not have been recognized until shipment of the product in 2018 under the current guidance. In addition to the aforementioned impact on drug delivery revenue, the adoption of ASC 606 will impact the treatment of contract acquisition costs such as commissions, which will be capitalized and amortized over the expected period of benefit. Upon adoption, the Company expects to increase its current and other assets for the net value of commissions paid prior to adoption less amortization to date. The new standard will also require an enhanced level of disclosures in the Company's quarterly and annual consolidated financial statements. In January 2016, the FASB issued ASU 2016-01 ("ASU 2016-01"), Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 changes the current GAAP model for the accounting of equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. All equity investments in unconsolidated entities (other than those accounted for using the equity method of accounting) will generally be measured at fair value through earnings. There will no longer be an available-for-sale classification (changes in fair value reported in other comprehensive income (loss)) for equity securities with readily determinable fair values. In addition, the FASB clarified guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. The classification and measurement guidance will be effective in fiscal years beginning after December 15, 2017, and interim periods within those years. While the Company is continuing to evaluate the potential impact of ASU 2016-01, the Company anticipates that the new guidance may create some volatility in earnings related to changes in fair value of its short term marketable securities. The Company does not expect the adoption of ASU 2016-01 to have a material impact on its consolidated financial statements.

In February 2016, the FASB issued ASU 2016-02, Leases ("ASU 2016-02"). ASU 2016-02 requires lessees to recognize the assets and liabilities on their balance sheet for the rights and obligations created by most leases and continue to recognize expenses on their income statements over the lease term. It will also require disclosures designed to give financial statement users information on the amount, timing, and uncertainty of cash flows arising from leases. The guidance is effective for annual reporting periods beginning after December 15, 2018, and interim periods within those years. Early adoption is permitted for all entities. While the Company is currently evaluating the impact of ASU 2016-02, the Company currently expects that the new guidance will require an increase in the Company's long-lived assets and a corresponding increase to long-term obligations associated with leased office and warehouse space.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force) ("ASU 2016-15"). ASU 2016-15 clarifies how entities should classify certain cash receipts and cash payments on the statement of cash flows. The

guidance also clarifies how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. The guidance is effective for annual reporting periods beginning after December 15, 2017, and interim periods within those years. Early adoption is permitted for all entities. The Company is currently evaluating the impact of ASU 2016-15 but does not expect it to be material to the consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment ("ASU 2017-04"). ASU 2017-04 simplifies the accounting for goodwill impairments by eliminating "Step 2" from the goodwill impairment test,

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which requires an entity to calculate the implied fair value of goodwill to measure a goodwill impairment charge, and alternatively, requires an entity to measure the impairment of goodwill assigned to a reporting unit as the amount by which the carrying value of the assets and liabilities of the reporting unit, including goodwill, exceeds the reporting unit's fair value. The guidance is effective for annual reporting periods beginning after December 15, 2019, and interim periods within those years. Early adoption is permitted for all entities. The Company is currently evaluating the impact of ASU 2017-04 but does not expect it to be material to the consolidated financial statements.

In May 2017, the FASB issued ASU 2017-09, Compensation-Stock Compensation (Topic 718): Scope of Modification Accounting. ("ASU 2017-09"). ASU 2017-09 specifies the types of changes to the terms or conditions of a share-based payment award that require an entity to apply modification accounting in accordance with Topic 718. The new standard is effective for the Company on January 1, 2018 and early adoption is permitted. The Company does not believe that the adoption of ASU 2017-09 will have a material impact on its consolidated financial statements.

In August 2017, the FASB issued ASU 2017-12, Targeted Improvements to Accounting for Hedging Activities. ("ASU 2017-12"). ASU 2017-12 updates the current hedge accounting guidance with the objective of improving the financial reporting of hedging activities by better portraying the economic results of an entity's risk management activities in its financial statements. The new guidance is effective for the Company on January 1, 2019 and early adoption is permitted. The Company is currently evaluating the impact of ASU 2017-12 on its consolidated financial statements.

Note 3. Discontinued Operations

In February 2016, the Company sold Neighborhood Diabetes to Liberty Medical for approximately \$6.2 million in cash, which included \$1.2 million of closing adjustments finalized in June 2016 and paid by Liberty Medical. The results of operations, assets, and liabilities of Neighborhood Diabetes are classified as discontinued operations for all periods presented, except for certain corporate overhead costs which remain in continuing operations.

In connection with the 2016 disposition, the Company entered into a transition services agreement pursuant to which Insulet provided various services to Liberty Medical on an interim transitional basis. The services generally commenced on the closing date and terminated six months following the closing. Services provided by Insulet included certain information technology and back office support. The charges for such services were generally intended to allow the service provider to recover all out-of-pocket costs. Billings by Insulet under the transition services agreement were recorded as a reduction of the costs to provide the respective service in the applicable expense category in the consolidated statements of operations. This transitional support provided Liberty Medical the time required to establish its stand-alone processes for such activities that were previously provided by Insulet as described above and did not constitute significant continuing support of Liberty Medical's operations. Total expenses incurred for such transition services, which were reimbursed in full, were \$0.1 million and \$0.8 million for the three and nine months ended September 30, 2016, respectively. No expenses were incurred for such transition services for the three and nine months ended September 30, 2017.

Following the disposition, the Company entered into a distribution agreement with the Neighborhood Diabetes subsidiary of Liberty Medical to continue to act as a distributor for the Company's products. Omnipod System sales transacted through Neighborhood Diabetes prior to the divestiture that were previously eliminated in consolidation were \$0.0 million and \$0.3 million for the three and nine months ended September 30, 2016, respectively. This amount was historically reported in the Neighborhood Diabetes revenue results and is being presented based on current market terms of products sold to the Neighborhood Diabetes subsidiary of Liberty Medical.

Post divestiture, Omnipod System sales to the Neighborhood Diabetes subsidiary of Liberty Medical were \$0.0 million and \$0.4 million for the three and nine months ended September 30, 2016, respectively. There were no sales of the Omnipod System to this entity in 2017.

The following is a summary of the operating results of Neighborhood Diabetes included in discontinued operations for the three and nine months ended September 30, 2016:



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| (In thousands)   | Three<br>Months<br>Ended<br>September<br>30, 2016 | Nine<br>Months<br>Ended<br>September<br>30, 2016 |
|--|---|--|
| Discontinued operations:   |   |  |
| Revenue <sup>(1)</sup>   | \$ —  | \$ 7,730   |
| Cost of revenue  | 133   | 5,502  |
| Gross profit   | (133 )  | 2,228  |
| Total operating, interest and other (income) expenses <sup>(2)</sup> | (69 )   | 3,523  |
| Loss from discontinued operations before taxes                       | (64 )   | (1,295 )   |
| Income tax expense   | —   | 408  |
| Net loss from discontinued operations                                | \$ (64 )  | \$ (1,703 )                                      |

<sup>(1)</sup> Revenue includes revenue from the operations of Neighborhood Diabetes through date of sale in February 2016.

<sup>(2)</sup> Includes \$1.3 million loss on sale of Neighborhood Diabetes for the nine months ended September 30, 2016.

There were no results from discontinued operations for Neighborhood Diabetes for the three and nine months ended September 30, 2017.

Depreciation and amortization expense included in discontinued operations was \$0.0 million and \$0.1 million for the three and nine months ended September 30, 2016, respectively. There was no depreciation and amortization expense included in discontinued operations for the three and nine months ended September 30, 2017.

Net operating cash flows used in discontinued operations in the nine months ended September 30, 2016 were \$2.0 million. There were no net operating cash flows used in discontinued operations in the nine months ended September 30, 2017.

#### Note 4. Fair Value Measurements

The Company applies ASC 820, Fair Value Measurements and Disclosures (“ASC 820”) related to the fair value measurement of certain of its assets and liabilities. ASC 820 defines fair value as the price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. A single estimate of fair value results from a complex series of judgments about future events and uncertainties and relies heavily on estimates and assumptions. When estimating fair value, depending on the nature and complexity of the asset or liability, the Company may use one or all of the following approaches:

- Market approach, which is based on market prices and other information from market transactions involving identical or comparable assets or liabilities.

- Cost approach, which is based on the cost to acquire or construct comparable assets less an allowance for functional and/or economic obsolescence.

- Income approach, which is based on the present value of the future stream of net cash flows.

To measure fair value, the Company uses the following fair value hierarchy based on three levels of inputs, as described in ASC 820, of which the first two are considered observable and the last unobservable:

Level 1 — quoted prices in active markets for identical assets or liabilities

Level 2 — observable inputs other than quoted prices in active markets for identical assets or liabilities

Level 3 — unobservable inputs in which there is little or no market data available, which require the reporting entity to develop its own assumptions

Certain of the Company’s financial instruments, including cash and cash equivalents, accounts receivable, accounts payable, accrued expenses and other liabilities are carried at cost, which approximates their fair value because of the short-term maturity of these financial instruments.





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The following table provides a summary of assets that are measured at fair value as of September 30, 2017 and December 31, 2016, aggregated by the level in the fair value hierarchy within which those measurements fall:

| (in thousands)                     | Fair Value Measurements |          |           |         |
|------------------------------------|-------------------------|----------|-----------|---------|
|                                    | Total                   | Level 1  | Level 2   | Level 3 |
| September 30, 2017                 |                         |          |           |         |
| Recurring fair value measurements: |                         |          |           |         |
| Cash equivalents:                  |                         |          |           |         |
| Money market mutual funds          | \$45,343                | \$45,343 | \$—       | \$ —    |
| Total cash equivalents             | \$45,343                | \$45,343 | \$—       | \$ —    |
| Short-term investments:            |                         |          |           |         |
| U.S. government and agency bonds   | \$113,294               | \$92,344 | \$20,950  | \$ —    |
| Corporate bonds                    | 47,625                  | —        | 47,625    | —       |
| Certificates of deposit            | 12,604                  | —        | 12,604    | —       |
| Total short-term investments       | \$173,523               | \$92,344 | \$81,179  | \$ —    |
| December 31, 2016                  |                         |          |           |         |
| Recurring fair value measurements: |                         |          |           |         |
| Cash equivalents:                  |                         |          |           |         |
| Money market mutual funds          | \$93,467                | \$93,467 | \$—       | \$ —    |
| Corporate bonds                    | 4,203                   | —        | 4,203     | —       |
| Certificates of deposit            | 735                     | —        | 735       | —       |
| Total cash equivalents             | \$98,405                | \$93,467 | \$4,938   | \$ —    |
| Short-term investments:            |                         |          |           |         |
| U.S. government and agency bonds   | \$79,093                | \$49,963 | \$29,130  | \$ —    |
| Corporate bonds                    | 56,653                  | —        | 56,653    | —       |
| Certificates of deposit            | 25,650                  | —        | 25,650    | —       |
| Total short-term investments       | \$161,396               | \$49,963 | \$111,433 | \$ —    |

**Debt**

The estimated fair value of the Company's convertible debt is based on the Level 2 quoted market prices for the same or similar issues and includes the impact of the conversion features.

The carrying amounts, net of unamortized discounts and issuance costs, and the estimated fair values of the Company's convertible debt as of September 30, 2017 and December 31, 2016 are as follows:

| (in thousands)                 | September 30, 2017 |                      | December 31, 2016 |                      |
|--------------------------------|--------------------|----------------------|-------------------|----------------------|
|                                | Carrying Value     | Estimated Fair Value | Carrying Value    | Estimated Fair Value |
| 2% Convertible Senior Notes    | \$61,849           | \$84,097             | \$59,737          | \$71,909             |
| 1.25% Convertible Senior Notes | \$283,104          | \$391,196            | \$273,031         | \$320,969            |

**Note 5. Short-term Investments**

The Company's short-term investments are classified as available-for-sale and have maturity dates that range from zero months to 12.5 months as of September 30, 2017. The investments are all classified as short-term as they are available for current operations. Amortized costs, gross unrealized holding gains and losses, and fair values at September 30,



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2017 and December 31, 2016 are as follows:

| (in thousands)                   | Amortized<br>cost | Gross<br>Unrealized<br>Gains | Gross<br>Unrealized<br>Losses | Fair<br>Value |
|----------------------------------|-------------------|------------------------------|-------------------------------|---------------|
| September 30, 2017               |                   |                              |                               |               |
| U.S. government and agency bonds | \$ 113,456        | \$ —                         | \$ (162 )                     | \$ 113,294    |
| Corporate bonds                  | 47,660            | 1                            | (37 )                         | 47,624        |
| Certificates of deposit          | 12,605            | —                            | —                             | 12,605        |
| Total short-term investments     | \$ 173,721        | \$ 1                         | \$ (199 )                     | \$ 173,523    |

December 31, 2016

|                                  |            |      |           |            |
|----------------------------------|------------|------|-----------|------------|
| U.S. government and agency bonds | \$ 79,211  | \$ — | \$ (118 ) | \$ 79,093  |
| Corporate bonds                  | 56,742     | —    | (89 )     | 56,653     |
| Certificates of deposit          | 25,650     | —    | —         | 25,650     |
| Total short-term investments     | \$ 161,603 | \$ — | \$ (207 ) | \$ 161,396 |

The Company had no realized gains or losses as of September 30, 2017 or December 31, 2016.

#### Note 6. Convertible Debt

The Company had outstanding convertible debt and related deferred financing costs on its consolidated balance sheet as follows:

| (in thousands)   | As of                 |                      |
|--|-----------------------|----------------------|
|  | September<br>30, 2017 | December<br>31, 2016 |
| Principal amount of the 2% Convertible Senior Notes    | \$67,084              | \$67,084             |
| Principal amount of the 1.25% Convertible Senior Notes | 345,000               | 345,000              |
| Unamortized debt discount                              | (58,994 )             | (69,684 )            |
| Deferred financing costs                               | (8,137 )              | (9,632 )             |
| Long-term debt, net of discount                        | \$344,953             | \$332,768            |

Interest expense related to the convertible notes was as follows:

| (in thousands)                           | Three Months<br>Ended |                       | Nine Months<br>Ended September |                       |
|--|-----------------------|-----------------------|--------------------------------|-----------------------|
|  | September 30,<br>2017 | September 30,<br>2016 | September 30,<br>2017          | September 30,<br>2016 |
| Contractual coupon interest              | \$1,449               | \$1,041               | \$4,276                        | \$3,054               |
| Accretion of debt discount               | 3,612                 | 1,901                 | 10,690                         | 5,330                 |
| Amortization of debt issuance costs      | 505                   | 222                   | 1,495                          | 785                   |
| Loss on extinguishment of long-term debt | —                     | 2,551                 | —                              | 2,551                 |
| Total interest and other expense         | \$5,566               | \$5,715               | \$16,461                       | \$11,720              |

#### 1.25% Convertible Senior Notes

In September 2016, the Company issued and sold \$345.0 million in principal amount of 1.25% Convertible Senior Notes, due September 15, 2021 (the "1.25% Notes"). The interest rate on the notes is 1.25% per annum, payable semi-annually in arrears in cash on March 15 and September 15 of each year. Interest began accruing on September 13, 2016; the first interest payment was paid in March 2017. The 1.25% Notes are convertible into the Company's common stock at an initial conversion rate of 17.1332 shares of common stock per \$1,000 principal amount of the 1.25% Notes, which is equivalent to a conversion price of approximately \$58.37 per share, subject to adjustment under certain circumstances. The 1.25% Notes will be convertible prior to the close of business on the business day immediately preceding June 15, 2021 only under certain circumstances and during certain periods, and will be convertible on or after June 15, 2021 until the close of business on the second scheduled trading day immediately preceding September 15, 2021, regardless of those circumstances.

The Company recorded a debt discount of \$66.7 million related to the 1.25% Notes which results from allocating a portion of the proceeds to the fair value of the conversion feature. The fair value of the debt discount was estimated using a

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trinomial lattice model based on the following inputs: Company's stock price, expected volatility, term to maturity, risk-free interest rate, and dividend yield. The debt discount was recorded as additional paid-in capital and the remaining liability reflects the value of the Company's nonconvertible debt borrowing rate of 5.8% per annum. This debt discount is being amortized as non-cash interest expense over the five year term of the 1.25% Notes. The Company incurred debt issuance costs and other expenses related to this offering of approximately \$11.3 million, of which \$2.2 million has been reclassified as a reduction to the value of the amount allocated to equity. The remainder is presented as a reduction of debt in the consolidated balance sheet, is being amortized using the effective interest method, and is recorded as non-cash interest expense over the five year term of the 1.25% Notes.

The 1.25% Notes contain provisions that allow for additional interest to holders of the notes upon failure to timely file documents or reports that the Company is required to file with the SEC. The additional interest is at a rate of 0.50% per annum of the principal amounts of the notes outstanding for a period of 360 days.

If the Company merges or consolidates with a foreign entity, then additional taxes may be required to be paid by the Company under the terms of the 1.25% Notes.

The Company determined that the higher interest payments required and tax payments required in certain circumstances are considered embedded derivatives and should be bifurcated and accounted for at fair value. The Company assesses the value of the embedded derivatives at each balance sheet date. The derivatives had de minimis value at the balance sheet date.

Cash interest expense related to the 1.25% Notes was \$1.1 million and \$3.3 million in the three and nine months ended September 30, 2017, respectively. Non-cash interest expense related to the 1.25% Notes was comprised of the amortization of the debt discount and debt issuance costs and was \$3.4 million and \$10.1 million in the three and nine months ended September 30, 2017, respectively.

As of September 30, 2017, the Company included \$283.1 million on its balance sheet in long-term debt related to the 1.25% Notes.

**2% Convertible Senior Notes**

In June 2014, the Company issued and sold \$201.3 million in principal amount of 2% Convertible Senior Notes due June 15, 2019 (the "2% Notes"). The interest rate on the notes is 2% per annum, payable semi-annually in arrears in cash on June 15 and December 15 of each year. The 2% Notes are convertible into the Company's common stock at an initial conversion rate of 21.5019 shares of common stock per \$1,000 principal amount of the 2% Notes, which is equivalent to a conversion price of approximately \$46.51 per share, subject to adjustment under certain circumstances. The Company recorded a debt discount of \$35.6 million related to the 2% Notes. The debt discount was recorded as additional paid-in capital to reflect the value of the Company's nonconvertible debt borrowing rate of 6.2% per annum. This debt discount is being amortized as non-cash interest expense over the five year term of the 2% Notes. The Company incurred deferred financing costs related to this offering of approximately \$6.7 million, of which \$1.2 million has been reclassified as an offset to the value of the amount allocated to equity. The remainder is recorded as a reduction to debt in the consolidated balance sheet and is being amortized as non-cash interest expense over the five year term of the 2% Notes.

In September 2016, in connection with the issuance of \$345 million in principal amount of the 1.25% Notes, the Company repurchased approximately \$134.2 million in principal amount of the 2% Notes for \$153.6 million. The extinguishment of the 2% Notes was accounted for separately from the issuance of the 1.25% Notes as both transactions were arm's-length in nature and were not contingent upon one another. The \$153.6 million paid to extinguish the debt was allocated to debt and equity based on their respective fair values immediately prior to the transaction. The fair value of the debt was estimated using a trinomial lattice model based on the following inputs: Company's stock price, expected volatility, term to maturity, risk-free interest rate, and dividend yield. The Company allocated \$121.4 million of the payment to the debt and \$32.9 million to equity.

The Company recorded a loss on extinguishment of debt of \$2.6 million in connection with the repurchase and redemption of the 2% Notes during the year ended December 31, 2016, representing the excess of the \$121.4 million allocated to the debt over its carrying value, net of unamortized debt discount, deferred financing costs and accrued interest.

The 2% Notes contain provisions that allow for additional interest to the holders of the notes upon the failure to timely file documents or reports that the Company is required to file with the SEC. The additional interest is at a rate of 0.25% per annum of the principal amount of the notes outstanding for the first 180 days and 0.50% per annum of the principal amount of the notes outstanding for a period up to 360 days.

If the Company is purchased by a company outside of the U.S., then additional taxes may be required to be paid by the Company under the terms of the 2% Notes.

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The Company determined that the higher interest and tax payments required in certain circumstances are considered embedded derivatives and should be bifurcated and accounted for at fair value. The Company assesses the value of the embedded derivatives at each balance sheet date. The derivatives had de minimis value at the balance sheet date.

Cash interest expense related to the 2% Notes was \$0.3 million and \$0.9 million in the three months ended September 30, 2017 and 2016, respectively. Cash interest expense related to the 2% Notes was \$1.0 million and \$2.9 million in the nine months ended September 30, 2017 and 2016, respectively.

Non-cash interest expense related to the 2% Notes was comprised of the amortization of the debt discount and debt issuance costs and was \$0.7 million and \$1.6 million in the three months ended September 30, 2017 and 2016, respectively. Non-cash interest expense related to the 2% Notes was comprised of the amortization of the debt discount and debt issuance costs and was \$2.1 million and \$5.6 million in the nine months ended September 30, 2017 and 2016, respectively.

As of September 30, 2017, the Company included \$61.8 million on its balance sheet in long-term debt related to the 2% Notes.

## Note 7. Net Loss Per Share

Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding for the period, excluding unvested restricted common shares. Diluted net loss per share is computed using the weighted average number of common shares outstanding and, when dilutive, potential common share equivalents from options, restricted stock units and warrants (using the treasury-stock method), and potential common shares from convertible securities (using the if-converted method). Because the Company reported a net loss for the three and nine months ended September 30, 2017 and 2016, all potential dilutive common shares have been excluded from the computation of the diluted net loss per share for all periods presented, as the effect would have been anti-dilutive.

Potential dilutive common share equivalents consist of the following:

|   | Three and Nine<br>Months Ended<br>September 30, |            |
|---|---|------------|
|   | 2017  | 2016       |
| 2.00% Convertible Senior Notes          | 1,442,433                                       | 1,442,433  |
| 1.25% Convertible Senior Notes          | 5,910,954                                       | 5,910,954  |
| Unvested restricted stock units         | 1,007,729                                       | 971,814    |
| Outstanding options                     | 3,489,393                                       | 3,541,936  |
| Total dilutive common share equivalents | 11,850,509                                      | 11,867,137 |

## Note 8. Accounts Receivable, Net

Accounts receivable consist of amounts due from third-party payors, patients, third-party distributors and government agencies. The Company records an allowance for doubtful accounts at the time potential collection risk is identified.

The Company estimates its allowance based on historical experience, assessment of specific risk, discussions with individual customers or various assumptions and estimates that are believed to be reasonable under the circumstances.

The Company believes the reserve is adequate to mitigate current collection risk.

Customers that represented greater than 10% of gross accounts receivable as of September 30, 2017 and December 31, 2016 were as follows:

|             | As of                    |                      |
|-------------|--------------------------|----------------------|
|             | September<br>30,<br>2017 | December<br>31, 2016 |
| Amgen, Inc. | 13 %                     | 16 %                 |
| Ypsomed     | 28 %                     | 19 %                 |





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The components of accounts receivable are as follows:

| (in thousands)                  | September<br>30, 2017 | December<br>31, 2016 |
|---------------------------------|-----------------------|----------------------|
| Trade receivables               | \$ 50,210             | \$ 31,714            |
| Allowance for doubtful accounts | (3,037 )              | (2,911 )             |
| Total accounts receivable, net  | \$ 47,173             | \$ 28,803            |

## Note 9. Inventories, Net

Inventories are held at the lower of cost or market, determined under the first-in, first-out method, and include the costs of material, labor and overhead. Inventory has been recorded at cost, or net realizable value as appropriate, as of September 30, 2017 and December 31, 2016. The Company reviews inventories for net realizable value based on quantities on hand and expectations of future use. Work in process is calculated based upon a buildup in the stage of completion using estimated labor inputs for each stage in production.

The components of inventories are as follows:

| (in thousands)      | As of<br>September<br>30,<br>2017 | December<br>31, 2016 |
|---------------------|-----------------------------------|----------------------|
| Raw materials       | \$ 2,289                          | \$ 1,911             |
| Work-in-process     | 15,168                            | 15,681               |
| Finished goods, net | 17,597                            | 17,922               |
| Total inventories   | \$ 35,054                         | \$ 35,514            |

## Note 10. Other Intangible Assets, Net

The Company's finite-lived intangible assets are stated at cost less accumulated amortization. The Company assesses its intangible and other long-lived assets for impairment whenever events or changes in circumstances suggest that the carrying value of an asset may not be recoverable. The Company recognizes an impairment loss for intangibles and other finite-lived assets if the carrying amount of a long-lived asset is not recoverable based on its undiscounted future cash flows. Any such impairment loss is measured as the difference between the carrying amount and the fair value of the asset. The estimation of useful lives and expected cash flows requires the Company to make significant judgments regarding future periods that are subject to some factors outside its control. Changes in these estimates can result in significant revisions to the carrying value of these assets and may result in material charges to the results of operations.

The Company recorded \$2.1 million of other intangible assets in 2015 as a result of the July 2015 acquisition of its Canadian distribution business. The Company determined that the estimated useful life of the contractual relationship asset is 5 years and is amortizing the asset over their estimated lives, based on the expected cash flows of the assets. The Company adopted ASU 2016-19 on January 1, 2017 and, as a result, reclassified \$1.5 million of net internal-use software costs from property and equipment to other intangible assets as of December 31, 2016.

The components of other intangible assets are as follows:

| (in thousands)                              | As of<br>September 30, 2017 |                             |                      | December 31, 2016           |                             |                      |
|---|-----------------------------|-----------------------------|----------------------|-----------------------------|-----------------------------|----------------------|
|   | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Book<br>Value | Gross<br>Carrying<br>Amount | Accumulated<br>Amortization | Net<br>Book<br>Value |
| Customer and contractual relationships, net | \$ 2,149                    | \$ (1,726 )                 | \$ 423               | \$ 1,994                    | \$ (1,466 )                 | \$ 528               |
| Internal-use software                       | 7,175                       | (3,229 )                    | 3,946                | 4,064                       | (2,551 )                    | 1,513                |
| Total intangible assets                     | \$ 9,324                    | \$ (4,955 )                 | \$ 4,369             | \$ 6,058                    | \$ (4,017 )                 | \$ 2,041             |

Amortization expense for intangible assets was approximately \$0.3 million and \$0.3 million for the three months ended September 30, 2017 and 2016, respectively. Amortization expense for intangible assets was approximately \$0.8 million and \$0.9 million for the nine months ended September 30, 2017 and 2016, respectively. Amortization expense is recorded in general and administrative expenses in the consolidated statements of operations.

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Amortization expense expected for the next five years and thereafter is as follows:  
(in thousands)

| Years Ending December 31, | Customer and Contractual Relationships | Internal-Use Software | Total   |
|---------------------------|--|-----------------------|---------|
| 2017 (remaining)          | \$ 66                                  | \$ 324                | \$390   |
| 2018                      | 159                                    | 1,171                 | 1,330   |
| 2019                      | 132                                    | 881                   | 1,013   |
| 2020                      | 66                                     | 661                   | 727     |
| 2021                      | —                                      | 578                   | 578     |
| Thereafter                | —                                      | 331                   | 331     |
| Total                     | \$ 423                                 | \$ 3,946              | \$4,369 |

As of September 30, 2017, the weighted average amortization period of the Company's intangible assets is approximately 3.9 years.

## Note 11. Accrued Expenses and Other Current Liabilities

The components of accrued expenses and other current liabilities are as follows:

| (in thousands)                                       | September 30, 2017 | December 31, 2016 |
|--|--------------------|-------------------|
| Employee compensation and related costs              | \$ 27,389          | \$ 21,999         |
| Professional and consulting services                 | 8,972              | 6,753             |
| Supplier charges                                     | 932                | 2,886             |
| Warranty   | 1,583              | 1,642             |
| Other  | 6,021              | 7,948             |
| Total accrued expenses and other current liabilities | \$ 44,897          | \$ 41,228         |

## Product Warranty Costs

The Company provides a four-year warranty on its PDMs sold in the United States and a five-year warranty on its PDMs sold in Canada and may replace any Omnipod Systems that do not function in accordance with product specifications. The Company estimates its warranty at the time the product is shipped based on historical experience and the estimated cost to service the claims. Warranty expense is recorded in cost of revenue on the statement of operations. Cost to service the claims reflects the current product cost, which has been decreasing over time. As these estimates are based on historical experience, and the Company continues to introduce new products and versions, the Company also considers the anticipated performance of the product over its warranty period in estimating warranty reserves.

A reconciliation of the changes in the Company's product warranty liability is as follows:

| (in thousands)                         | Three Months Ended September 30, 2017 |          | Nine Months Ended September 30, 2016 |          |
|--|---------------------------------------|----------|--------------------------------------|----------|
| Balance at the beginning of the period | \$4,817                               | \$4,294  | \$4,388                              | \$4,152  |
| Warranty expense                       | 1,483                                 | 1,149    | 3,123                                | 3,288    |
| Warranty claims settled                | (1,303 )                              | (1,101 ) | (2,514 )                             | (3,098 ) |
| Balance at the end of the period       | \$4,997                               | \$4,342  | \$4,997                              | \$4,342  |

| (in thousands) | September 30, 2017 | December 31, 2016 |
|----------------|--------------------|-------------------|
|----------------|--------------------|-------------------|

## Composition of balance:

|            |          |          |
|------------|----------|----------|
| Short-term | \$ 1,583 | \$ 1,642 |
| Long-term  | 3,414    | 2,746    |

Total warranty liability: \$ 4,997    \$ 4,388

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## Note 12. Commitments and Contingencies

The Company records a liability in the consolidated financial statements for loss contingencies when a loss is known or considered probable and the amount can be reasonably estimated. If the reasonable estimate of a known or probable loss is a range, and no amount within the range is a better estimate than any other, the minimum amount of the range is accrued. If a loss is reasonably possible but not known or probable, and can be reasonably estimated, the estimated loss or range of loss is disclosed.

## Operating Leases

The Company leases facilities in Massachusetts, California, Tennessee, the United Kingdom, Canada and China. The Company's leases are accounted for as operating leases. The leases generally provide for a base rent plus real estate taxes and certain operating expenses related to the leases.

The Company leases approximately 100,000 square feet of laboratory and office space for its corporate headquarters in Billerica, Massachusetts. The leases expire in November 2022 and contain escalating payments over the life of each lease. Additionally, the Company leases approximately 29,000 square feet of warehousing space in Billerica, Massachusetts under a lease expiring in September 2019. The Company leases other facilities in Canada, China, the United Kingdom, California and Tennessee containing a total of approximately 11,000 square feet under leases expiring from 2017 to 2020.

Certain of the Company's operating lease agreements contain scheduled rent increases. Rent expense is recorded using the straight-line method and deferred rent is included in other liabilities in the accompanying balance sheets. The Company has considered ASC 840-20, Leases in accounting for these lease provisions. Rental expense under operating leases was \$0.7 million and \$0.7 million for the three months ended September 30, 2017 and 2016. Rental expense under operating leases was \$2.1 million and \$1.9 million for the nine months ended September 30, 2017 and 2016.

The aggregate future minimum lease payments related to these leases as of September 30, 2017 are as follows:

| (in thousands)                     | Minimum Lease |
|------------------------------------|---------------|
| Years Ending December 31, Payments |               |
| 2017 (remaining)                   | \$ 725        |
| 2018                               | 2,702         |
| 2019                               | 2,681         |
| 2020                               | 2,402         |
| 2021                               | 2,383         |
| Thereafter                         | 2,131         |
| Total                              | \$ 13,024     |

## Legal Proceedings

In December 2015, the Company received a revised audit report on behalf of the Centers for Medicare and Medicaid Services and the State of New York alleging overpayment of certain Medicaid claims to Neighborhood Diabetes. As of December 31, 2015, the Company had determined that it was probable that a loss had been incurred and recorded an aggregate liability of \$0.4 million within loss from discontinued operations, which was subsequently reduced to \$0.3 million during 2016. The change in the liability was recorded in discontinued operations. In June 2017, the Company reached an agreement to settle the claim for \$0.3 million, which was subsequently paid in July 2017.

In May 2016, the Company reached a settlement agreement for \$0.5 million with the Connecticut Department of Social Services Office of Quality Assurance relating to an audit alleging overpayment of certain Medicaid claims to Neighborhood Diabetes. The settlement amount for this audit was consistent with the amount previously accrued.

In April 2016, the Company reached a settlement agreement for \$0.5 million with the Massachusetts Department of Revenue for sales and use tax audits related to Insulet Corporation, which resulted in a \$0.2 million reduction of the previously recorded liability and a credit to general and administrative expenses during 2016.

Between May 5, 2015 and June 16, 2015, three class action lawsuits were filed by shareholders in the U.S. District Court, Massachusetts, against the Company and certain individual current and former executives of the Company. Two suits subsequently were voluntarily dismissed. *Arkansas Teacher Retirement System v. Insulet, et al.*,

1:15-cv-12345, which remains outstanding, alleges that the Company (and certain executives) committed violations of Sections 10(b) and 20(a) and Rule 10b-5 of the Securities Exchange Act of 1934 by making allegedly false and misleading statements about the Company's business, operations, and prospects. The lawsuit seeks, among other things, compensatory damages in connection with the Company's allegedly inflated stock price between May 7, 2013 and April 30, 2015, as well as

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attorneys' fees and costs. The Company currently cannot reasonably estimate a possible loss, or range of loss, in connection with this matter.

On April 26, 2017, a derivative action (Walker v. DeSisto, et al., 1:17-cv-10738) was filed, and on October 13, 2017, a second derivative action (Carnazza v. DeSisto, et al., 1:17-cv-11977) was filed, both on behalf of the Company, each by a shareholder in the U.S. District Court of Massachusetts against the Company (as a nominal defendant) and certain individual current and former officers and directors of the Company. Both actions were filed as related actions to the securities class action referenced above, and the allegations in the actions are substantially similar to those alleged in the securities class action. The actions seek, among other things, damages, disgorgement of certain types of compensation or profits, and attorneys' fees and costs. The Company currently cannot reasonably estimate a possible loss, or range of loss, in connection with the either of these actions.

The Company is, from time to time, involved in the normal course of business in various legal proceedings, including intellectual property, contract, employment and product liability suits. Although the Company is unable to quantify the exact financial impact of any of these matters, the Company believes that none of these currently pending matters will have an outcome material to its financial condition or business.

## Note 13. Equity

The Company accounts for stock-based compensation under the provisions of ASC 718-10, Compensation — Stock Compensation ("ASC 718-10"), which requires all share-based payments to employees and directors, including grants of stock options and restricted stock units, to be recognized in the income statement based on their fair values.

Share-based payments that contain performance conditions are recognized when such conditions are probable of being achieved.

The Company grants share-based awards to employees in the form of options to purchase the Company's common stock, the ability to purchase stock at a discounted price under the employee stock purchase plan and restricted stock units. The Company uses the Black-Scholes option pricing model to determine the weighted-average fair value of options granted and determines the intrinsic value of restricted stock units based on the closing price of its common stock on the date of grant. The Company recognizes the compensation expense of share-based awards on a straight-line basis for awards with only service conditions and on an accelerated basis for awards with performance conditions. Compensation expense is recognized over the vesting period of the awards.

The following table reflects the Company's stock-based compensation expense related to share-based awards recognized in the three and nine months ended September 30, 2017 and 2016:

|                              | Three Months Ended September 30, |         | Nine Months Ended September 30, |          | Unamortized Expense (Years) |     |
|------------------------------|----------------------------------|---------|---------------------------------|----------|-----------------------------|-----|
|                              | 2017                             | 2016    | 2017                            | 2016     | At September 30, 2017       |     |
| (\$ in thousands)            |                                  |         |                                 |          |                             |     |
| Stock options                | \$3,127                          | \$2,578 | \$8,815                         | \$7,372  | \$18,264                    | 2.4 |
| Restricted stock units       | 5,621                            | 3,439   | 14,358                          | 9,359    | 30,411                      | 1.9 |
| Employee stock purchase plan | 149                              | 71      | 379                             | 142      | 99                          | 0.2 |
| Total                        | \$8,897                          | \$6,088 | \$23,552                        | \$16,873 | \$48,774                    |     |

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### Equity Award Plans

In May 2007, in conjunction with the Company's initial public offering, the Company adopted its 2007 Stock Option and Incentive Plan (the "2007 Plan"). The 2007 Plan was amended and restated in November 2008, May 2012 and May 2015 to provide for the issuance of additional shares and to amend certain other provisions. Under the 2007 Plan, awards were granted to persons who were, at the time of grant, employees, officers, non-employee directors or key persons (including consultants and prospective employees) of the Company or the Company's subsidiaries. The 2007 Plan provided for the grant of stock options, restricted stock units, stock appreciation rights, deferred stock awards, restricted stock, unrestricted stock, cash-based awards, performance share awards or dividend equivalent rights. Options granted under the 2007 Plan generally vest over a period of four years and expire ten years from the date of grant. In May 2017, the Company adopted the 2017 Stock Option and Incentive Plan (the "2017 Plan"), which has replaced the 2007 Plan as the means by which the Company makes equity and cash awards. Effective May 18, 2017, the 2017 Plan became effective (the "2017 Plan Effective Date") and the Company ceased granting awards from the 2007 Plan. Outstanding awards under the 2007 Plan remain subject to the terms of the 2007 Plan. Under the 2017 Plan, awards may be granted to persons who are, at the time of grant, employees, officers, non-employee directors, consultants, or advisers of the Company or the Company's subsidiaries and affiliates. The 2017 Plan provides for the grant of stock options, restricted stock units, stock appreciation rights, deferred stock awards, restricted stock, unrestricted stock, cash-based awards, performance share awards or dividend equivalent rights. Stock options granted under the 2017 Plan generally vest over a period of four years and expire ten years from the date of grant. Shares of stock subject to awards granted under the 2007 Plan and the 2017 Plan that are forfeited, expire or otherwise terminate without delivery generally become available for future issuance under the 2017 Plan. As of September 30, 2017, approximately 5.1 million shares remain available for future grant under the 2017 Plan.

### Stock Options

The Company awarded 34,500 shares of performance-based incentive stock options in the nine months ended September 30, 2017. There were 55,000 shares of performance-based incentive stock options awarded in the nine months ended September 30, 2016. The stock options were granted under the 2007 and 2017 Plans and vest over a four year period from the grant date with the potential of an accelerated vesting period pursuant to the achievement of certain performance conditions.

The determination of the fair value of share-based payment awards utilizing the Black-Scholes model is affected by the stock price and the following assumptions, including expected volatility, expected life of the awards, the risk-free interest rate, and the dividend yield.

Expected volatility measures the amount that a stock price has fluctuated or is expected to fluctuate during a period and is computed over expected terms based upon the historical volatility of the Company's stock.

The expected life of the awards is estimated based on the midpoint scenario, which combines historical exercise data with hypothetical exercise data for outstanding options, as the Company believes this data currently represents the best estimate of the expected life of a new employee option. The Company stratifies its employee population into two groups based upon organizational hierarchy.

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

The dividend yield assumption is based on Company history and expectation of paying no dividends. 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.

Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Stock-based compensation expense recognized in the financial statements is based on awards that are ultimately expected to vest. 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.

The Company evaluates the assumptions used to value the awards on a quarterly basis and if factors change and different assumptions are utilized, stock-based compensation expense may differ significantly from what has been



recorded in the past. If there are any modifications or cancellations of the underlying unvested securities, the Company may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense.

The estimated grant date fair values of the employee stock options were calculated using the Black-Scholes option pricing model.

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The following summarizes the activity under the Company's stock option plans during the nine months ended September 30, 2017:

|  | Number of<br>Options<br>(#) | Weighted<br>Average<br>Exercise<br>Price (\$) | Aggregate<br>Intrinsic<br>Value (\$<br>in 000s) | Weighted Average<br>Remaining Contractual Term<br>(Years) |
|--|-----------------------------|---|---|---|
| Balance, December 31, 2016                                       | 3,441,303                   | \$ 32.27                                      |   |   |
| Granted  | 519,231                     | 45.23   |   |   |
| Exercised <sup>(1)</sup>   | (385,345 )                  | 26.11   | \$ 7,696  |   |
| Canceled   | (85,796 )                   | 34.82   |   |   |
| Balance, September 30, 2017                                      | 3,489,393                   | \$ 34.82                                      | \$ 70,718                                       | 7.8   |
| Vested, September 30, 2017 <sup>(2)</sup>                        | 1,860,596                   | \$ 33.41                                      | \$ 40,326                                       | 7.1   |
| Vested or expected to vest, September 30, 2017 <sup>(2)(3)</sup> | 3,282,804                   |   | \$ 67,057                                       |   |

(1) The aggregate intrinsic value was calculated based on the positive difference between the estimated fair value of the Company's common stock as of the date of exercise and the exercise price of the underlying options. The aggregate intrinsic value of options exercised in the nine months ended September 30, 2017 and 2016 was \$7.7 million and \$4.4 million, respectively.

(2) The aggregate intrinsic value was calculated based on the positive difference between the estimated fair value of the Company's common stock as of September 30, 2017, and the exercise price of the underlying options.

(3) Represents the number of vested options as of September 30, 2017, plus the number of unvested options expected to vest.

#### Restricted Stock Units

In the nine months ended September 30, 2017, the Company awarded 432,877 restricted stock units to certain employees and non-employee members of the Board of Directors, which included 168,857 restricted stock units subject to the achievement of performance conditions (performance-based restricted stock units). For performance-based restricted stock units for which the performance criteria has not yet been achieved, the Company recognized stock compensation expense of \$1.8 million and \$4.0 million in the three and nine months ended September 30, 2017 as it expects a portion of the performance-based restricted stock units granted in 2016 and 2017 will be earned based on its evaluation of the performance criteria at December 31, 2017 and December 31, 2019, respectively. An additional \$0.1 million and \$0.4 million of stock compensation expense was recognized in the three and nine months ended September 30, 2017, respectively, for performance-based restricted stock units for which the performance criteria has been achieved. The restricted stock units were granted under the 2007 and 2017 Plans and generally vest annually over a one or three year period from the grant date, except for the performance-based restricted stock units, which follow different vesting patterns.

The restricted stock units granted during the nine months ended September 30, 2017 have a weighted average fair value of \$47.48 per share based on the closing price of the Company's common stock on the date of grant and were valued at approximately \$20.6 million on their grant date. The Company is recognizing the compensation expense over the vesting period. Approximately \$3.8 million and \$2.6 million in the three months ended September 30, 2017 and 2016, respectively, of stock-based compensation expense related to the vesting of non-performance based restricted stock units was recognized. Approximately \$10.0 million and \$7.3 million in the nine months ended September 30, 2017 and 2016, respectively, of stock-based compensation expense related to the vesting of non-performance based restricted stock units was recognized. Under the terms of the awards, the Company will issue shares of common stock on each of the vesting dates.

The following table summarizes the status of the Company's restricted stock units during the nine months ended September 30, 2017:

| Number of<br>Shares (#) | Weighted<br>Average |
|-------------------------|---------------------|
|-------------------------|---------------------|

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|                             |            | Fair Value (\$) |
|-----------------------------|------------|-----------------|
| Balance, December 31, 2016  | 962,219    | \$ 31.14        |
| Granted                     | 432,877    | 47.48           |
| Vested                      | (375,050 ) | 31.51           |
| Forfeited                   | (12,317 )  | 34.23           |
| Balance, September 30, 2017 | 1,007,729  | \$ 37.98        |

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Employee Stock Purchase Plan

The Employee Stock Purchase Plan (“ESPP”) authorizes the issuance of up to a total of 380,000 shares of common stock to participating employees. The Company will make one or more offerings each year to eligible employees to purchase stock under the ESPP. Between January 1, 2008 and June 30, 2016, offering periods began on the first business day occurring on or after each January 1 and July 1 and ended on the last business day occurring on or before the following June 30 and December 31, respectively. Beginning as of July 1, 2016, offering periods begin on the first business day occurring on or after each December 1 and June 1 and will end on the last business day occurring on or before the following May 31 and November 30, respectively. In order to permit a transition to the new offering cycle, a one-time offering period began on July 1, 2016 and ended on November 30, 2016.

Each employee who is a participant in the Company’s ESPP may purchase up to a maximum of 800 shares per offering period or \$25,000 worth of common stock, valued at the start of the purchase period, per year by authorizing payroll deductions of up to 10% of his or her base salary. Unless the participating employee withdraws from the offering period, his or her accumulated payroll deductions will be used to purchase common stock.

For all offering periods ending on or before June 30, 2016, the purchase price for each share purchased was 85% of the fair market value of the common stock on the last day of the offering period. For all offering periods beginning on or after July 1, 2016, the purchase price for each share purchased is 85% of the lower of (i) the fair market value of the common stock on the first day of the offering period or (ii) the fair market value of the common stock on the last day of the offering period.

The accumulated payroll deductions of any employee who is not a participant on the last day of an offering period will be refunded. An employee’s rights under the ESPP terminate upon voluntary withdrawal from the plan or when the employee ceases employment with the Company for any reason.

The ESPP may be terminated or amended by the Board of Directors at any time. An amendment to increase the number of shares of common stock that is authorized under the ESPP, and certain other amendments, require the approval of stockholders.

Note 14. Income Taxes

The Company accounts for income taxes under the asset and liability method, which requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of events that have been included in the financial statements. Deferred tax assets and liabilities are determined based on differences between the financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates that will be in effect in the years in which the differences are expected to reverse. The Company reviews its deferred tax assets for recoverability considering historical profitability, projected future taxable income, and the expected timing of the reversals of existing temporary differences and tax planning strategies. The effect of a change in tax rates on deferred tax assets and liabilities is recognized in income in the period that includes the enactment date.

The Company follows the provisions of ASC 740-10, Income Taxes (“ASC 740-10”) on accounting for uncertainty in income taxes recognized in its financial statements. ASC 740-10 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In addition, ASC 740-10 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company recognizes estimated interest and penalties for uncertain tax positions in income tax expense.

The Company files federal, state and foreign tax returns. These returns are generally open to examination by the relevant tax authorities from three to four years from the date they are filed. The tax filings relating to the Company's federal and state tax returns are currently open to examination for tax years 2014 through 2016 and 2012 through 2016, respectively. In addition, the Company has generated tax losses since its inception in 2000. These years may be subject to examination if the losses are carried forward and utilized in future years.

At September 30, 2017 and December 31, 2016, the Company provided a full valuation allowance against its domestic net deferred tax asset because it is not more likely than not that the future tax benefit will be realized. In addition, the Company has a net deferred tax asset in foreign jurisdictions where no valuation allowance is recorded as it is more likely than not that the future tax benefit will be realized.



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Income tax expense was \$0.1 million for each of the three months ended September 30, 2017 and 2016. Income tax expense was \$0.3 million and \$0.2 million for the nine months ended September 30, 2017 and 2016, respectively. Income tax expense for both periods was primarily driven by income generated in foreign jurisdictions, mainly Canada.

The Company had no unrecognized tax benefits at September 30, 2017.

## 15. Segment Reporting

As further described in Note 2, the Company has concluded that it operates as one segment.

Worldwide revenue for the Company's products is categorized as follows:

|                       | Three Months<br>Ended September<br>30, |          | Nine Months Ended<br>September 30, |           |
|-----------------------|--|----------|------------------------------------|-----------|
| (in thousands)        | 2017                                   | 2016     | 2017                               | 2016      |
| U.S. Omnipod          | \$70,065                               | \$59,641 | \$195,081                          | \$166,691 |
| International Omnipod | 32,481                                 | 19,107   | 84,200                             | 51,046    |
| Drug Delivery         | 19,229                                 | 16,123   | 53,963                             | 45,677    |
| Total                 | \$121,775                              | \$94,871 | \$333,244                          | \$263,414 |

Geographic information about revenue, based on the region of the customer's shipping location, is as follows:

|                | Three Months<br>Ended September<br>30, |          | Nine Months Ended<br>September 30, |           |
|----------------|--|----------|------------------------------------|-----------|
| (in thousands) | 2017                                   | 2016     | 2017                               | 2016      |
| United States  | \$89,294                               | \$75,764 | \$249,044                          | \$212,368 |
| All other      | 32,481                                 | 19,107   | 84,200                             | 51,046    |
| Total          | \$121,775                              | \$94,871 | \$333,244                          | \$263,414 |

Geographic information about long-lived assets, net, excluding goodwill and other intangible assets is as follows:

| (in thousands) | September 30, December 31, |           |
|----------------|----------------------------|-----------|
|                | 2017                       | 2016      |
| United States  | \$ 68,106                  | \$ 19,341 |
| China          | 20,456                     | 25,431    |
| Other          | 60                         | 197       |
| Total          | \$ 88,622                  | \$ 44,969 |

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Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

FORWARD-LOOKING STATEMENTS

You should read the following discussion of our financial condition and results of operations in conjunction with our consolidated financial statements and the accompanying condensed notes to those financial statements included in this Quarterly Report on Form 10-Q. This Quarterly Report on Form 10-Q contains forward-looking statements which are made pursuant to the safe harbor provisions of Section 27A of the Securities Act of 1933 and of Section 21E of the Securities Exchange Act of 1934. These forward-looking statements are based on our current expectations and beliefs concerning future developments and their potential effects on us. There can be no assurance that future developments affecting us will be those that we have anticipated. These forward-looking statements involve a number of risks, uncertainties (some of which are beyond our control) or other assumptions that may cause actual results or performance to be materially different from those expressed or implied by these forward-looking statements.

These risks and uncertainties include, but are not limited to:

- risks associated with our dependence on our principal product, the Omnipod System;
- fluctuations in quarterly results of operations;
- our ability to sustain or reduce production costs and increase customer orders and manufacturing volumes;
- adverse changes in general economic conditions;
- impact of healthcare reform laws;
- our inability to raise additional funds in the future on acceptable terms or at all;
- potential supply problems or price fluctuations with sole source or third-party suppliers on which we are dependent;
- the potential establishment of a competitive bid program;
- failure to retain supplier pricing discounts and achieve satisfactory gross margins;
- failure to retain key supplier and payor partners;
- international business risks;
- our inability to effectively assume the distribution and commercial support for our Omnipod System in Europe following the expiration of our global distribution agreement with Ypsomed on June 30, 2018;
- our inability to secure and retain adequate coverage or reimbursement for the Omnipod System by third-party payors and potential adverse changes in reimbursement rates or policies relating to the Omnipod System;
- failure to retain key payor partners and their members;
- failure to retain and manage successfully our Medicare and Medicaid business;
- potential adverse effects resulting from competition;
- reliance on information technology systems and our ability to control related risks, including a cyber-attack or other breach or disruption of these systems;
- technological breakthroughs and innovations adversely affecting our business, and our own new product development initiatives may prove to be ineffective or not commercially successful;
- potential termination of our license to incorporate a blood glucose meter into the Omnipod System, or our inability to enter into new license agreements;
- challenges to the further development of our non-insulin drug delivery business;
- our ability to protect our intellectual property and other proprietary rights; conflicts with the intellectual property of third-parties, including claims that our current or future products infringe or misappropriate the proprietary rights of others;
- adverse regulatory or legal actions relating to the Omnipod System;
- our products and operations are subject to extensive government regulation, which could restrict our ability to carry on or expand our operations;
- failure of our contract manufacturers or component suppliers to comply with the FDA's quality system regulations;

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potential adverse impact resulting from a recall, or discovery of serious safety issues, of our products;

the potential violation of federal or state laws prohibiting “kickbacks” or protecting the confidentiality of patient health information, or any challenge to or investigation into our practices under these laws;

product liability lawsuits that may be brought against us;

reduced retention rates of our customer base;

unfavorable results of clinical studies relating to the Omnipod System or the products of our competitors;

potential future publication of articles or announcement of positions by diabetes associations or other organizations that are unfavorable to the Omnipod System;

the concentration of substantially all of our manufacturing operations at a single location in China and substantially all of our inventory at a single location in Massachusetts;

our ability to effectively manage the construction of our planned manufacturing facility in the U.S.;

our ability to attract and retain personnel;

our ability to manage our growth;

risks associated with potential future acquisitions or investments in new businesses;

our ability to generate sufficient cash to service all of our indebtedness;

the expansion of our distribution network;

our ability to successfully maintain effective internal control over financial reporting;

the volatility of the price of our common stock;

risks related to future sales of our common stock or the conversion of any of our 2% Convertible Senior Notes due June 15, 2019 and 1.25% Convertible Senior Notes due September 15, 2021;

potential indemnification obligations in connection with the disposition of our former Neighborhood Diabetes supplies business;

potential limitations on our ability to use our net operating loss carryforwards; and

anti-takeover provisions in our organizational documents.

The factors discussed above are not intended to be a complete statement of all risks and uncertainties and should be evaluated with all other risks described in our Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on February 28, 2017 in the section entitled “Risk Factors” as updated by Item 1A “Risk Factors” herein, and in our other filings from time to time with the Securities and Exchange Commission. Should one or more of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, actual results may vary in material respects from those projected in these forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements.

Executive Level Overview

We are primarily engaged in the development, manufacturing and sale of our proprietary Omnipod System, an innovative, discreet and easy-to-use continuous insulin delivery system for people with insulin-dependent diabetes. The Omnipod System features a small, lightweight, self-adhesive disposable tubeless Omnipod device, which is worn on the body for approximately three days at a time, and its wireless companion, the handheld PDM. Conventional insulin pumps require people with insulin-dependent diabetes to learn to use, manage and wear a number of cumbersome components, including up to 42 inches of tubing. In contrast, the Omnipod System features only two discreet, easy-to-use devices that eliminate the need for a bulky pump, tubing and separate blood glucose meter, provides for virtually pain-free automated cannula insertion, communicates wirelessly and integrates a blood glucose meter. We believe that the Omnipod System’s unique proprietary design and features allow people with insulin-dependent diabetes to manage their diabetes with unprecedented freedom, comfort, convenience, and ease. We began commercial sale of the Omnipod System in the United States in 2005. We sell the Omnipod System in the United States through direct sales to customers or through our distribution partners. The Omnipod System is currently available in multiple countries in Europe, Canada and Israel.

In addition to using the Omnipod System for insulin delivery, we also partner with global pharmaceutical and biotechnology companies to tailor the Omnipod System technology platform for the delivery of subcutaneous drugs across multiple therapeutic areas.





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In June 2011, we acquired Neighborhood Diabetes. Through Neighborhood Diabetes, we provided customers with blood glucose testing supplies, traditional insulin pumps, pump supplies and pharmaceuticals and had the ability to process claims as either durable medical equipment or through pharmacy benefits. In February 2016, we sold Neighborhood Diabetes to Liberty Medical. Additional information regarding the sale of Neighborhood Diabetes is provided in Note 3 to the consolidated financial statements included in this Form 10-Q.

We announced on July 20, 2017 our plans to assume, on July 1, 2018, the distribution, sales, marketing, training and support activities of our Omnipod System across Europe following the expiration of our global distribution agreement with Ypsomed on June 30, 2018. Until the expiration of the distribution agreement, Ypsomed will remain the distributor of our Omnipod products in Europe. We do not expect that the anticipated transition will have a material impact on our financial trends for the remainder of 2017. Once we assume direct distribution and commercial support following the expiration of the distribution agreement with Ypsomed on June 30, 2018, we expect our revenue and gross margins to increase, as average customer pricing in Europe is higher than our current distributor pricing to Ypsomed. Throughout 2018, we expect to incur increased operating expenses as we invest in our European operations. In addition, we will be required to pay to Ypsomed a per unit fee for direct sales over the 12 months following the expiration of the global distribution agreement of our Omnipod device to former customers of Ypsomed, as defined in the distribution agreement. The actual amount of the fee is dependent on a number of factors, such as the European Omnipod customer installed base as of June 30, 2018, the number of customers who choose to continue to purchase Omnipod devices over the successive 12 months, and the volume of the devices sold to these customers during the 12-month period following the expiration of the distribution agreement. While the actual fee could vary significantly, assuming the continued growth of Omnipod in Europe through June 30, 2018, and limited attrition in the 12 months thereafter, we estimate that the fee could total approximately \$50 million. Once European operations are established, excluding nonrecurring transition-related costs, we expect that the assumption of direct distribution will be accretive to our consolidated results of operations.

### Third Quarter 2017 Revenue Results:

• Total revenue of \$121.8 million

U.S. Omnipod revenue of \$70.1 million

International Omnipod revenue of \$32.5 million

Drug Delivery revenue of \$19.2 million

Our long-term financial objective is to achieve and sustain profitable growth. Our efforts in 2017 are primarily focused on the expansion of our customer base in the United States and internationally, increasing our gross profit and product development. Achieving these objectives is expected to require additional investments in certain personnel and initiatives, as well as enhancements to our supply chain operation capacity, efficiency and effectiveness. We believe that we will continue to incur net losses in the near term in order to achieve these objectives. However, we believe that the accomplishment of our near-term objectives will have a positive impact on our financial condition in the future.

### Components of Financial Operations

**Revenue.** We derive most of our revenue from global sales of the Omnipod System. Our revenue also includes sales of devices based on the Omnipod System technology platform to global pharmaceutical and biotechnology companies for the delivery of subcutaneous drugs across multiple therapeutic areas.

**Cost of revenue.** Cost of revenue consists primarily of raw material, labor, warranty, inventory reserve and overhead costs such as freight-in and depreciation and the cost of products we acquire from third party suppliers.

**Research and development.** Research and development expenses consist primarily of personnel costs and outside services within our product development, regulatory and clinical functions and product development projects. We generally expense research and development costs as incurred.

**Sales and marketing.** Sales and marketing expenses consist primarily of personnel costs within our sales, marketing, reimbursement support, customer care and training functions, sales commissions paid to our sales representatives, costs associated with promotional activities and participation in industry trade shows.

General and administrative. General and administrative expenses consist primarily of salaries and other related costs for personnel serving the executive, finance, legal, information technology and human resource functions, as well as legal fees, accounting fees, insurance costs, bad debt expenses, shipping, handling and facilities-related costs.

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## Results of Operations

This section discusses our consolidated results of operations for the third quarter and the nine months ended September 30, 2017 compared to the same periods of 2016, and should be read in conjunction with the consolidated financial statements and accompanying condensed notes included in this Form 10-Q.

TABLE 1: RESULTS OF OPERATIONS

| (Unaudited)   | Three Months Ended September 30, |            |           |          | Nine Months Ended September 30, |             |           |          |  |
|---|----------------------------------|------------|-----------|----------|---------------------------------|-------------|-----------|----------|--|
| (in Thousands)                                      | 2017                             | 2016       | Change \$ | Change % | 2017                            | 2016        | Change \$ | Change % |  |
| Revenue:  |                                  |            |           |          |                                 |             |           |          |  |
| U.S. Omnipod  | \$70,065                         | \$59,641   | \$10,424  | 17 %     | \$195,081                       | \$166,691   | \$28,390  | 17 %     |  |
| International Omnipod                               | 32,481                           | 19,107     | 13,374    | 70 %     | 84,200                          | 51,046      | 33,154    | 65 %     |  |
| Drug Delivery                                       | 19,229                           | 16,123     | 3,106     | 19 %     | 53,963                          | 45,677      | 8,286     | 18 %     |  |
| Total revenue                                       | 121,775                          | 94,871     | 26,904    | 28 %     | 333,244                         | 263,414     | 69,830    | 27 %     |  |
| Cost of revenue                                     | 48,151                           | 39,230     | 8,921     | 23 %     | 135,583                         | 113,265     | 22,318    | 20 %     |  |
| Gross profit  | 73,624                           | 55,641     | 17,983    | 32 %     | 197,661                         | 150,149     | 47,512    | 32 %     |  |
| Gross margin  | 60.5 %                           | 58.6 %     |           |          | 59.3 %                          | 57.0 %      |           |          |  |
| Operating expenses:                                 |                                  |            |           |          |                                 |             |           |          |  |
| Research and development                            | 20,141                           | 13,734     | 6,407     | 47 %     | 55,670                          | 39,676      | 15,994    | 40 %     |  |
| Sales and marketing                                 | 28,718                           | 22,147     | 6,571     | 30 %     | 86,288                          | 69,119      | 17,169    | 25 %     |  |
| General and administrative                          | 22,718                           | 17,342     | 5,376     | 31 %     | 62,322                          | 47,923      | 14,399    | 30 %     |  |
| Total operating expenses                            | 71,577                           | 53,223     | 18,354    | 34 %     | 204,280                         | 156,718     | 47,562    | 30 %     |  |
| Operating income (loss)                             | 2,047                            | 2,418      | (371 )    | (15 )%   | (6,619 )                        | (6,569 )    | (50 )     | 1 %      |  |
| Interest expense and other, net                     | 4,153                            | 5,369      | (1,216 )  | (23 )%   | 13,034                          | 11,293      | 1,741     | 15 %     |  |
| Loss from continuing operations before income taxes | (2,106 )                         | (2,951 )   | 845       | (29 )%   | (19,653 )                       | (17,862 )   | (1,791 )  | 10 %     |  |
| Income tax expense                                  | 121                              | 66         | 55        | 83 %     | 318                             | 195         | 123       | 63 %     |  |
| Net loss from continuing operations                 | (2,227 )                         | (3,017 )   | 790       | (26 )%   | (19,971 )                       | (18,057 )   | (1,914 )  | 11 %     |  |
| Loss from discontinued operations, net of tax       | —                                | (64 )      | 64        | (100)%   | —                               | (1,703 )    | 1,703     | (100)%   |  |
| Net loss  | \$(2,227 )                       | \$(3,081 ) | \$854     | (28 )%   | \$(19,971 )                     | \$(19,760 ) | \$(211 )  | 1 %      |  |

## Revenue

Our total revenue increased to \$121.8 million, up \$26.9 million, or 28%, in the third quarter of 2017 compared to the third quarter of 2016, due to strong growth in our U.S. Omnipod revenue, International Omnipod revenue and our on-body injection device for drug delivery. Our U.S. Omnipod revenue increased to \$70.1 million, up \$10.4 million, or 17%, primarily due to growth in our installed base of Omnipod users as we continue to expand awareness of the Omnipod System. Our International Omnipod revenue increased to \$32.5 million, up \$13.4 million, or 70%, primarily due to growth in distributor sales from continued adoption in existing and newer markets such as France. Our drug delivery revenue increased to \$19.2 million, up \$3.1 million, or 19%, due to strong growth in demand for our primary drug delivery device on greater market adoption of Amgen's Neulasta Onpro kit.

Our total revenue increased to \$333.2 million, up \$69.8 million, or 27%, in the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016, due to strong growth in our U.S. Omnipod revenue, International Omnipod revenue and our on-body injection device for drug delivery. Our U.S. Omnipod revenue increased to \$195.1 million, up \$28.4 million, or 17%, primarily due to growth in our installed base of Omnipod users as we continue to expand awareness of the Omnipod System. Our International Omnipod revenue increased to \$84.2 million, up \$33.2 million, or 65%, primarily due to growth in distributor sales from continued adoption in existing and newer markets such as France. Our drug delivery revenue increased to \$54.0 million, up \$8.3 million, or 18%, due to strong growth in demand for our primary drug delivery device on greater market adoption of Amgen's Neulasta Onpro kit.

For the year ending December 31, 2017, we expect strong revenue growth across all of our product lines as we continue our expansion in the U.S. and internationally.

**Cost of Revenue**

Cost of revenue increased to \$48.2 million, up \$8.9 million, or 23%, in the third quarter of 2017 compared to the same period in 2016 and increased to \$135.6 million, up \$22.3 million, or 20%, in the nine months ended September 30, 2017 compared to the same period in 2016, reflecting an increase in sales volumes, partially offset by improvements in supply chain operations.

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### Gross Margin

Gross margin increased to 60%, up 1.9% in the third quarter of 2017 compared to the same period in 2016. Gross margin for the nine months ended September 30, 2017 was 59% compared with 57% for the nine months ended September 30, 2016. The margin increase in each period was primarily due to improvements in supply chain operations, partially offset by the unfavorable mix impact of higher distributor sales in Europe.

For the year ending December 31, 2017, we expect gross margin to increase as compared to 2016 primarily due to improvements in supply chain operations, partially offset by the unfavorable mix impact of higher distributor sales in Europe.

### Research and Development

Research and development expenses increased to \$20.1 million, up \$6.4 million, or 47%, for the three month period ended September 30, 2017 compared to the same period in 2016 and increased to \$55.7 million, up \$16.0 million, or 40%, for the nine months ended September 30, 2017 compared to the same period in 2016. The increase in both periods was primarily due to an increase in expenses related to our development projects, including our digital mobile Omnipod platform, which involves interaction with continuous glucose monitoring technology, and our artificial pancreas program.

For the year ending December 31, 2017, we expect overall research and development spending to increase as compared to 2016 due to the development efforts on our on-going projects described above.

### Sales and Marketing

Sales and marketing expenses increased to \$28.7 million, up \$6.6 million, or 30%, for the three month period ended September 30, 2017 compared to the same period in 2016 and increased to \$86.3 million, up \$17.2 million, or 25%, for the nine months ended September 30, 2017 compared to the same period in 2016. The increase in sales and marketing expenses in both periods was primarily attributable to increased personnel-related expenses associated with the expansion of our customer support, market access and sales force personnel, investments to support our assumption in mid-2018 of direct commercial support for Omnipod in Europe, and increased advertising expenses associated with direct to patient marketing activities.

For the year ending December 31, 2017, we expect sales and marketing expense to increase as compared to 2016 due to sales and marketing efforts as described above.

### General and Administrative

General and administrative expenses increased to \$22.7 million, up \$5.4 million, or 31%, for the three month period ended September 30, 2017 compared to the same period in 2016 and increased to \$62.3 million, up \$14.4 million, or 30%, for the nine months ended September 30, 2017 compared to the same period in 2016. This increase was primarily attributable to increased personnel-related costs and fees related to external consultants and professional service providers to support the growth in our business.

For the year ending December 31, 2017, we expect overall general and administrative expenses to increase as compared to 2016 as we continue to grow the business and make investments in our operating structure to support this continued growth.

### Interest Expense and Other, Net

Interest expense and other, net, decreased to \$4.2 million, down \$1.2 million, or 23%, for the three month period ended September 30, 2017 compared to the same period in 2016 and increased to \$13.0 million, up \$1.7 million, or 15%, for the nine months ended September 30, 2017 compared to the same period in 2016. The decrease in the three month period is primarily due to a \$2.6 million charge related to the extinguishment of debt in the prior period, partially offset by additional interest expense, including cash and non-cash interest, associated with the issuance in September 2016 of 1.25% convertible senior notes, which increased our net outstanding long-term debt. The increase in the nine month period is due to a net increase on our outstanding long-term debt, partially offset by a lower effective interest rate on outstanding debt. Please refer to Liquidity and Capital Resources for further discussion of our convertible debt.



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## Liquidity and Capital Resources

As of September 30, 2017, we had \$102.2 million in cash and cash equivalents and \$173.5 million in short-term investments. We believe that our current liquidity, together with the cash expected to be generated from sales, will be sufficient to meet our projected operating and debt service requirements for at least the next twelve months.

To lower our manufacturing costs, increase supply redundancy, add capacity closer to our largest customer base and support growth, we are constructing a highly-automated manufacturing facility in Acton, Massachusetts with planned production out of the facility beginning in 2019. We expect capital expenditures to increase above historic levels to fund the construction of the manufacturing facility and related equipment purchases. We believe that our current liquidity will be sufficient to meet our projected expenditures associated with this project.

## Convertible Debt

In September 2016, we issued and sold \$345.0 million in principal amount of 1.25% Convertible Senior Notes due September 15, 2021 ("1.25% Notes"). The interest rate on the notes is 1.25% per annum, payable semi-annually in arrears in cash on March 15 and September 15 of each year. Interest began accruing on September 13, 2016; the first interest payment was paid in March 2017. The 1.25% Notes are convertible into our common stock at an initial conversion rate of 17.1332 shares of common stock per \$1,000 principal amount of the 1.25% Notes, which is equivalent to a conversion price of approximately \$58.37 per share, subject to adjustment under certain circumstances. The 1.25% Notes will be convertible prior to the close of business on the business day immediately preceding June 15, 2021 only under certain circumstances and during certain periods, and will be convertible on or after June 15, 2021 until the close of business on the second scheduled trading day immediately preceding September 15, 2021, regardless of those circumstances.

Cash interest expense related to the 1.25% Notes was \$1.1 million and \$3.3 million in the three and nine months ended September 30, 2017, respectively. Non-cash interest expense related to the 1.25% Notes of \$3.4 million and \$10.1 million was comprised of the amortization of the debt discount and debt issuance costs in the three and nine months ended September 30, 2017, respectively.

In June 2014, we issued and sold \$201.3 million in principal amount of 2% Convertible Senior Notes due June 15, 2019 ("2% Notes"). The interest rate on the notes is 2% per annum, payable semi-annually in arrears in cash on June 15 and December 15 of each year. The 2% Notes are convertible into our common stock at an initial conversion rate of 21.5019 shares of common stock per \$1,000 principal amount of the 2% Notes, which is equivalent to a conversion price of approximately \$46.51 per share, subject to adjustment under certain circumstances.

In September 2016, in connection with the issuance of \$345.0 million in principal amount of 1.25% Notes discussed above, we repurchased approximately \$134.2 million in principal amount of the 2% Notes for \$154.3 million, including \$0.7 million of accrued interest. The \$154.3 million paid to extinguish the debt was allocated to debt and equity based on their respective fair values immediately prior to the transaction. We allocated \$121.4 million of the payment to the debt and \$32.9 million to equity.

Cash interest expense related to the 2% Notes was \$0.3 million and \$0.9 million in the three months ended September 30, 2017 and 2016, respectively, and was \$1.0 million and \$2.9 million in the nine months ended September 30, 2017 and 2016, respectively.

Non-cash interest expense related to the 2% Notes of \$0.7 million and \$1.6 million was comprised of the amortization of the debt discount and debt issuance costs in the three months ended September 30, 2017 and 2016, respectively.

Non-cash interest expense related to the 2% Notes of \$2.1 million and \$5.6 million was comprised of the amortization of the debt discount and debt issuance costs in the nine months ended September 30, 2017 and 2016, respectively.

Additional information regarding our debt issuances is provided in Note 6 to the consolidated financial statements included in this Form 10-Q.



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## Summary of Cash Flows

| (In thousands)                                       | Nine Months Ended |            |
|--|-------------------|------------|
|  | 2017              | 2016       |
| Cash provided by (used in):                          |                   |            |
| Operating activities                                 | \$ 19,407         | \$(4,159 ) |
| Investing activities                                 | (61,485 )         | (80,827 )  |
| Financing activities                                 | 6,650             | 177,558    |
| Effect of exchange rate changes on cash              | 487               | 158        |
| Net (decrease) increase in cash and cash equivalents | \$(34,941 )       | \$92,730   |

## Operating Activities

Our net cash provided by operating activities for the nine months ended September 30, 2017 was \$19.4 million compared to net cash used in operating activities of \$4.2 million in the same period of 2016, an increase of \$23.6 million. The increase in cash provided by operating activities in the current period is primarily due to additional inventory purchases in 2016 in order to support customer demand and to allow for alternative shipping methods, the growth of our business in the current period and the timing of cash disbursements. This impact was partially offset by an increase in accounts receivable, which was primarily due to an increase in sales.

## Investing Activities

Our net cash used in investing activities for the nine months ended September 30, 2017 was \$61.5 million compared to \$80.8 million in the same period of 2016. Investing activities in the current period primarily consists of \$47.8 million of capital expenditures, primarily associated with investments in our supply chain operations, which include approximately \$29.8 million for facility and equipment in process of construction to support our U.S. manufacturing initiatives, and \$13.7 million of investments in marketable securities, net of sales and maturities. Cash used in investing activities in the nine months ended September 30, 2016 primarily related to investments in marketable securities of \$76.2 million.

## Financing Activities

Our net cash provided by financing activities for the nine months ended September 30, 2017 was \$6.7 million, which primarily includes proceeds from the exercise of stock options, as compared to net cash of \$177.6 million provided in the same period of 2016. The decrease in cash provided by financing activities in the current period as compared to the same period in the prior year was primarily attributable to proceeds from the issuance of our 1.25% Notes, net of the retirement of our 2% Notes as further described above, that occurred in the nine months ended September 30, 2016 where no such convertible debt financing activity occurred in the current period.

## Commitments and Contingencies

We lease our facilities in Massachusetts, California, Tennessee, the United Kingdom, Canada and China. These leases are accounted for as operating leases and generally provide for a base rent plus real estate taxes and certain operating expenses related to the leases. Certain of our operating lease agreements contain scheduled rent increases. Rent expense is recorded using the straight-line method and deferred rent is included in other liabilities in the accompanying consolidated balance sheets.

## Legal Proceedings

The significant estimates and judgments related with establishing litigation reserves are discussed under "Legal Proceedings" in Note 12 to the consolidated financial statements included in this Form 10-Q.

## Off-Balance Sheet Arrangements

As of September 30, 2017, we did not have any off-balance sheet financing arrangements.

## Critical Accounting Policies and Estimates

Our financial statements are based on the selection and application of generally accepted accounting principles, which require us to make estimates and assumptions about future events that affect the amounts reported in our financial

statements and the accompanying condensed notes. Future events and their effects cannot be determined with certainty.

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Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates, and any such differences may be material to our financial statements.

We have reviewed our policies and estimates to determine our critical accounting policies for the nine months ended September 30, 2017. We have made no material changes to the critical accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2016.

### Recent Accounting Pronouncements

Information with respect to recent accounting pronouncements is provided in Note 2 to the consolidated financial statements included in this Form 10-Q.

### Item 3. Quantitative and Qualitative Disclosures about Market Risk

We do not use derivative financial instruments in our investment portfolio and have no foreign exchange contracts. Our financial instruments consist of cash, cash equivalents, short-term investments, accounts receivable, accounts payable, accrued expenses, debt and long-term obligations. We consider investments that, when purchased, have a remaining maturity of 90 days or less to be cash equivalents. The primary objectives of our investment strategy are to preserve principal, maintain proper liquidity to meet operating needs and maximize yields. To minimize our exposure to an adverse shift in interest rates, we invest mainly in short-term investments and cash equivalents. We do not believe that a 10% change in interest rates would have a material impact on the fair value of our investment portfolio or our interest income.

As of September 30, 2017, we had outstanding debt recorded on our consolidated balance sheet of \$345.0 million, net of our deferred financing costs and unamortized debt discount totaling \$67.1 million, related to our 2% and 1.25% Notes. As the interest rates are fixed, changes in interest rates do not affect the value of our debt.

Our business is subject to risks, including, but not limited to: unique economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign exchange rate volatility. We are primarily exposed to currency exchange rate fluctuations related to our subsidiary operation in Canada. The majority of our sales outside of the U.S. are currently transacted in U.S. dollars and are not subject to material foreign currency fluctuations.

Fluctuations in foreign currency rates could affect our revenue, cost of revenue and operating margins and could result in exchange losses. In addition, currency devaluations can result in a loss if we hold deposits of that currency. A hypothetical 10% increase or decrease in foreign currencies that we transact in would not have a material adverse impact on our business, financial condition or results of operations.

### Item 4. Controls and Procedures

#### Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2017. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”) means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2017, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at a reasonable assurance level.

#### Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the nine months ended September 30, 2017 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

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Item 1. Legal Proceedings

Information regarding our material pending legal proceedings, which is incorporated herein by reference, is provided in Note 12 to the consolidated financial statements in this Form 10-Q.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2016, which could materially affect our business, financial condition or future results. These risks are not the only risks we face.

Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results. Other than the risks listed below, there have been no material changes in our risk factors from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2016.

Our planned assumption on July 1, 2018 of the distribution, sales, marketing, training and support activities of our Omnipod System in Europe following the expiration of our current third-party global distribution agreement creates several business and operational risks related to the future sales of our Omnipod System in Europe.

On July 20, 2017, we announced our plan to assume, on July 1, 2018, the distribution, sales, marketing, training and support activities of our Omnipod System across Europe following the expiration of our global distribution agreement with Ypsomed on June 30, 2018. Until the expiration of the agreement, Ypsomed will remain the distributor of our Omnipod products in Europe. While we do not expect this transition to materially affect our financial trends for the remainder of 2017, there could be a negative effect on our sales during the transition period if Ypsomed places more emphasis on selling its own proprietary products and other products, instead of ours, during this period, thereby reducing our sales. In addition, to retain current revenue streams after July 1, 2018, we will need to secure the existing customer installed base of Omnipod users in Europe, and there can be no assurance that we will succeed in doing so. More generally, if we are unable to effectively establish direct distribution and commercial support for the Omnipod System in Europe in a timely manner (which may include hiring employees in many of these jurisdictions), we may not be able to service the current Omnipod users in Europe and grow the business as we anticipate. We expect to incur increased operating expenses as we invest in these European operations, and it is possible that the ultimate economic benefits that we derive from these investments could be less than anticipated, or that such expected economic benefits could fail to materialize at all. Any of the foregoing risks could negatively affect our future revenues and, depending on severity, potentially cause a materially adverse effect on our business and results of operations.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

Number Description

10.1 Form of Insulet Corporation 2017 Stock Option and Incentive Plan Performance Vesting Restricted Stock Unit Agreement for Officers

31.1 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Executive Officer.

31.2 Certification pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 by Chief Financial Officer.

32.1\* Certification pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, by Chief Executive Officer and Chief Financial Officer.

101 The following materials from Insulet Corporation's Quarterly Report on Form 10-Q for the quarter ended June 30, 2017 formatted in XBRL (eXtensible Business Reporting Language), as follows:

(i) Consolidated Balance Sheets as of September 30, 2017 (Unaudited) and December 31, 2016

(ii) Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2017 and 2016 (Unaudited)

(iii) Consolidated Statements of Comprehensive Loss for the Three and Nine Months Ended September 30, 2017 and 2016 (Unaudited)

(iv) Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2017 and 2016 (Unaudited)

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

\* This certification shall not be deemed "filed" for purposes of Section 18 of the Securities Exchange Act of 1934, or otherwise subject to the liability of that Section, nor shall it be deemed to be incorporated by reference into any filing under the Securities Act of 1933 or the Securities Exchange Act of 1934.

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SIGNATURES

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

INSULET CORPORATION

(Registrant)

Date: November 2, 2017 /s/ Patrick J. Sullivan

Patrick J. Sullivan  
Chief Executive Officer  
(Principal Executive Officer)

Date: November 2, 2017 /s/ Michael L. Levitz

Michael L. Levitz  
Chief Financial Officer  
(Principal Financial and Accounting Officer)