MASIMO CORP
Form 10-Q
August 02, 2017
Table of Contents

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

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended July 1, 2017
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _____ to _____
Commission File Number 001-33642

MASIMO CORPORATION
(Exact Name of Registrant as Specified in its Charter)

Delaware	33-0368882
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)
52 Discovery Irvine, California	92618
(Address of Principal Executive Offices)	(Zip Code)

(949) 297-7000
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ý 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 ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer ý	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 ý

Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Class	Number of Shares Outstanding as of July 1, 2017
Common stock, $0.001 par value	51,940,147

Table of Contents

MASIMO CORPORATION
FORM 10-Q FOR THE QUARTER ENDED JULY 1, 2017
TABLE OF CONTENTS

Table of Contents

PART I. FINANCIAL INFORMATION
Item 1. Financial Statements
MASIMO CORPORATION
CONDENSED CONSOLIDATED BALANCE SHEETS
(unaudited, in thousands, except par values)

	July 1, 2017	December 31, 2016
ASSETS		
Current assets		
Cash and cash equivalents	$331,448	$ 305,970
Accounts receivable, net of allowance for doubtful accounts of $1,460 and $1,698 at July 1, 2017 and December 31, 2016, respectively.	104,159	101,667
Inventories	88,458	72,542
Other current assets	41,929	27,048
Total current assets	565,994	507,227
Deferred cost of goods sold	93,936	79,948
Property and equipment, net	137,723	135,996
Intangible assets, net	28,099	29,376
Goodwill	20,388	19,780
Deferred tax assets	39,012	38,975
Other non-current assets	10,516	9,223
Total assets	$895,668	$ 820,525
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$38,270	$ 34,334
Accrued compensation	31,871	43,180
Accrued and other current liabilities	36,677	104,654
Deferred revenue	38,526	38,198
Total current liabilities	145,344	220,366
Deferred revenue	24,652	25,336
Other non-current liabilities	16,268	14,587
Total liabilities	186,264	260,289
Commitments and contingencies		
Stockholders' equity		
Preferred stock, $0.001 par value; 5,000 shares authorized; 0 shares issued and outstanding at July 1, 2017 and December 31, 2016	—	—
Common stock, $0.001 par value; 100,000 shares authorized; 51,940 and 50,188 shares issued and outstanding at July 1, 2017 and December 31, 2016, respectively	52	50
Treasury stock, 14,255 shares at July 1, 2017 and December 31, 2016	(404,276)	(404,276)
Additional paid-in capital	436,549	382,263
Accumulated other comprehensive loss	(4,161)	(7,027)
Retained earnings	681,240	589,226
Total stockholders' equity	709,404	560,236
Total liabilities and stockholders' equity	$895,668	$ 820,525

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

Table of Contents

MASIMO CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(unaudited, in thousands, except per share amounts)

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Revenue:				
Product	$182,802	$164,607	$360,899	$327,897
Royalty and other revenue	10,131	8,029	18,336	15,906
Total revenue	192,933	172,636	379,235	343,803
Cost of goods sold	64,496	57,501	126,664	114,455
Gross profit	128,437	115,135	252,571	229,348
Operating expenses:				
Selling, general and administrative	66,377	63,888	131,949	126,399
Research and development	15,192	14,818	30,559	29,183
Total operating expenses	81,569	78,706	162,508	155,582
Operating income	46,868	36,429	90,063	73,766
Non-operating income	158	471	1,032	969
Income before provision for income taxes	47,026	36,900	91,095	74,735
Provision (benefit) for income taxes	346	6,877	(919)	17,135
Net income	$46,680	$30,023	$92,014	$57,600
Net income per share:				
Basic	$0.90	$0.61	$1.80	$1.17
Diluted	$0.83	$0.57	$1.65	$1.10
Weighted-average shares used in per share calculations:				
Basic	51,677	49,256	51,164	49,340
Diluted	56,173	52,703	55,867	52,404

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

Table of Contents

MASIMO CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(unaudited, in thousands)

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Net income	$46,680	$30,023	$92,014	$57,600
Other comprehensive income, net of tax:				
Foreign currency translation adjustments	2,300	(1,209)	2,866	190
Comprehensive income	$48,980	$28,814	$94,880	$57,790

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

Table of Contents

MASIMO CORPORATION
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(unaudited, in thousands)

	Six Months Ended	
	July 1, 2017	July 2, 2016
Cash flows from operating activities:		
Net income	$92,014	$57,600
Adjustments to reconcile net income to net cash (used in) provided by operating activities:		
Depreciation and amortization	9,462	8,132
Stock-based compensation	6,142	6,204
Loss on disposal of property, equipment and intangibles	365	401
Gain on deconsolidation of variable interest entity	—	(273)
Provision for doubtful accounts	(193)	(51)
Provision for deferred income taxes	—	5,001
Changes in operating assets and liabilities:		
Increase in accounts receivable	(2,094)	(3,739)
Increase in inventories	(15,554)	(297)
Increase in other current assets	(14,694)	(7,462)
Increase in deferred cost of goods sold	(13,700)	(1,566)
Increase in other non-current assets	(1,288)	(6,596)
Increase in accounts payable	3,139	7,943
Decrease in accrued compensation	(11,679)	(3,937)
Decrease in accrued liabilities	(67,641)	(13,807)
Increase in deferred revenue	327	5,263
Increase in other non-current liabilities	985	3,875
Net cash (used in) provided by operating activities	(14,409)	56,691
Cash flows from investing activities:		
Purchases of property and equipment, net	(8,512)	(10,734)
Increase in intangible assets	(1,574)	(1,349)
Reduction in cash resulting from deconsolidation of variable interest entity	—	(763)
Net cash used in investing activities	(10,086)	(12,846)
Cash flows from financing activities:		
Borrowings under line of credit	—	45,000
Repayments on line of credit	—	(55,000)
Debt issuance costs	—	(621)
Repayments of capital lease obligations	(70)	(69)
Proceeds from issuance of common stock	48,218	18,997
Repurchases of common stock	—	(68,218)
Net cash provided by (used in) financing activities	48,148	(59,911)
Effect of foreign currency exchange rates on cash	1,825	(196)
Net increase in cash and cash equivalents	25,478	(16,262)
Cash and cash equivalents at beginning of period	305,970	132,317
Cash and cash equivalents at end of period	$331,448	$116,055

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

Table of Contents

MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Description of the Company

Masimo Corporation (the Company) is a global medical technology company that develops, manufactures and markets a variety of noninvasive patient monitoring technologies. The Company's mission is to improve patient outcomes and reduce cost of care by taking noninvasive monitoring to new sites and applications®. The Company's patient monitoring solutions generally incorporate a monitor or circuit board, proprietary single-patient use or reusable sensors, software and/or cables. The Company primarily sells its products to hospitals, emergency medical service providers, home care providers, physician offices, veterinarians, long term care facilities and consumers through its direct sales force, distributors and original equipment manufacturer (OEM) partners.

The Company invented Masimo Signal Extraction Technology® (SET®), which provides the capabilities of Measure-through Motion and Low Perfusion™ pulse oximetry to address the primary limitations of conventional pulse oximetry. Over the years, the Company's product offerings have expanded significantly to also include noninvasive optical blood constituent monitoring, optical organ oximetry monitoring, electrical brain function monitoring, acoustic respiration monitoring and optical gas monitoring. The Company also developed the Root® patient monitoring and connectivity platform and the Masimo Patient SafetyNet[1] remote patient surveillance monitoring system. These solutions and related products are based upon Masimo SET®, rainbow® and other proprietary algorithms. These software-based technologies are incorporated into a variety of product platforms depending on customers' specifications. In addition, these technologies are supported by a substantial intellectual property portfolio that the Company has built through internal development, acquisitions and license agreements.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations. The accompanying condensed consolidated financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, including normal recurring accruals, necessary to present fairly the Company's condensed consolidated financial statements. The accompanying condensed consolidated balance sheet as of December 31, 2016 was derived from the Company's audited consolidated financial statements at that date. The accompanying condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016 (fiscal year 2016), filed with the SEC on February 15, 2017. The results for the six months ended July 1, 2017 are not necessarily indicative of the results to be expected for the fiscal year ending December 30, 2017 (fiscal year 2017) or for any other interim period or for any future year.

Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation. In accordance with GAAP, current authoritative guidance is applied when determining whether an entity is subject to consolidation.

Fiscal Periods

The Company follows a conventional 52/53 week fiscal year. Under a conventional 52/53 week fiscal year, a 52 week fiscal year includes four quarters of 13 fiscal weeks while a 53 week fiscal year includes three 13 fiscal week quarters and one 14 fiscal week quarter. The Company's last 53 week fiscal year was fiscal year 2014. Fiscal year 2017 is a 52 week fiscal year. All references to years in these notes to condensed consolidated financial statements are fiscal years unless otherwise noted.

[1] The use of the trademark Patient SafetyNet is under license from the University HealthSystem Consortium.

7

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

Use of Estimates

The Company prepares its financial statements in conformity with GAAP, which requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates include the determination of accounts receivable allowances, inventory reserves, warranty reserves, rebate accruals, valuation of the Company's stock options, goodwill valuation, deferred taxes and any associated valuation allowances, distributor channel inventory, royalty revenues, deferred revenue, uncertain income tax positions, litigation costs and related accruals. Actual results could differ from such estimates.

Reclassifications

Certain amounts in the accompanying condensed consolidated financial statements for prior periods have been reclassified to conform to the current period presentation.

Fair Value Measurements

Authoritative guidance describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value:

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

Level 2—Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that can be corroborated by observable market data for substantially the full term of the assets or liabilities.

Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

Pursuant to current authoritative guidance, entities are allowed an irrevocable option to elect the fair value for the initial and subsequent measurement for specified financial assets and liabilities on a contract-by-contract basis. The Company did not elect to apply the fair value option under this guidance to specific assets or liabilities on a contract-by-contract basis. There were no transfers between Level 1, Level 2 and Level 3 inputs during the six months ended July 1, 2017. The Company carries cash and cash equivalents at cost, which approximates fair value. As of July 1, 2017 and December 31, 2016, the Company did not have any short-term investments or other financial assets that were required to be measured under the fair value hierarchy.

Cash and Cash Equivalents

The Company considers all highly liquid investments with an original maturity from date of purchase of three months or less, or highly liquid investments that are readily convertible into known amounts of cash, to be cash equivalents.

Accounts Receivable and Allowance for Doubtful Accounts

Accounts receivable consist of trade receivables recorded upon recognition of revenue for product revenues, reduced by reserves for estimated bad debts and returns. Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Credit is extended based on evaluation of the customer's financial condition. Collateral is generally not required. The allowance for doubtful accounts is determined based on historical write-off experience, current customer information and other relevant factors, including specific identification of past due accounts, based on the age of the receivable in excess of the contemplated or contractual due date. Accounts are charged off against the allowance when the Company believes they are uncollectible.

Inventories

Inventories are stated at the lower of cost or net realizable value. Cost is determined using a standard cost method, which approximates the first in, first out method, and includes material, labor and overhead costs. Inventory reserves are recorded for inventory items that have become excess or obsolete or are no longer used in current production and for inventory items that have a market price less than carrying value in inventory.

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

Property and Equipment

Property and equipment are stated at cost. Depreciation is calculated using the straight-line method over estimated useful lives as follows:

	Useful Lives
Buildings	39 years
Building improvements	7 to 15 years
Leasehold improvements	Lesser of useful life or term of lease
Machinery and equipment	5 to 7 years
Vehicles	5 years
Tooling	3 years
Computer equipment	2 to 6 years
Furniture and office equipment	2 to 6 years
Demonstration units	3 years

Land is not depreciated and construction-in-progress is not depreciated until placed in service. Normal repair and maintenance costs are expensed as incurred, whereas significant improvements that materially increase values or extend useful lives are capitalized and depreciated over the remaining estimated useful lives of the related assets. Upon sale or retirement of depreciable assets, the related cost and accumulated depreciation or amortization are removed from the accounts and any gain or loss on the sale or retirement is recognized in income.

Intangible Assets

The Company’s policy is to renew its patents and trademarks. Total renewal costs for patents and trademarks for the six months ended July 1, 2017 and July 2, 2016 were $0.1 million and $0.3 million, respectively. As of July 1, 2017, the weighted-average number of years until the next renewal was one year for patents and six years for trademarks. Costs to renew patents and trademarks are capitalized and amortized over the remaining useful life of the intangible asset. The Company continually evaluates the amortization period and carrying basis of patents and trademarks to determine whether any events or circumstances warrant a revised estimated useful life or reduction in value. Capitalized application costs are charged to operations when it is determined that the patent or trademark will not be obtained or is abandoned.

Impairment of Goodwill, Intangible Assets and Other Long-Lived Assets

Goodwill is recorded as the difference, if any, between the aggregate consideration paid for an acquisition and the fair value of the acquired net tangible and intangible assets. Goodwill is not amortized, but instead is tested annually for impairment, or more frequently when events or changes in circumstances indicate that goodwill might be impaired. In assessing goodwill impairment for each of its reporting units, the Company has the option to first assess the qualitative factors to determine whether the existence of events or circumstances leads to a determination that it is more likely than not that the fair value of a reporting unit is less than its carrying amount. The Company’s qualitative assessment of the recoverability of goodwill considers various macroeconomic, industry-specific and Company-specific factors, including: (i) severe adverse industry or economic trends; (ii) significant Company-specific actions; (iii) current, historical or projected deterioration of the Company’s financial performance; or (iv) a sustained decrease in the Company’s market capitalization below its net book value. If, after assessing the totality of events or circumstances, the Company determines it is unlikely that the fair value of a reporting unit is less than its carrying amount, then performing the two-step impairment test is unnecessary. However, if the Company concludes otherwise, then the Company is required to perform the first step of the two-step impairment test by comparing the fair value of the reporting unit, determined using future projected discounted operating cash flows, with its carrying amount, including goodwill. If the fair value of the reporting unit exceeds its carrying amount, goodwill is not considered impaired; otherwise, goodwill is considered impaired and the loss is measured by performing step two. Under step two, the impairment loss is measured by comparing the implied fair value of the reporting unit goodwill with the carrying amount of goodwill. The Company also has the option to bypass the qualitative assessment and proceed directly to

performing the first step of the two-step goodwill impairment test. The Company may resume performing the qualitative assessment in any subsequent period. The annual impairment test is performed during the fourth fiscal quarter.

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

The Company reviews long-lived assets and identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted operating cash flow expected to be generated by the asset. If such asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount exceeds the fair value of the asset. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell.

No impairment of goodwill, intangible assets or other long-lived assets was recorded during the three and six months ended July 1, 2017 and July 2, 2016.

Revenue Recognition and Deferred Revenue

The Company follows the current authoritative guidance for revenue recognition. Based on these requirements, the Company recognizes revenue from the sale of products or services when: (i) persuasive evidence of an arrangement exists, (ii) delivery has occurred or services have been rendered, (iii) the price is fixed or determinable, and (iv) collectability is reasonably assured. In the case of the license or sale of software that does not function together with hardware components to provide the essential functionality of the hardware, revenue is recognized pursuant to the software revenue recognition guidance.

The Company derives the majority of its revenue from four primary sources: (i) direct sales under long-term sensor purchase agreements with end-user hospitals where the Company provides up-front monitoring equipment at no up-front charge in exchange for a multi-year sensor purchase commitment, (ii) other direct sales of noninvasive monitoring solutions to end-user hospitals, emergency medical response organizations and other direct customers; (iii) sales of noninvasive monitoring solutions to distributors who then typically resell to end-user hospitals, emergency medical response organizations and other direct customers; and (iv) sales of integrated circuit boards to OEM customers who incorporate the Company’s embedded software technology into their multiparameter monitoring devices.

The Company enters into agreements to sell its noninvasive monitoring solutions and services, sometimes as part of multiple deliverable arrangements that include various combinations of products and services. While the majority of the Company’s sales transactions contain standard business terms and conditions, there are some transactions that contain non-standard business terms and conditions. As a result, contract interpretation and analysis is sometimes required to determine the appropriate accounting, including: (i) how the arrangement consideration should be allocated among the deliverables when multiple deliverables exist, (ii) when to recognize revenue on the deliverables, and (iii) whether undelivered elements are essential to the functionality of the delivered elements. Changes in judgments on these assumptions and estimates could materially impact the timing of revenue recognition.

In the case of multiple deliverable arrangements, the authoritative guidance provides a hierarchy to determine the selling price to be used for allocating revenue to deliverables as follows: (i) vendor-specific objective evidence (VSOE) of selling price, (ii) third-party evidence of selling price (TPE), and (iii) best estimate of the selling price (ESP). VSOE of selling price is defined as the price charged when the same element is sold separately. VSOE generally exists only when the deliverable is sold separately and is the price actually charged for that deliverable. TPE generally does not exist for the majority of the Company’s products. The objective of ESP is to determine the price at which the Company would transact a sale if the product was sold on a stand-alone basis. In the absence of VSOE and TPE, the Company determines ESP for its products by considering multiple factors including, but not limited to, features and functionality of the product, geographies, type of customer, contractual prices pursuant to Group Purchasing Organization (GPO) contracts, the Company’s pricing and discount practices, and market conditions.

A deliverable in an arrangement qualifies as a separate unit of accounting if the delivered item has value to the customer on a stand-alone basis. Most of the Company’s products in a multiple deliverable arrangement qualify as separate units of accounting. In the case of the Company’s monitoring equipment containing embedded Masimo SET® or rainbow SET™ software, the Company has determined that the hardware and software components function together to deliver the equipment’s essential functionality and, therefore, represent a single deliverable. However, software

deliverables, such as rainbow® parameter software, which do not function together with hardware components to provide the equipment's essential functionality, are accounted for under software revenue recognition guidance. The revenue for these multiple-element arrangements is allocated to the software deliverables and the non-software deliverables based on the relative selling prices of all of the deliverables in the arrangement using the hierarchy in the revenue recognition accounting guidance for arrangements with multiple deliverables.

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

Sales under long-term sensor purchase contracts are generally structured such that the Company agrees to provide at no up-front charge certain monitoring-related equipment, software, installation, training and/or warranty support in exchange for the hospital's agreement to purchase sensors over the term of the agreement, which generally ranges from three to six years. These contracts generally do not provide for any payments that are not dependent upon the Company's future delivery of sensors, which are essential to the functionality of the monitoring equipment and, therefore, represent a substantive performance obligation. As a result, the Company generally does not recognize any revenue when the monitoring and related equipment and software are delivered to the hospitals, but rather recognizes revenue for these delivered elements on a pro-rata basis as the sensors are delivered under the long-term purchase commitment, when installation and training are complete. Accordingly, the cost of the monitoring and related equipment initially placed at the hospitals is deferred and amortized to cost of goods sold over the life of the underlying long-term sensor purchase contract. In cases where such contracts do provide for guaranteed payments that are unrelated to the future delivery of sensors, the Company recognizes the net present value of such payments as revenue from the monitoring and related equipment and expenses the cost of such equipment to cost of goods sold, as the equipment is delivered and when installation and training are complete. Some of the Company's long-term sensor contracts also contain provisions for certain payments to be made directly to the end-user hospital customer at the inception of the arrangement. These payments are generally treated as prepaid discounts which are deferred and amortized on a straight-line basis as contra-revenue over the life of the underlying long-term sensor purchase contract. Many of the Company's distributors purchase sensor products that they then resell to end-user hospitals that are typically fulfilling their purchase obligations to the Company under such end-user hospital's long-term sensor purchase commitments. Upon shipment to the distributor, revenue is deferred until the distributor ships the product to the Company's end-user customers based on an estimate of the inventory held by these distributors at the end of the accounting period.

The Company also earns revenue from the sale of integrated circuit boards and other products, as well as from rainbow® parameter software licenses, to OEMs under various agreements. Revenue from the sale of products to the OEMs is generally recognized at the time of shipment. Revenue related to software licenses to OEMs is generally recognized upon shipment of the OEM's product to its customers, as represented to the Company by the OEM.

The Company also provides certain customers with the ability to purchase sensors under rebate programs. Under these programs, the customers may earn rebates based on their purchasing activity. The Company estimates and provides allowances for these programs at the time of sale as a reduction to revenue.

In general, customers do not have a right of return for credit or refund. However, the Company allows returns under certain circumstances. At the end of each period, the Company estimates and accrues for these returns as a reduction to revenue and accounts receivable. The Company estimates returns based on several factors, including contractual limitations and past returns history.

The majority of the Company's royalty and other revenue arises from an agreement with Medtronic plc (Medtronic, formerly Covidien Ltd.) that provides for quarterly royalty payments to the Company based upon U.S. sales of certain Medtronic products. An estimate of these royalty revenues is recorded quarterly in the period earned based on the prior quarter's historical results, adjusted for any new information or trends known to management at the time of estimation. This estimated revenue is adjusted prospectively when the Company receives the Medtronic royalty report, approximately sixty days after the end of the previous quarter. From time-to-time, the Company also recognizes revenue upon the achievement of pre-agreed milestones related to non-recurring engineering (NRE) services provided for certain OEM customers. Costs incurred by the Company related to these NRE services are generally deferred until such time that the milestones are achieved and the associated revenue is recognized.

Product Warranty

The Company generally provides a warranty against defects in material and workmanship for a period ranging from six to forty-eight months, depending on the product type. In traditional sales activities, including direct and OEM sales, the Company establishes an accrued liability for the estimated warranty costs at the time of revenue recognition,

with a corresponding provision to cost of sales. Customers may also purchase extended warranty coverage separately or as part of a long-term sensor purchase agreement. Revenue related to extended warranty coverage is recognized over the extended life of the contract and the related extended warranty costs are expensed as incurred.

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

Changes in the product warranty accrual were as follows (in thousands):

	Six Months Ended	
	July 1, 2017	July 2, 2016
Warranty accrual, beginning of period	$910	$1,222
Accrual for warranties issued	606	521
Changes to pre-existing warranties (including changes in estimates)	(5)	(40)
Settlements made	(485)	(488)
Warranty accrual, end of period	$1,026	$1,215

Litigation Costs and Contingencies

The Company records a charge equal to at least the minimum estimated liability for a loss contingency or litigation settlement when both of the following conditions are met: (i) information available prior to issuance of the financial statements indicates that it is probable that a liability had been incurred at the date of the financial statements, and (ii) the range of loss can be reasonably estimated. The determination of whether a loss contingency or litigation settlement is probable or reasonably possible involves a significant amount of management judgment, as does the estimation of the range of loss given the nature of contingencies. Liabilities related to litigation settlements with multiple elements are recorded based on the fair value of each element. Legal and other litigation related expenses are recognized as the services are provided. The Company records insurance and other indemnity recoveries for litigation expenses when both of the following conditions are met: (a) the recovery is probable, and (b) collectability is reasonably assured. Insurance recoveries are only recorded to the extent the litigation costs to which they relate have been incurred and recognized in the financial statements.

Comprehensive Income

Authoritative accounting guidance establishes requirements for reporting and disclosure of comprehensive income and its components. Comprehensive income includes foreign currency translation adjustments and any related tax benefits that have been excluded from net income and reflected in stockholders' equity.

The change in accumulated other comprehensive loss was as follows (in thousands):

	Six Months Ended July 1, 2017
Accumulated other comprehensive loss, beginning of period	$(7,027)
Foreign currency translation adjustments	2,866
Accumulated other comprehensive loss, end of period	$(4,161)

Net Income Per Share

Basic net income per share is computed by dividing net income by the weighted-average number of shares outstanding during the period. Net income per diluted share is computed by dividing the net income by the weighted-average number of shares and potential shares outstanding during the period, if the effect of potential shares is dilutive. Potential shares include incremental shares of stock issuable upon the exercise of stock options and the vesting of both restricted share units (RSUs) and performance share units (PSUs). For both the three and six months ended July 1, 2017, weighted options to purchase 0.1 million shares of common stock were outstanding but not included in the computation of diluted net income per share because the effect of including such shares would have been antidilutive in the applicable period. For the three and six months ended July 2, 2016, weighted options to purchase less than 1.6 million and 1.4 million shares of common stock, respectively, were outstanding, but were not included in the computation of diluted net income per share because the effect of including such shares would have been antidilutive

in the applicable period. For the three and six months ended July 1, 2017 and July 2, 2016, certain RSUs were considered contingently issuable shares as their vesting is contingent upon the occurrence of certain future events. Since such events had not occurred and were not considered probable of occurring as of July 1, 2017 and July 2, 2016, 2.7 million weighted average shares related to such RSUs have been excluded from the calculation of potential shares.

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

A reconciliation of basic and diluted net income per share is as follows (in thousands, except per share amounts):

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Net income	$46,680	$30,023	$92,014	$57,600
Basic net income per share:				
Weighted-average shares outstanding - basic	51,677	49,256	51,164	49,340
Net income per basic share	$0.90	$0.61	$1.80	$1.17
Diluted net income per share:				
Weighted-average shares outstanding - basic	51,677	49,256	51,164	49,340
Diluted share equivalent: stock options and RSUs	4,496	3,447	4,703	3,064
Weighted-average shares outstanding - diluted	56,173	52,703	55,867	52,404
Net income per diluted share	$0.83	$0.57	$1.65	$1.10

Supplemental Cash Flow Information

Supplemental cash flow information includes the following (in thousands):

	Six Months Ended	
	July 1, 2017	July 2, 2016
Cash paid during the year for:		
Interest (net of amounts capitalized)	$321	$2,603
Income taxes	81,662	19,292
Noncash investing and financing activities:		
Unpaid purchases of property, plant and equipment	$2,113	$1,168
Unsettled common stock proceeds from option exercises	237	187

Seasonality

The healthcare business in the United States and overseas is subject to quarterly fluctuations in hospital and other alternative care admissions. Historically, the Company has typically experienced higher product revenues during the traditional “flu season” that often increases hospital and acute care facility admissions in the Company’s first and fourth fiscal quarters. At the same time, the Company has frequently experienced a sequential decline in product revenues in its second and/or third fiscal quarters, primarily due to the summer vacation season during which the flu season has moderated and people tend to avoid and/or delay elective procedures. Because the Company’s non-sales variable operating expenses often do not fluctuate in the same manner as its quarterly product sales, its quarterly operating income may fluctuate disproportionately to its quarterly revenue.

Recently Issued Accounting Pronouncements

In May 2017, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2017-09, Compensation – Stock Compensation (Topic718) : Scope of Modification Accounting (ASU 2017-09). The new standard is intended to provide clarity and reduce both (1) diversity in practice and (2) cost and complexity when applying the guidance in Accounting Standards Codification (ASC) Topic 718 to a change to the terms or conditions of a share-based payment award. The amendments in this new standard provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply “modification accounting” to such changes. ASU 2017-09 will become effective for all entities for annual and interim periods beginning after December 15, 2017, and early adoption is permitted. The Company is currently evaluating the expected impact of this standard, but does not expect it to have a material impact on its consolidated financial statements upon adoption.

13

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

In January 2017, the FASB issued ASU No. 2017-04, Intangibles – Goodwill and Other (ASU 2017-04). The new standard is intended to eliminate the requirement to calculate the implied fair value of goodwill to measure a goodwill impairment charge. Instead, a goodwill impairment charge will be based on the excess of a reporting unit's carrying amount over its fair value. ASU 2017-04 is effective for annual and interim fiscal reporting periods beginning after December 15, 2019 and early adoption is permitted. The Company is currently evaluating the expected impact of this standard, but does not expect it to have a material impact on its consolidated financial statements upon adoption.
In January 2017, the FASB issued ASU No. 2017-01, Business Combinations (ASU 2017-01). The new standard is intended to clarify the definition of a business and requires an entity to evaluate if substantially all of the fair value of the gross assets acquired is concentrated in a single identifiable asset or a group of similar identifiable assets. If so, the set of transferred assets and activities is not considered to be a business under ASU 2017-01. ASU 2017-01 also requires a business to include at least one substantive process and narrows the definition of business outputs. The new standard will be effective on January 1, 2018, and early adoption is permitted with prospective application to any business development transaction. The Company is currently evaluating the expected impact of this standard, but does not expect it to have a material impact on its consolidated financial statements upon adoption.
In November 2016, the FASB issued ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (ASU 2016-18). The new standard is intended to reduce diversity in practice by adding or clarifying guidance on classification and presentation of changes in restricted cash on the statement of cash flows. ASU 2016-18 is effective for annual and interim fiscal reporting periods beginning after December 15, 2017, and early adoption is permitted. The Company is currently evaluating the expected impact of this standard, but does not expect it to have a material impact on its consolidated financial statements upon adoption.
In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other than Inventory (ASU 2016-16). The new standard eliminates the exception that allowed the income tax consequences of an intra-entity transfer of assets other than inventory to be deferred until the transferred asset was sold to a third party or otherwise recovered through use, and now requires recognition of such income tax consequences at the time the non-inventory asset is transferred. ASU 2016-16 is effective for annual and interim fiscal reporting periods beginning after December 15, 2017, and early adoption is permitted. The Company is currently evaluating the expected impact of this standard, but does not expect it to have a material impact on its consolidated financial statements upon adoption.
In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments (ASU 2016-15). The new standard amended the existing accounting standards for the Statement of Cash Flows and provides guidance on eight specific cash flow issues. ASU 2016-15 is effective for annual and interim fiscal reporting periods beginning after December 15, 2019, and early adoption is permitted. The Company is currently evaluating the expected impact of this standard but does not expect it to have a material impact on its consolidated financial statements upon adoption.
In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (ASU 2016-13). The new standard requires entities to use a current expected credit loss model, which is a new impairment model based on expected losses rather than incurred losses. Under this model, an entity would recognize an impairment allowance equal to its current estimate of all contractual cash flows that the entity does not expect to collect. The entity's estimate would consider relevant information about past events, current conditions, and reasonable and supportable forecasts. ASU 2016-13 is effective for annual and interim fiscal reporting periods beginning after December 15, 2019, with early adoption permitted for annual reporting periods beginning after December 15, 2018. The Company is currently evaluating the expected impact of this standard but does not expect it to have a material impact on its consolidated financial statements upon adoption.
In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) (ASU 2016-02). The new standard requires lessees to recognize most leases on their balance sheets but continue to recognize lease expenses in their income statement in a manner similar to current practice. The new standard states that a lessee will recognize a lease liability

for the obligation to make lease payments and a right-of-use asset for the right to use the underlying asset for the lease term. Expense related to leases determined to be operating leases will be recognized on a straight-line basis, while those determined to be financing leases will be recognized following a front-loaded expense profile in which interest and amortization are presented separately in the income statement. ASU 2016-02 is effective for annual and interim fiscal reporting periods beginning after December 15, 2018, and early application is permitted. The Company is currently evaluating the expected impact of this standard on its consolidated financial statements, but anticipates that, among other things, the required recognition of a lease liability and related right-of-use asset will significantly increase both the assets and liabilities recognized and reported on its balance sheet.

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

In addition, the Company anticipates that the classification of certain leases for which the Company is the lessor may change under the new guidance, resulting in the immediate expensing of certain costs that are currently deferred and expensed over the life of the lease. The Company currently expects to complete its assessment of the full financial impact of the new lease accounting guidance during the next six to twelve months and has not yet finalized any decision related to the timing of adoption for this guidance.

In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, (ASU 2016-01). The new standard requires that (i) all equity investments, other than equity-method investments, in unconsolidated entities generally be measured at fair value in net income and (ii) changes in fair value due to instrument-specific credit risk be recognized separately in other comprehensive income when the fair value option has been elected for financial liabilities. ASU 2016-01 is effective for annual and interim fiscal reporting periods beginning after December 15, 2017. The Company is currently evaluating the expected impact of this standard but does not expect it to have a material impact on its consolidated financial statements upon adoption.

In May 2014, the FASB issued ASU No. 2014-09, Revenue (Topic 606): Revenue from Contracts with Customers (ASU 2014-09). The new standard provides a single, principles-based five-step model to be applied to all contracts with customers while enhancing disclosures about revenue, providing additional guidance for transactions that were not previously addressed comprehensively and improving guidance for multiple-element arrangements. ASU 2014-09 will replace most existing revenue recognition guidance under GAAP when it becomes effective. The standard permits the use of either the retrospective or cumulative effect transition method upon adoption. In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which amended ASU 2014-09, providing for a one year deferral period for the implementation of ASU 2014-09. ASU 2014-09 will now be effective for annual and interim periods beginning on or after December 15, 2017. In March 2016, the FASB issued ASU No. 2016-08, Revenue from Contracts with Customers: Principal versus Agent Considerations under FASB ASC Topic 606, which provides guidance on principal versus agent considerations. In April 2016, the FASB issued ASU No. 2016-10, Revenue from Contracts with Customers (Topic 606) – Identifying Performance Obligations and Licensing, which amended ASU 2014-09 by providing clarity in identifying performance obligations and licensing implementation guidance. In May 2016, the FASB issued ASU No. 2016-12, Revenue from Contracts with Customers (Topic 606) – Narrow-Scope Improvements and Practical Expedients, which further amended ASU 2014-09 by providing additional clarity in recognizing revenue from contracts that have been modified prior to the transition period to the new standard, as well as providing additional disclosure requirements for businesses and other organizations that make the transition to the new standard by adjusting amounts from prior reporting periods via retrospective application. In December 2016, the FASB issued ASU No. 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers (ASU 2016-20). ASU 2016-20 affects narrow aspects of ASC Topic 606, including contract modifications, contract costs, and the balance sheet classification of items as contract assets versus receivables. The Company is continuing to evaluate the expected impact of the new revenue guidance contained in ASC Topic 606 on its consolidated financial statements and anticipates, among other things, that the adoption of such standard will result in the acceleration of certain revenue from product sales to distributors that is currently deferred under the “sell-through” method, as well as the capitalization and deferral of certain contract-related costs that are currently expensed when incurred. The Company currently expects to complete its assessment of the full financial impact of the new revenue recognition guidance, including the method of adoption, during the next three to five months and to adopt the guidance when it becomes effective for the Company on December 31, 2017 (fiscal year 2018).

3. Variable Interest Entity (VIE)

The Company follows authoritative guidance for the consolidation of a VIE, which requires an enterprise to determine whether its variable interest gives it a controlling financial interest in a VIE. Determination about whether an enterprise should consolidate a VIE is required to be evaluated continuously as changes to existing relationships or

future transactions may result in consolidating or deconsolidating the VIE.

Cercacor is an independent entity that was spun off from the Company to its stockholders in 1998. Joe Kiani, the Company's Chairman and Chief Executive Officer (CEO), is also the Chairman and CEO of Cercacor. The Company is a party to a Cross-Licensing Agreement with Cercacor, which was most recently amended and restated effective January 1, 2007 (the Cross-Licensing Agreement), that governs each party's rights to certain intellectual property held by the two companies. The Company is also a party to various other agreements with Cercacor.

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

As a result of changes in the capital structure of Cercacor, as well as certain of its contractual relationships with the Company, the Company completed a re-evaluation of the authoritative consolidation guidance during the first quarter of 2016 and determined that although Cercacor remained a VIE, the Company was no longer its primary beneficiary as it could no longer be deemed to have the power to direct the activities of Cercacor that most significantly impact Cercacor's economic performance and had no obligation to absorb Cercacor's losses pursuant to the Company's on-going contractual relationships with Cercacor. Based on such determination, the Company discontinued consolidating Cercacor within its consolidated financial statements effective as of January 3, 2016. However, Cercacor continues to be a related party following its deconsolidation. The Company recognized a gain of $0.3 million upon such deconsolidation, which has been reported within non-operating income in the accompanying condensed consolidated statement of operations. See Note 4 to these condensed consolidated financial statements for a description of the Company's continuing business relationships with Cercacor.

4. Related Party Transactions

The Company's Chairman and CEO is also the Chairman and CEO of Cercacor. The Company is a party to the following agreements with Cercacor:

- Cross-Licensing Agreement - The Company and Cercacor are parties to the Cross-Licensing Agreement, which governs each party's rights to certain intellectual property held by the two companies. The Company is subject to certain annual minimum aggregate royalty obligations for use of the rainbow® licensed technology. The current annual minimum royalty obligation is $5.0 million. Actual aggregate royalty liabilities to Cercacor under the license were $1.9 million and $1.6 million for the three months ended July 1, 2017 and July 2, 2016, respectively. Actual aggregate royalty liabilities to Cercacor under the license were $3.5 million and $3.1 million for the six months ended July 1, 2017 and July 2, 2016, respectively.
- Administrative Services Agreement - The Company is a party to an administrative services agreement with Cercacor (G&A Services Agreement), which governs certain general and administrative services that the Company provides to Cercacor. Amounts charged by the Company pursuant to the G&A Services Agreement were less than $0.1 million for each of the three and six months ended July 1, 2017 and July 2, 2016.
- Sublease Agreement - In March 2016, the Company entered into a sublease agreement with Cercacor for approximately 16,830 square feet of excess office and laboratory space located at 40 Parker, Irvine, California (Cercacor Sublease). The Cercacor Sublease began on May 1, 2016 and expires on November 30, 2019. The Company recognized less than $0.1 million and $0.2 million in sublease income for the three and six months ended July 1, 2017, respectively. The Company recognized less than $0.1 million in sublease income for each of the three and six months ended July 2, 2016.

Net amounts due to Cercacor at each of July 1, 2017 and December 31, 2016 were $0.6 million and $0.4 million, respectively.

The Company's CEO is also the Chairman of the Masimo Foundation for Ethics, Innovation and Competition in Healthcare (Masimo Foundation), a non-profit organization that was founded in 2010 to provide a platform for encouraging ethics, innovation and competition in healthcare. The Company's Chief Financial Officer (CFO) is also a Director of the Masimo Foundation.

The Company's CEO is the Chairman of both the Patient Safety Movement Foundation (PSMF), a non-profit organization that was founded in 2013 to work with hospitals, medical technology companies and patient advocates to unite the healthcare ecosystem and eliminate the more than 200,000 U.S. preventable hospital deaths that occur every year by 2020, and the Patient Safety Movement Coalition (PSMC), a not-for-profit social welfare organization that was founded in 2013 to promote patient safety legislation. The Company's CFO serves as the Treasurer and Secretary of PSMF, as well as the Secretary of PSMC.

The Company's CEO also serves on the board of directors of Atheer Labs, which is working with the Company on the development of next generation Root® applications, and the board of directors of Children's Hospital of Orange County and CHOC Children's at Mission Hospital, two non-profit hospitals devoted exclusively to caring for children,

both of which are also customers of the Company.

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

5. Inventories

Inventories consist of the following (in thousands):

	July 1, 2017	December 31, 2016
Raw materials	$42,562	$ 32,647
Work-in-process	6,755	7,701
Finished goods	39,141	32,194
Total inventories	$88,458	$ 72,542

6. Other Current Assets

Other current assets consist of the following (in thousands):

	July 1, 2017	December 31, 2016
Prepaid income taxes	$16,493	$ 981
Prepaid expenses	12,941	13,051
Royalties receivable	8,000	7,500
Employee loans and advances	325	305
Due from related party	21	77
Other current assets	4,149	5,134
Total other current assets	$41,929	$ 27,048

7. Property and Equipment

Property and equipment, net, consists of the following (in thousands):

	July 1, 2017	December 31, 2016
Building and building improvements	$86,015	$ 85,966
Machinery and equipment	43,737	41,683
Land	23,762	23,762
Leasehold improvements	14,908	8,289
Computer equipment	14,199	13,549
Tooling	13,485	12,895
Furniture and office equipment	10,719	9,669
Demonstration units	467	448
Vehicles	45	45
Construction-in-progress	5,654	7,923
Total property and equipment	212,991	204,229
Accumulated depreciation and amortization	(75,268)	(68,233)
Property and equipment, net	$137,723	$ 135,996

For the six months ended July 1, 2017 and July 2, 2016, depreciation expense of property and equipment was $7.0 million and $6.3 million, respectively.

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

8. Intangible Assets

Intangible assets, net, consist of the following (in thousands):

	July 1, 2017	December 31, 2016
Patents	$20,275	$ 19,950
Customer relationships	7,669	7,669
Licenses	7,500	7,500
Acquired technology	5,580	5,580
Trademarks	3,916	3,777
Capitalized software development costs	2,539	2,539
Other	3,680	3,674
Total intangible assets	51,159	50,689
Accumulated amortization	(23,060)	(21,313)
Intangible assets, net	$28,099	$ 29,376

Total amortization expense for the six months ended July 1, 2017 and July 2, 2016 was $2.5 million and $1.8 million, respectively. All of these intangible assets have a 10 year weighted average amortization period.

Estimated amortization expense for future fiscal years is as follows (in thousands):

Fiscal year	Amount
2017 (balance of year)	$5,244
2018	4,656
2019	3,574
2020	3,259
2021	2,482
Thereafter	8,884
Total	$28,099

9. Accrued and Other Current Liabilities

Accrued and other current liabilities consist of the following (in thousands):

	July 1, 2017	December 31, 2016
Contract related payables	$14,522	$ 10,673
Income taxes payable	4,848	76,316
Accrued customer rebates, fees and reimbursements	4,225	3,893
Accrued taxes	4,205	5,135
Accrued legal fees	1,510	1,362
Accrued warranty	1,026	910
Related party payable	670	525
Accrued donations	493	503
Other	5,178	5,337
Total accrued and other current liabilities	$36,677	$ 104,654

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

10. Restated Credit Facility

In January 2016, the Company entered into an Amended and Restated Credit Agreement (Restated Credit Facility) with JPMorgan Chase Bank, N.A., as Administrative Agent and a Lender, Bank of America, N.A., as Syndication Agent and a Lender, Citibank, N.A., as Documentation Agent and a Lender, and various other Lenders (collectively, the Lenders). The Restated Credit Facility currently provides for up to $250.0 million in borrowings in multiple currencies, with an option, subject to certain conditions, for the Company to increase the aggregate borrowing capacity to up to $350.0 million in the future. All unpaid principal under the Restated Credit Facility will become due and payable on January 8, 2021.

Borrowings under the Restated Credit Facility will be deemed, at the Company's election, either: (i) an Alternate Base Rate (ABR) Loan, which bears interest at the ABR plus a spread (ABR Spread) based upon a Company leverage ratio, or (ii) a Eurodollar Loan, which bears interest at the Adjusted LIBO Rate (as defined below) plus a spread (Eurodollar Spread) based upon a Company leverage ratio. The ABR Spread is 0.125% to 1.00% and the Eurodollar Spread is 1.125% to 2.0%. Subject to certain conditions, the Company may also request swingline loans from time to time (Swingline Loans) that bear interest similar to an ABR Loan.

The ABR is determined by taking the greatest of (i) the prime rate, (ii) the federal funds effective rate plus 0.50%, and (iii) the one-month Adjusted LIBO Rate plus 1.0%. The Adjusted LIBO Rate is equal to LIBOR for the applicable interest period multiplied by the statutory reserve rate for such period.

The Company is obligated under the Restated Credit Facility to pay a fee ranging from 0.175% to 0.300% per annum, based upon a Company leverage ratio, with respect to any unused portion of the line of credit. This fee and interest on any ABR Loan are due and payable quarterly in arrears. Interest on any Eurodollar Loan is due and payable at the end of the applicable interest period (or at each three month interval in the case of loans with interest periods greater than three months). Interest on any Swingline Loan is due and payable on the date that the Swingline Loan is required to be repaid. The Company may prepay the loans and terminate the commitments in whole at any time, without premium or penalty, subject to reimbursement of certain costs in the case of Eurodollar Loans.

Pursuant to the terms of the Restated Credit Facility, the Company is subject to certain covenants, including financial covenants related to a leverage ratio and an interest charge coverage ratio, and other customary negative covenants. The Company's obligations under the Restated Credit Facility are secured by substantially all of the Company's personal property, including certain equity interests in U.S. domestic and first-tier foreign subsidiaries.

As of July 1, 2017, the Restated Credit Facility had no outstanding draws and outstanding standby letters of credit totaling $0.3 million. The Company incurred interest expense related to the Restated Credit Facility of $0.3 million and $1.2 million for the six months ended July 1, 2017 and July 2, 2016, respectively. The Company was in compliance with all covenants under the Restated Credit Facility as of July 1, 2017.

11. Other Non-Current Liabilities

Other non-current liabilities consist of the following (in thousands):

	July 1, 2017	December 31, 2016
Unrecognized tax benefit	$14,308	$ 13,442
Deferred rent, long-term	1,328	558
Deferred tax liability, long-term	339	340
Other	293	247
Total other non-current liabilities	$16,268	$ 14,587

Unrecognized tax benefit relates to the Company's long-term portion of tax liability associated with uncertain tax positions. Authoritative guidance prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. See Note 16 to these condensed consolidated financial statements for further details.

19

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

12. Stock Repurchase Program

In September 2015, the Company's Board of Directors (Board) authorized a stock repurchase program, whereby the Company may purchase up to 5.0 million shares of its common stock over a period of up to three years (2015 Repurchase Program). The 2015 Repurchase Program may be carried out at the discretion of a committee comprised of the Company's Chief Executive Officer and Chief Financial Officer through open market purchases, one or more Rule 10b5-1 trading plans, block trades and privately negotiated transactions. The total remaining shares authorized for repurchase under the 2015 Repurchase Program approximated 2.9 million shares as of July 1, 2017. The Company expects to fund the 2015 Repurchase Program through its available cash, future cash from operations, funds available under the Restated Credit Facility or other potential sources of capital.

13. Stock-Based Compensation

The total stock-based compensation expense for the six months ended July 1, 2017 and July 2, 2016 was $6.1 million and $6.2 million, respectively. As of July 1, 2017, an aggregate of 14.5 million shares of common stock were reserved for future issuance under the Company's equity plans, of which 4.6 million shares were available for future grant under the Masimo Corporation 2017 Equity Incentive Plan (2017 Equity Plan). Additional information related to the Company's current equity incentive plans, stock-based award activity and valuation of stock-based awards is included below.

Equity Incentive Plans

2017 Equity Incentive Plan

On June 1, 2017, the Company's stockholders ratified and approved the 2017 Equity Plan. The 2017 Equity Plan permits the grant of stock options, restricted stock, restricted stock units (RSUs), stock appreciation rights, performance share units (PSUs), performance shares, performance bonus awards and other stock or cash awards to employees, directors and consultants of the Company and employees and consultants of any parent or subsidiary of the Company. The aggregate number of shares that may be awarded under the 2017 Equity Plan is 5.0 million shares. The 2017 Equity Plan provides that equity awards issued under the 2017 Equity Plan must generally vest over a period of not less than one year following the date of grant. The exercise price per share of each option granted under the 2017 Equity Plan may not be less than the fair market value of a share of the Company's common stock on the date of grant, which is generally equal to the closing price of the Company's common stock on the NASDAQ Global Select Market on the grant date.

2007 Stock Incentive Plan

Effective June 1, 2017, upon the approval and ratification of the 2017 Equity Plan, the Company's 2007 Stock Incentive Plan (2007 Equity Plan) terminated, provided that awards outstanding under the 2007 Equity Plan will continue to be governed by the terms of that plan. In addition, upon the effectiveness of the 2017 Equity Plan, an aggregate of 5.0 million shares of the Company's common stock registered under prior registration statements for issuance pursuant to the 2007 Equity Plan were deregistered and concurrently registered under the 2017 Equity Plan.

Stock-Based Award Activity

Stock Options

The number and weighted-average exercise price of options issued and outstanding under all of the Company's equity plans are as follows (in thousands, except for exercise prices):

	Six Months Ended July 1, 2017	
	Shares	Average Exercise Price
Options outstanding, beginning of period	8,521	$ 28.56
Granted	281	88.64
Canceled	(109)	32.03
Exercised	(1,745)	27.58

Options outstanding, end of period	6,948	$ 31.19
Options exercisable, end of period	4,082	$ 26.42

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

Total stock option expense for the three and six months ended July 1, 2017 was $2.5 million and $5.5 million, respectively. As of July 1, 2017, the Company had $28.7 million of unrecognized compensation cost related to non-vested stock options that are expected to vest over a weighted average period of approximately 3.4 years. The weighted-average remaining contractual term of options outstanding with an exercise price less than the closing price of the Company's common stock as of July 1, 2017 was 5.9 years. The weighted-average remaining contractual term of options exercisable, with an exercise price less than the closing price of the Company's common stock as of July 1, 2017 was 4.5 years.

RSUs

The number of RSUs issued and outstanding under all of the Company's equity plans are as follows (in thousands, except for grant date fair value amounts):

	Six Months Ended July 1, 2017	
	Units	Weighted Average Grant Date Fair Value
RSUs outstanding, beginning of period	2,706	$ 41.45
Granted	33	86.42
Canceled	(25)	85.79
Expired	—	—
Vested	(6)	43.09
RSUs outstanding, end of period	2,708	$ 41.59

Total RSU expense for the three and six months ended July 1, 2017 was $0.1 million and $0.2 million, respectively. As of July 1, 2017, the Company had $0.6 million of unrecognized compensation cost related to non-vested RSU awards expected to be recognized and vest over a weighted-average period of approximately 0.9 years.

On July 27, 2017, in connection with the First Amendment to November 4, 2015 Amended and Restated Employment Agreement (First Amendment), the Company and Mr. Kiani agreed to, among other things modify certain vesting provisions related to the previous award of 2.7 million RSUs to the Company's Chairman and Chief Executive Officer (see "Employment and Severance Agreements" in Note 14 to these condensed consolidated financial statements for further details).

PSUs

The number of PSUs outstanding under all of the Company's equity plans are as follows (in thousands, except for grant date fair value amounts):

	Six Months Ended July 1, 2017	
	Units	Weighted Average Grant Date Fair Value
PSUs outstanding, beginning of period	—	$ —

Granted	240	90.87
Canceled	—	—
Expired	—	—
Vested	—	—
PSUs outstanding, end of period	240	$ 90.87

During the second quarter of 2017, the Company awarded 240,000 PSUs that will vest in part over time based on the achievement of certain 2017 performance criteria approved by the Board. If earned, 20% of the PSUs granted will vest upon achievement of the performance criteria and the remaining award will vest in equal installments at the beginning of each of the following four years after the year in which the performance achievement level has been determined. The number of shares that may be earned can range from 0% to 100% of the target amount; therefore, the maximum number of shares that can be issued under these awards is 240,000. Total PSU expense for both the three and six months ended July 1, 2017 was $0.6 million. As of July 1, 2017, the Company had $13.9 million of unrecognized compensation cost related to non-vested PSU awards expected to be recognized and vest over a weighted-average period of approximately 2.6 years.

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

Valuation of Stock-Based Award Activity

The Black-Scholes option pricing model is used to estimate the fair value of options granted under the Company's stock-based compensation plans. The range of assumptions used and the resulting weighted-average fair value of options granted at the date of grant were as follows:

	Three Months Ended		Six Months Ended	
	July 1, 2017	July 2, 2016	July 1, 2017	July 2, 2016
Risk-free interest rate	1.8% to 2.0%	1.1% to 1.5%	1.8% to 2.2%	1.1% to 1.9%
Expected term (in years)	5.5	5.7	5.5	5.7
Estimated volatility	29.8% to 30.3%	31.7% to 32.8%	29.7% to 30.3%	31.7% to 35.7%
Expected dividends	0%	0%	0%	0%
Weighted-average fair value of options granted	$28.58	$14.7	$27.82	$13.24

The aggregate intrinsic value of options is calculated as the positive difference, if any, between the market value of the Company's common stock on the date of exercise or the respective period end, as appropriate, and the exercise price of the options. The aggregate intrinsic value of options outstanding with an exercise price less than the closing price of the Company's common stock as of July 1, 2017 was $417.0 million. The aggregate intrinsic value of options exercisable with an exercise price less than the closing price of the Company's common stock as of July 1, 2017 was $264.4 million. The aggregate intrinsic value of options exercised during the six months ended July 1, 2017 was $108.6 million.

The fair value of each RSU and PSU award is determined based on the closing price of the Company's common stock on the grant date, or the modification date, if any.

14. Commitments and Contingencies

Leases

The Company leases certain facilities in North and South America, Europe, the Middle East and Asia-Pacific regions under operating lease agreements expiring at various dates through November 2026. Certain facility leases contain predetermined price escalations and in some cases renewal options. The Company recognizes the lease costs using a straight-line method based on total lease payments. The Company has received leasehold improvement incentives in connection with certain leased facilities in the U.S. These leasehold improvement incentives have been recorded as deferred rent and are being amortized as a reduction to rent expense on a straight-line basis over the life of the lease. As of each of July 1, 2017 and December 31, 2016, accrued rent expense in excess of the amount paid aggregated $1.4 million and $0.7 million, respectively, which is classified within other current and non-current liabilities in the accompanying condensed consolidated balance sheets. In addition, the Company leases automobiles in the U.S. and Europe that are classified as operating leases and expire at various dates through November 2020. The majority of these leases are non-cancellable. The Company also has outstanding capital leases for office equipment and computer equipment, all of which are non-cancellable.

Future minimum lease payments, including interest, under operating and capital leases for each of the following fiscal years ending on or about December 31 are (in thousands):

	As of July 1, 2017		
	Operating Leases	Capital Leases	Total
2017 (balance of year)	$3,130	$ 2	$3,132
2018	6,017	—	6,017
2019	5,260	—	5,260
2020	3,057	—	3,057
2021	2,526	—	2,526
Thereafter	7,169	—	7,169

Total	$27,159	$ 2	$27,161

22

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

Rental expense related to operating leases was $1.6 million and $3.2 million for the three and six months ended July 1, 2017, respectively, and $1.6 million and $3.1 million for the three and six months ended July 2, 2016, respectively. Included in the future capital lease payments as of July 1, 2017 is interest aggregating less than $0.1 million.

Employee Retirement Savings Plan

The Company sponsors a qualified defined contribution plan or 401(k) plan, the Masimo Retirement Savings Plan (MRSP), covering the Company's full-time U.S. employees who meet certain eligibility requirements. In general, the Company matches an employee's contribution up to 3% of the employee's compensation, subject to a maximum amount. The Company may also contribute to the MRSP on a discretionary basis. The Company contributed $0.6 million and $1.2 million to the MRSP for the three and six months ended July 1, 2017, respectively, and $0.5 million and $1.1 million to the MRSP for the three and six months ended July 2, 2016, respectively.

In addition, the Company also sponsors various defined contribution plans in certain locations outside of the United States (Subsidiary Plans). For the three and six months ended July 1, 2017, the Company contributed $0.1 million and $0.2 million, respectively. For the three and six months ended July 2, 2016, the Company contributed $0.1 million and $0.2 million to the Subsidiary Plans, respectively.

Employment and Severance Agreements

On July 27, 2017, the Company entered into the First Amendment with Joe Kiani, the Company's Chairman and Chief Executive Officer, which amended that certain Amended and Restated Employment Agreement entered into between the Company and Mr. Kiani on November 4, 2015 (together with the First Amendment, the Amended Employment Agreement). The First Amendment, among other things, eliminates Mr. Kiani's eligibility for an automatic annual bonus equal to 100% of his base salary, imposes an annual cap on any annual bonus awarded by the Compensation Committee at 200% of his base salary, eliminates his guaranteed grant of 300,000 stock options in fiscal year 2017, modifies certain definitions and conditions related to Mr. Kiani's ability to terminate his employment with the Company for "Good Reason", and eliminates the annual 10% reduction of both: (1) the 2.7 million shares subject to the RSU award previously granted to Mr. Kiani (Award Shares) that will vest in certain circumstances, and (2) the $35.0 million cash payment (Cash Payment) that Mr. Kiani will be entitled to receive in certain circumstances.

Pursuant to the terms of the Amended Employment Agreement, upon a "Qualifying Termination" (as defined in the Amended Employment Agreement), Mr. Kiani will be entitled to receive a cash severance benefit equal to two times the sum of his then-current base salary and the average annual bonus paid to Mr. Kiani during the immediately preceding three years, the full amount of the Award Shares and the full amount of the Cash Payment. In addition, in the event of a "Change in Control" (as defined in the Amended Employment Agreement) prior to a Qualifying Termination, on each of the one year and two year anniversaries of the Change in Control, 50% of the Cash Payment and 50% of the Award Shares will vest, subject in each case to Mr. Kiani's continuous employment through each such anniversary date; however, in the event of a Qualifying Termination or a termination of Mr. Kiani's employment due to death or disability prior to either of such anniversaries, any unvested amount of the Cash Payment and all of the unvested Award Shares shall vest and be paid in full. Additionally, in the event of a Change in Control prior to a Qualifying Termination, Mr. Kiani's stock options and any other equity awards will vest in accordance with their terms, but in no event later than in two equal installments on each of the one year and two year anniversaries of the Change in Control, subject in each case to Mr. Kiani's continuous employment through each such anniversary date. As of July 1, 2017, the expense related to the Award Shares that would be recognized in the Company's consolidated financial statements upon the occurrence of a Qualifying Termination under the Restated Employment Agreement was approximately $257.9 million.

As of July 1, 2017, the Company had severance plan participation agreements with six executive officers. The participation agreements (the Agreements) are governed by the terms and conditions of the Company's 2007 Severance Protection Plan (the Severance Plan), which became effective on July 19, 2007 and which was amended effective December 31, 2008. Under each of the Agreements, the applicable executive officer may be entitled to receive certain salary, equity, medical and life insurance benefits if he is terminated by the Company without cause or if he terminates

his employment for good reason under certain circumstances. The executive officers are also required to give the Company six months advance notice of their resignation under certain circumstances.

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

Purchase Commitments

Pursuant to contractual obligations with vendors, the Company had $77.9 million of purchase commitments as of July 1, 2017, which are expected to be purchased within one year. These purchase commitments have been made for certain inventory items in order to secure sufficient levels of those items and to achieve better pricing.

Other Contractual Commitments

In the normal course of business, the Company may provide bank guarantees to support government hospital tenders in certain foreign jurisdictions. As of July 1, 2017, the Company had approximately $0.3 million in unsecured bank guarantees.

In certain circumstances, the Company also provides limited indemnification within its various customer contracts whereby the Company indemnifies the parties to whom it sells its products with respect to potential infringement of intellectual property, and against bodily injury caused by a defective Company product. It is not possible to predict the maximum potential amount of future payments under these or similar agreements, due to the conditional nature of the Company's obligations and the unique facts and circumstances involved. As of July 1, 2017, the Company had not incurred any significant costs related to contractual indemnification of its customers.

Concentrations of Risk

The Company is exposed to credit loss for the amount of its cash deposits with financial institutions in excess of federally insured limits. The Company invests its excess cash in time deposits with major financial institutions. As of July 1, 2017, the Company had $331.4 million of bank balances, of which $3.1 million was covered by either the U.S. Federal Deposit Insurance Corporation limit or foreign countries' deposit insurance organizations.

While the Company and its contract manufacturers rely on sole source suppliers for certain components, steps have been taken to minimize the impact of a shortage or stoppage of shipments, such as maintaining a safety stock of inventory and designing products that could be modified to use different components. However, there can be no assurance that a shortage or stoppage of shipments of the materials or components that the Company purchases will not result in a delay in production or adversely affect the Company's business.

The Company's ability to sell its products to U.S. hospitals depends in part on its relationships with GPOs. Many existing and potential customers for the Company's products become members of GPOs. GPOs negotiate pricing arrangements and contracts, sometimes exclusively, with medical supply manufacturers and distributors, and these negotiated prices are made available to a GPO's affiliated hospitals and other members. During the three and six months ended July 1, 2017, revenue from the sale of the Company's products to U.S. hospitals that are members of GPOs amounted to $105.6 million and $205.3 million, respectively, and for the three and six months ended July 2, 2016, revenue from the sale of the Company's products to U.S. hospitals that are members of GPOs amounted to $93.3 million and $185.3 million, respectively.

For the three months ended July 1, 2017, the Company had sales through two just-in-time distributors that represented 13.3% and 11.3% of total revenue, respectively. For the three months ended July 2, 2016, the Company had sales through the same two just-in-time distributors that represented 14.8% and 12.7% of total revenue, respectively. For the six months ended July 1, 2017, the Company had sales through two just-in-time distributors that represented 13.7% and 11.7% of total revenue, respectively. For the six months ended July 2, 2016, the Company had sales through the same two just-in-time distributors that represented 15.4% and 11.9% of total revenue, respectively.

As of July 1, 2017, two just-in-time distributors represented 8.3% and 5.0% of the Company's accounts receivable balance. As of December 31, 2016, two different just-in-time distributors represented 7.5% and 5.6% of the Company's accounts receivable balance, respectively.

For the six months ended July 1, 2017 and July 2, 2016, the Company recorded $18.3 million and $15.9 million, respectively, in royalty revenues from Medtronic. In exchange for these royalty payments, the Company has provided Medtronic the ability to ship its patent infringing product with a covenant not to sue Medtronic as long as Medtronic abides by the terms of the settlement agreement between the companies.

24

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

Litigation

On July 26, 2017, a patent infringement complaint was filed against the Company in the U.S. District Court for the District of Delaware by Silkeen, LLC. The complaint alleges that the Company's pulse oximetry products infringe certain claims of U.S. Patent No. 7,944,469 titled "System and Method for Using Self-Learning Rules to Enable Adaptive Security Monitoring."

The Company believes it has good and substantial defenses to the claims, but there is no guarantee the Company will prevail. The Company is unable to determine whether any loss will ultimately occur or to estimate the range of such loss; therefore, no amount of loss has been accrued by the Company in the accompanying condensed consolidated financial statements. The Company's policy is and has been not to settle patent infringement claims where it does not believe there is infringement of a valid patent, even if the cost of litigation would exceed the cost of settlement.

On January 2, 2014, a putative class action complaint was filed against the Company in the U.S. District Court for the Central District of California by Physicians Healthsource, Inc. (PHI). The complaint alleges that the Company sent unsolicited facsimile advertisements in violation of the Junk Fax Protection Act of 2005 and related regulations. The complaint seeks $500 for each alleged violation, treble damages if the District Court finds the alleged violations to be knowing, plus interest, costs and injunctive relief. On April 14, 2014, the Company filed a motion to stay the case pending a decision on a related petition filed by the Company with the Federal Communications Commission (FCC). On May 22, 2014, the District Court granted the motion and stayed the case pending a ruling by the FCC on the petition. On October 30, 2014, the FCC granted some of the relief and denied some of the relief requested in the Company's petition. Both parties appealed the FCC's decision on the petition. On November 25, 2014, the District Court granted the parties' joint request that the stay remain in place pending a decision on the appeal. On March 31, 2017, the D.C. Circuit Court of Appeals vacated and remanded the FCC's decision, holding that the applicable FCC rule was unlawful to the extent it requires opt-out notices on solicited faxes. The stay of the District Court litigation has not yet been lifted. On April 28, 2017, PHI filed a petition seeking rehearing by the D.C. Circuit Court of Appeals. The D.C. Circuit Court of Appeals denied the requested rehearing on June 6, 2017. The plaintiffs have stated that they intend to file a petition to the United States Supreme Court seeking review of the D.C. Circuit Court of Appeals' opinion. The Company believes it has good and substantial defenses to the claims in the District Court litigation, but there is no guarantee that the Company will prevail. The Company is unable to determine whether any loss will ultimately occur or to estimate the range of such loss; therefore, no amount of loss has been accrued by the Company in the accompanying condensed consolidated financial statements.

On January 31, 2014, an amended putative class action complaint was filed against the Company in the U.S. District Court for the Northern District of Alabama by and on behalf of two participants in the Surfactant, Positive Pressure, and Oxygenation Randomized Trial at the University of Alabama. On April 21, 2014, a further amended complaint was filed adding a third participant. The complaint alleges product liability and negligence claims in connection with pulse oximeters the Company modified and provided at the request of study investigators for use in the trial. On August 13, 2015, the U.S. District Court for the Northern District of Alabama granted summary judgment in favor of the Company on all claims. The plaintiffs have appealed the U.S. District Court for the Northern District of Alabama's decision. The appellate hearing before the Eleventh Circuit Court of Appeals was held on December 13, 2016, and the parties are awaiting a decision. On July 7, 2017, the Eleventh Circuit Court of Appeals (Eleventh Circuit) issued a Certification to the Supreme Court of Alabama seeking guidance on a legal question. In that Certification, the Eleventh Circuit stated that the plaintiffs failed to establish that participation in the clinical study caused any injuries, and that the negligence, negligence per se, breach of fiduciary duty and products liability claims, which includes the claims currently alleged against the Company, were properly dismissed. The Company is unable to determine whether any loss will ultimately occur or to estimate the range of such loss; therefore, no amount of loss has been accrued by the Company in the accompanying consolidated financial statements.

From time to time, the Company may be involved in other litigation and investigations relating to claims and matters arising out of its operations in the normal course of business. The Company believes that it currently is not a party to

any other legal proceedings which, individually or in the aggregate, would have a material adverse effect on its condensed consolidated financial position, results of operations or cash flows.

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

15. Segment Information and Enterprise Reporting

The Company's chief decision maker, the Chief Executive Officer, reviews financial information presented on a consolidated basis, accompanied by disaggregated information about revenues by geographic region, for purposes of making operating decisions and assessing financial performance. Accordingly, the Company considers itself to be in a single reporting segment, specifically noninvasive patient monitoring solutions and related products. The Company does not assess the performance of its geographic regions on other measures of income or expense, such as depreciation and amortization, operating income or net income including noncontrolling interest. In addition, the Company's assets are primarily located in the U.S. The Company does not produce reports for, or measure the performance of, its geographic regions on any asset-based metrics. Therefore, geographic information is presented only for revenues and long-lived assets.

The following schedule presents an analysis of the Company's product revenues based upon the geographic area to which the product was shipped (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	July 1, 2017		July 2, 2016		July 1, 2017		July 2, 2016	
Geographic area by destination:								
United States	$126,455	69.2 %	$117,045	71.1 %	$251,137	69.6 %	$230,549	70.3 %
Europe, Middle East and Africa	33,693	18.4	25,988	15.8	64,195	17.8	57,958	17.7
Asia and Australia	16,988	9.3	16,602	10.1	33,724	9.3	30,184	9.2
North and South America (excluding United States)	5,666	3.1	4,972	3.0	11,843	3.3	9,206	2.8
Total product revenue	$182,802	100.0%	$164,607	100.0%	$360,899	100.0%	$327,897	100.0%

The Company's consolidated long-lived assets (total non-current assets excluding deferred taxes, goodwill and intangible assets) by geographic area are (in thousands, except percentages):

	July 1, 2017		December 31, 2016	
Long-lived assets by geographic area:				
United States	$232,208	95.9 %	$216,784	96.3 %
International	9,967	4.1	8,383	3.7
Total	$242,175	100.0%	$225,167	100.0%

16. Income Taxes

The Company has provided for income taxes in fiscal 2017 interim periods based on the estimated effective income tax rate for the complete fiscal year and adjusted for discrete tax events, including excess tax benefits or deficiencies related to stock-based compensation, in the period such events occur. The income tax provision is computed on the estimated pretax income of the consolidated entities located within each taxing jurisdiction based on legislation enacted as of the balance sheet date. For the six months ended July 1, 2017 and July 2, 2016, the Company recorded discrete tax benefits of approximately $30.2 million and $5.1 million, respectively, related to excess tax benefits realized from stock-based compensation.

Deferred tax assets and liabilities are determined based on the future tax consequences associated with temporary differences between income and expenses reported for accounting and tax purposes. A valuation allowance for deferred tax assets is recorded to the extent that the Company cannot determine that the ultimate realization of the net deferred tax assets is more likely than not. Realization of deferred tax assets is principally dependent upon the achievement of future taxable income, the estimation of which requires significant judgment by the Company's management. The judgment of the Company's management regarding future profitability may change due to many factors, including future market conditions and the Company's ability to successfully execute its business plans or tax planning strategies. These changes, if any, may require material adjustments to these deferred tax asset balances.

26

Table of Contents
MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS—(Continued)
(unaudited)

As of July 1, 2017, the liability for income taxes associated with uncertain tax positions was approximately $15.3 million. If fully recognized, approximately $13.8 million (net of federal benefit on state taxes) would impact the Company's effective tax rate. The remaining balance relates to timing differences. It is reasonably possible that the amount of unrecognized tax benefits in various jurisdictions may change in the next twelve months due to the expiration of statutes of limitation and audit settlements. However, due to the uncertainty surrounding the timing of these events, an estimate of the change within the next twelve months cannot currently be made.
The Company conducts business in multiple jurisdictions and, as a result, one or more of the Company's subsidiaries files income tax returns in U.S. federal, various state, local and foreign jurisdictions. The Company has concluded all U.S. federal income tax matters through fiscal year 2011. All material state, local and foreign income tax matters have been concluded through fiscal year 2009. The Company does not believe that the results of any tax authority examination would have a significant impact on its consolidated financial statements.

Table of Contents

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

This Quarterly Report on Form 10-Q contains "forward-looking statements" as defined in Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, in connection with the Private Securities Litigation Reform Act of 1995 that involve risks and uncertainties, as well as assumptions that, if they never materialize or prove incorrect, could cause our results to differ materially and adversely from those expressed or implied by such forward-looking statements. Such forward-looking statements include any expectation of earnings, revenues or other financial items; any statements of the plans, strategies and objectives of management for future operations; factors that may affect our operating results or financial condition; statements concerning new products, technologies or services; statements related to future capital expenditures; statements related to future economic conditions or performance; statements related to our stock repurchase program; statements as to industry trends and other matters that do not relate strictly to historical facts or statements of assumptions underlying any of the foregoing. These statements are often identified by the use of words such as "anticipate," "believe," "continue," "could," "estimate," "expect," "intend," "may" or "will," the negative versions of these terms and similar expressions or variations. The statements are based on the beliefs and assumptions of our management based on information currently available to management. Such forward-looking statements are subject to risks, uncertainties and other factors that could cause actual results and the timing of certain events to differ materially and adversely from future results expressed or implied by such forward-looking statements. Factors that could cause or contribute to such differences include, but are not limited to, those identified below, and those discussed in the section titled "Risk Factors" included elsewhere in this Quarterly Report on Form 10-Q and in our other Securities and Exchange Commission (SEC) filings, including our Annual Report on Form 10-K for the fiscal year ended December 31, 2016, which we filed with the SEC on February 15, 2017. Furthermore, such forward-looking statements speak only as of the date of this report. We undertake no obligation to update any forward-looking statements to reflect events or circumstances occurring after the date of such statements.

Executive Overview

We are a global medical technology company that develops, manufactures and markets a variety of noninvasive monitoring technologies. We provide our products directly and through distributors and original equipment manufacturer (OEM) partners to hospitals, emergency medical service providers, physician offices, veterinarians, long-term care facilities and consumers. Our mission is to improve patient outcomes and reduce the cost of care. We were incorporated in California in May 1989 and reincorporated in Delaware in May 1996.

Our core business is Measure-through Motion and Low Perfusion™ pulse oximetry monitoring, known as Masimo Signal Extraction Technology® (SET®) pulse oximetry. Our product offerings have expanded significantly over the years to also include monitoring blood constituents with an optical signature, optical organ oximetry monitoring, electrical brain function monitoring, acoustic respiration monitoring, exhaled gas monitoring, patient monitoring with connectivity platforms, bedside and portable patient monitors and wearable wireless patient monitors. We have also developed a remote patient surveillance monitoring system, Patient SafetyNet, which currently allows up to 200 patients to be monitored simultaneously and remotely through a PC-based viewing station or by care providers through their pagers, voice-over-IP phones or smartphones.

Masimo SET® was designed to overcome the primary limitations of conventional pulse oximetry by maintaining accuracy in the presence of motion artifact, low perfusion and weak signal-to-noise situations. Pulse oximetry is the noninvasive measurement of the oxygen saturation level of arterial blood, which delivers oxygen to the body's tissues, and pulse rate. Pulse oximetry is one of the most common measurements taken inside and outside of hospitals around the world. We believe that Masimo SET® is trusted by clinicians to safely monitor approximately 100 million patients each year. Masimo SET® pulse oximetry has been shown by more than 100 independent studies and thousands of clinical evaluations during patient motion and low-perfusion conditions to provide more accurate measurements than other non-Masimo pulse oximeters, as well as to significantly reduce false alarms (specificity) and accurately detect true alarms (sensitivity) that can indicate a deteriorating patient condition. The use of Masimo SET® pulse oximetry has also been shown to improve patient outcomes by helping clinicians reduce retinopathy of prematurity in neonates, screen newborns for critical congenital heart disease, reduce ventilator weaning time and arterial blood gas measurements in the intensive care unit (ICU), and save lives and costs while reducing rapid response activations and

ICU transfers within medical-surgical units.

Our rainbow SET™ platform leverages Masimo SET® technology and incorporates licensed rainbow® technology to provide additional continuous noninvasive measurements. Our rainbow SET™ platform includes our rainbow® Pulse CO-Oximetry products, which we believe are the first devices cleared by the U.S. Food and Drug Administration (FDA) to noninvasively and continuously monitor multiple blood-based measurements using multiple wavelengths of light, which previously was only possible through intermittent invasive procedures. In addition to monitoring oxygen saturation (SpO_2), pulse rate (PR), perfusion index (Pi), Pleth Variability Index (PVi®) and Respiration Rate (RRa®), rainbow SET™ Pulse CO-Oximetry has the ability to provide noninvasive monitoring of total hemoglobin (SpHb®), carboxyhemoglobin (SpCO®) and methemoglobin

Table of Contents

(SpMet®), as well as the calculation of Oxygen Content (SpOC)™. The rainbow SET™ platform also allows for monitoring of arterial oxygen saturation, even under the presence of carboxyhemoglobin and methemoglobin, known as fractional arterial oxygen saturation ($SpfO_2$)™, Respiration Rate from the Pleth (RRp®),Oxygen Reserve Index™ (ORi)™ and Rainbow Pleth Variability Index (RPVi)™. Although $SpfO_2$™, RRp®, RPVi™ and ORi™ have received the CE Mark, they are not currently available for sale in the U.S.

In March 2017, we announced the CE Mark of our noninvasive blood pressure (NIBP) measurements for the Rad-97™ Pulse Co-Oximeter® and connectivity hub. Rad-97™ with NIBP enables clinicians to measure arterial blood pressure for adult, pediatric and neonatal patients, with three measurement modes: spot-check, automatic interval (which measures blood pressure routinely, at a desired interval) and stat interval (which continually measures blood pressure for a desired duration). An integrated port allows clinicians to connect a blood pressure cuff inflation hose directly to Rad-97™ and is compatible with both disposable and reusable cuffs, for a variety of patient types, designed for reliability and patient comfort.

In May 2017, we announced the introduction of Rad-G™, a combined pulse oximeter designed primarily for use in pneumonia screening and spot-checking of oxygen saturation (SpO_2) in low-resource settings. The Rad-G™ is a low-cost, rugged, handheld pulse oximetry device with a rechargeable battery and LCD display. It uses Measure-through Motion and Low Perfusion™ SET® pulse oximetry technology to measure SpO_2, RRp®, PR and Pi. The Rad-G™ is not currently available for sale in the U.S.

In June 2017, we announced the limited market release of the Spot-Check Rad-67™ Handheld Pulse CO-Oximeter®. Rad-67™ offers Measure-through Motion and Low Perfusion™ SET® pulse oximetry and upgradeable rainbow® noninvasive monitoring technology in a compact, portable spot-check device. With the universal reusable rainbow® DCI®-mini sensor, Rad-67™ features Next Generation SpHb® technology. The Rad-67™ has received the CE Mark, but is not currently available for sale in the U.S.

Following the introduction of our rainbow SET™ platform, we have continued to expand our technology offerings by introducing additional noninvasive measurements and technologies to create new market opportunities in both the hospital and non-hospital care settings. These offerings include:

- SedLine® - Brain function monitoring is most commonly used during surgery to help clinicians monitor sedation under anesthesia. SedLine® brain function monitoring technology measures the brain's electrical activity by detecting electroencephalogram (EEG) signals. In contrast to whole-scalp EEG monitoring, which is used for diagnostic purposes, this form of EEG monitoring is often referred to as processed EEG monitoring or brain function monitoring. Brain function monitors display the patient's EEG waveforms, but these are difficult for clinicians to interpret, so the EEG signals are processed and displayed as a single number called Patient State Index (PSi), which is related to the effects of anesthetic agents. Our SedLine® brain function monitoring technology can now be delivered through the Masimo Open Connect® (MOC®) connectivity port, MOC-9®, within our Root® patient monitoring and connectivity platform, which integrates our rainbow® and SET® measurements with multiple additional parameters, such as SedLine®. In addition, our SedLine® brain function monitoring technology also displays raw EEG waveforms, the PSI trend and the Density Spectral Array view to allow clinicians to compare EEG power in both sides of the brain over time to facilitate the detection of asymmetrical activity and agent-specific effects on the EEG signal. In 2016, we introduced Next Generation SedLine®, which improved PSi in the presence of EMG (electrical activity due to muscle movement) artifact and in patients with low power EEG signals (such as geriatric patients). Next Generation SedLine® has received CE Mark but is not currently available for sale in the U.S.
- NomoLine™ Capnography and Gas Monitoring - We offer a portfolio of sidestream and mainstream capnography products, as well as gas monitoring products, which include external "plug-in-and-measure" capnography and gas analyzers, integrated modules and handheld capnograph and capnometer devices. The gas monitoring products have the ability to measure multiple expired gases, such as carbon dioxide (CO_2), nitrous oxide (N_2O), oxygen (O_2) and other anesthetic agents. In the case of capnography, respiration rate is also calculated from the CO_2 waveform. These measurements are possible through either mainstream monitoring, which samples gases from a ventilated patient's breathing circuit, or sidestream monitoring, which samples gases from a breathing circuit in mechanically ventilated patients or through a cannula or mask in spontaneously breathing patients.
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O_3® - Organ oximetry, also known as regional oximetry, tissue oximetry and cerebral oximetry monitoring, uses near-infrared spectroscopy (NIRS) to provide continuous measurement of tissue oxygen saturation (rSO_2) to help detect regional hypoxemia that pulse oximetry alone can miss under certain conditions. In addition, our Root® monitor and O_3®sensors can automate the differential analysis of regional to central oxygen saturation derived from our SET® pulse oximeters. O_3® monitoring involves applying O_3® regional oximetry sensors to the forehead and connecting our O_3® MOC-9® module to any Root® monitor through one of its three MOC-9® ports. O_3® regional oximetry has received the CE Mark and FDA 510(k) clearance for use in subjects larger than 40 kg (approximately 88 lbs). In 2016, O_3® regional oximetry with the O_3® pediatric sensor received the CE Mark for use in pediatric patients weighing less than 40kg (approximately 88lbs).

Table of Contents

In May 2017, O_3® regional oximetry with the O_3® pediatric sensor received FDA 510(k) clearance for use in pediatric patients weighing less than 40kg (approximately 88lbs).

- rainbow Acoustic Monitoring® (RAM)™ - Our acoustic-based monitoring technology enables noninvasive monitoring of respiration rate (RRa®). Compared to traditional capnography, which monitors exhaled CO_2, most often through a nasal cannula, multiple clinical studies have shown that the noninvasive measurement of RRa® provides as good or better accuracy to monitor respiration rate and detect respiratory pause episodes, defined as a cessation of breathing for 30 seconds or more. Yet, due to its ease of use and wear, RAM™ is better tolerated by patients than capnography. When used with other clinical variables, RRa® may help clinicians assess respiratory depression and respiratory distress earlier and more often to help determine treatment options and potentially enable earlier interventions.
- Root® - Our Root® patient monitoring and connectivity platform integrates our breakthrough rainbow® and SET® measurements with multiple additional specialty measurements through its MOC-9® connectivity ports in an integrated, clinician-centric platform. The first three Masimo MOC-9® technologies for Root® were SedLine® brain function monitoring, NomoLine™ capnography and gas monitoring, and O_3® organ oximetry. In June 2017, we announced our first MOC® partnership, which enables third parties to utilize Root's® open architecture and built-in connectivity to independently develop, obtain regulatory approvals, and commercialize their own external MOC-9® module or our Open Connect Control (MOC-C)™ App for Root® using our MOC® software development kit (SDK). While we support the development efforts of our MOC® partners as needed, and help increase awareness of the availability of MOC-9® modules and MOC-C™ Apps, our MOC® partners use their existing distribution channels to sell their MOC-9® module or MOC-C™ App to customers.

In February 2017, we introduced a limited market release of the Early Warning Score (EWS) for Root®. EWS aggregates information from multiple vital signs and clinical observations to generate a score that represents the potential degree of patient deterioration. There are several EWS protocols, such as Pediatric Early Warning Score (PEWS), Modified Early Warning Score (MEWS) and National Early Warning Score (NEWS). These various scores require vital signs contributors such as oxygen saturation, pulse rate, respiration rate, body temperature and systolic blood pressure along with contributors input by clinicians, such as level of consciousness, use of supplemental oxygen and urine output. The weighting and number of contributors differ depending upon which EWS protocol is used. Root® can be customized for various predefined EWS protocols, or hospitals can configure their own set of required contributors, and their relative weights, to create an EWS unique to their care environment.

- Patient SafetyNet - Our patient surveillance, remote monitoring and clinician notification solution allows for monitoring of the oxygen saturation, pulse rate, perfusion index, hemoglobin, methemoglobin and respiration rate of up to 200 patients simultaneously from a single server. Patient SafetyNet offers a rich user interface with trending, real-time waveform capability at the central station and remote notification via pager or smart phone. Patient SafetyNet also features the Adaptive Connectivity Engine,™ which enables two-way, Health Level 7 (HL7) based connectivity to clinical/hospital information systems. The Adaptive Connectivity Engine™ significantly reduces the time and complexity to integrate and validate custom HL7 implementations and demonstrates our commitment to innovation that automates patient care with open, scalable and standards-based connectivity architecture.

The Patient SafetyNet Series 5000, together with Iris® Connectivity, Kite® and MyView™ through the Root® patient monitoring and connectivity platform, offers a new level of interoperability designed to enhance clinician workflows, and reduce the cost of care, from operating rooms to medical-surgical units. Patient SafetyNet Series 5000 with Iris® enables Root® to intake data from all devices connected to the patient, thereby acting as an in-room patient monitor and connectivity hub. Alarms and alerts for all devices are seamlessly forwarded to the patient's clinician and all device data are effortlessly documented in the patient's electronic medical record (EMR). The patient-centric user interface of the Patient SafetyNet Series 5000 displays near real-time data from all devices with Kite®, providing a single unified dashboard of patient information.

- MyView™ - MyView™ is a wireless, presence-detection system enables clinicians to automatically display customized clinical profiles on our devices, such as Root®, Radical-7® and the Patient SafetyNet View Station. When a clinician approaches the device, a clinician-worn MyView™ badge signals the device to display a preselected set of parameters and waveforms tailored to the individual clinician's preferences. MyView™ gives clinicians the ability to receive and review medical device information in a manner that is most conducive to optimizing their workflow, while the

presence mapping data collected by all the Masimo devices can provide information on how clinicians spend time with their patients. This provides nursing leadership and management with the opportunity to examine analytical data on patient and clinician interactions to optimize workflows across the unit, hospital or hospital system.

Table of Contents

- Patient SafetyNet Surveillance - Patient SafetyNet Surveillance is a software option for our Patient SafetyNet solution that provides real-time video images of a patient's room, including the patient with connected monitoring devices, adding existing communication technology to central monitoring. Two-way audio is available to allow the caregiver to listen to and communicate with the patient. The system utilizes the existing hospital information technology network and can provide viewing of images in the same care area.
- MightySat™ and MightySat Rx™ - Our fingertip pulse oximeters leverage Masimo SET® and are designed for those who want accurate measurements, even under challenging conditions such as movement and low perfusion. MightySat™ is intended for personal use and provides SpO_2, PR, RRp®, PVi® and Pi measurements in a compact, battery-powered design with an organic light-emitting diode color screen that can be rotated for real-time display of the pleth waveform as well as measurements. Its Bluetooth® wireless functionality enables measurement display via the free, downloadable Masimo Personal Health app on iOS and Android mobile devices, as well as the ability to trend and communicate measurements and interface with the Apple Health app. MightySat™ is available through online retailers such as Amazon.com and in select Apple stores. In the U.S., MightySat™ is intended for general health and wellness use and is not intended for medical use. However, MightySat Rx,™ the medical version of the product with optional Bluetooth® is intended for professional use. MightySat Rx™ received 510(k) clearance in late 2015. In February 2017, MightySat™ Rx with the RRp® measurement received CE Mark, but is not currently available for sale in the U.S.

Our solutions and related products are based upon our Masimo SET®, rainbow® and other proprietary algorithms. This software-based technology is incorporated into a variety of product platforms depending on our customers' specifications. Our technology is supported by a substantial intellectual property portfolio that we have built through internal development and, to a lesser extent, acquisitions and license agreements. In addition, we have exclusively licensed certain rainbow® technology from Cercacor Laboratories, Inc. (Cercacor) and have the right to incorporate such rainbow® technology into products that are intended for use by professional caregivers, including, but not limited to, hospital caregivers and alternate care facility caregivers.

Cercacor Laboratories, Inc.

Cercacor Laboratories, Inc. (Cercacor) is an independent entity spun off from us to our stockholders in 1998. Joe Kiani, our Chairman and Chief Executive Officer, is also the Chairman and Chief Executive Officer of Cercacor. We are a party to a cross-licensing agreement with Cercacor, which was amended and restated effective January 1, 2007 (the Cross-Licensing Agreement), which governs each party's rights to certain intellectual property held by the two companies. See Notes 3 and 4 to the condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional information related to Cercacor.

Stock Repurchase Program

In September 2015, our board of directors (Board) authorized a stock repurchase program, whereby we may purchase up to 5.0 million shares of our common stock over a period of up to three years. As of July 1, 2017, approximately 2.9 million shares remained authorized for repurchase under this program.

Our stock repurchase program may be carried out at the discretion of a committee comprised of our Chief Executive Officer and Chief Financial Officer through open market purchases, one or more Rule 10b5-1 trading plans, block trades and in privately negotiated transactions. For additional information regarding our current stock repurchase program, see Note 12 to the condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

Table of Contents

Results of Operations

The following table sets forth, for the periods indicated, our unaudited results of operations expressed as dollar amounts and as a percentage of total revenues (in thousands, except percentages):

	Three Months Ended				Six Months Ended			
	July 1, 2017	Percentage of Revenue	July 2, 2016	Percentage of Revenue	July 1, 2017	Percentage of Revenue	July 2, 2016	Percentage of Revenue
Revenue:								
Product	$182,802	94.7 %	$164,607	95.3 %	$360,899	95.2 %	$327,897	95.4 %
Royalty and other revenue	10,131	5.3	8,029	4.7	18,336	4.8	15,906	4.6
Total revenue	192,933	100.0	172,636	100.0	379,235	100.0	343,803	100.0
Cost of goods sold	64,496	33.4	57,501	33.3	126,664	33.4	114,455	33.3
Gross profit	128,437	66.6	115,135	66.7	252,571	66.6	229,348	66.7
Operating expenses:								
Selling, general and administrative	66,377	34.4	63,888	37.0	131,949	34.8	126,399	36.8
Research and development	15,192	7.9	14,818	8.6	30,559	8.1	29,183	8.5
Total operating expenses	81,569	42.3	78,706	45.6	162,508	42.9	155,582	45.3
Operating income	46,868	24.3	36,429	21.1	90,063	23.7	73,766	21.5
Non-operating income	158	0.1	471	0.3	1,032	0.3	969	0.3
Income before provision for income taxes	47,026	24.4	36,900	21.4	91,095	24.0	74,735	21.7
Provision (benefit) for income taxes	346	0.2	6,877	4.0	(919)	(0.2)	17,135	5.0
Net income	$46,680	24.2 %	$30,023	17.4 %	$92,014	24.3 %	$57,600	16.8 %

Comparison of the Three Months ended July 1, 2017 to the Three Months ended July 2, 2016

Revenue. Total revenue increased $20.3 million, or 11.8%, to $192.9 million for the three months ended July 1, 2017 from $172.6 million for the three months ended July 2, 2016. The following table details our total product revenues by the geographic area to which the products were shipped for each of the three months ended July 1, 2017 and July 2, 2016 (dollars in thousands):

	Three Months Ended					
	July 1, 2017		July 2, 2016		Increase/ (Decrease)	Percentage Change
United States	$126,455	69.2 %	$117,045	71.1 %	$ 9,410	8.0 %
Europe, Middle East and Africa	33,693	18.4	25,988	15.8	7,705	29.6
Asia and Australia	16,988	9.3	16,602	10.1	386	2.3
North and South America (excluding United States)	5,666	3.1	4,972	3.0	694	14.0
Total product revenue	$182,802	100.0%	$164,607	100.0%	$ 18,195	11.1 %
Royalty and other revenue	10,131		8,029		2,102	26.2
Total revenue	$192,933		$172,636		$ 20,297	11.8 %

Product revenue increased $18.2 million, or 11.1%, to $182.8 million for the three months ended July 1, 2017 from $164.6 million for the three months ended July 2, 2016. This increase was primarily due to higher sales of consumables and monitors, which was partially offset by the impact of approximately $1.3 million of unfavorable foreign exchange rate movements from the prior year period that reduced the U.S. Dollar translation of foreign sales that were denominated in various foreign currencies, primarily in Europe and Asia. We estimate that our installed base of circuit boards and pulse oximeters increased to approximately 1,545,000 units at July 1, 2017 as compared to 1,459,000 units at July 2, 2016.

Table of Contents

Product revenue generated through our direct and distribution sales channels increased $19.5 million, or 13.8%, to $160.4 million for the three months ended July 1, 2017, compared to $140.9 million for the three months ended July 2, 2016. Revenues from our OEM channel decreased $1.3 million, or 5.4%, to $22.4 million for the three months ended July 1, 2017 as compared to $23.7 million for the three months ended July 2, 2016. Total rainbow® product revenue increased by $2.2 million, or 14.6%, to $17.1 million for the three months ended July 1, 2017, compared to $14.9 million for the three months ended July 2, 2016, primarily due to an increase in rainbow® orders from a large international customer.

Royalty and other revenue consists primarily of royalties received from Medtronic plc (Medtronic, formerly Covidien Ltd.) related to its U.S. sales pursuant to the terms of our settlement agreement, and revenue from non-recurring engineering (NRE) services for certain OEM customers.

Gross Profit. Gross profit consists of total revenue less cost of goods sold. Our gross profit for the three months ended July 1, 2017 and July 2, 2016 was as follows (dollars in thousands):

	Three Months Ended							
	July 1, 2017	Gross Profit Percentage		July 2, 2016	Gross Profit Percentage		Increase/ (Decrease)	Percentage Change
Product gross profit	$118,372	64.8	%	$107,106	65.1	%	$ 11,266	10.5 %
Royalty and other revenue gross profit	10,065	99.4		8,029	100.0		2,036	25.4
Total gross profit	$128,437	66.6	%	$115,135	66.7	%	$ 13,302	11.6 %

Cost of goods sold includes labor, material, overhead and other similar costs related to the production, supply, distribution and support of our products. Cost of goods sold increased $7.0 million for the three months ended July 1, 2017 compared to the three months ended July 2, 2016, primarily due to higher product revenue and slightly higher production costs associated with the expansion of our manufacturing capacity. Product gross margins declined slightly to 64.8% for the three months ended July 1, 2017 compared to 65.1% for the three months ended July 2, 2016, primarily due to unfavorable production variances associated with the expansion of our manufacturing capacity.

Selling, General and Administrative. Selling, general and administrative expenses consist primarily of salaries and related expenses for sales, marketing and administrative personnel, sales commissions, advertising and promotion costs, professional fees related to legal, accounting and other outside services, public company costs and other corporate expenses. Selling, general and administrative expenses for the three months ended July 1, 2017 and July 2, 2016 were as follows (dollars in thousands):

Selling, General and Administrative					
Three Months Ended July 1, 2017	Percentage of Net Revenues	Three Months Ended July 2, 2016	Percentage of Net Revenues	Increase/ (Decrease)	Percentage Change
$66,377	34.4%	$63,888	37.0%	$2,489	3.9%

Selling, general and administrative expenses increased $2.5 million, or 3.9%, for the three months ended July 1, 2017 compared to the three months ended July 2, 2016. This increase was primarily attributable to higher marketing-related expenses of approximately $2.3 million, higher payroll and employee-related costs of approximately $1.0 million, higher professional services fees of approximately $0.6 million and higher occupancy costs of approximately $0.6 million, which were partially offset by approximately $2.0 million of lower legal fees. Stock-based compensation expense of approximately $2.6 million and $2.5 million was included in selling, general and administrative expenses for the three months ended July 1, 2017 and July 2, 2016, respectively.

Research and Development. Research and development expenses consist primarily of salaries and related expenses for engineers and other personnel engaged in the design and development of our products. These expenses also include third-party fees paid to consultants, prototype and engineering supply expenses and the costs of clinical trials.

Research and development expenses for the three months ended July 1, 2017 and July 2, 2016 were as follows (dollars in thousands):

Research and Development					
Three Months Ended July 1, 2017	Percentage of Net Revenues	Three Months Ended July 2, 2016	Percentage of Net Revenues	Increase/ (Decrease)	Percentage Change

$15,192	7.9%	$14,818	8.6%	$374	2.5%

Research and development expenses increased $0.4 million, or 2.5%, for the three months ended July 1, 2017 compared to the three months ended July 2, 2016, primarily due to higher payroll-related costs of approximately $1.7 million, higher

Table of Contents

engineering project expenses of approximately $0.4 million and higher professional fees of approximately $0.2 million, which were offset by capitalized costs related customer NRE services of approximately $2.0 million. Included in research and development expenses was approximately $0.6 million of stock-based compensation expense for each of the three months ended July 1, 2017 and July 2, 2016.

Non-operating Income. Non-operating income consists primarily of interest income, interest expense and foreign exchange losses. Non-operating income for the three months ended July 1, 2017 and July 2, 2016 was as follows (dollars in thousands):

Non-operating Income

Three Months Ended July 1, 2017	Percentage of Net Revenues	Three Months Ended July 2, 2016	Percentage of Net Revenues	Increase/ (Decrease)	Percentage Change
$158	0.1%	$471	0.3%	$(313)	(66.5)%

Non-operating income decreased by $0.3 million for the three months ended July 1, 2017 compared to the three months ended July 2, 2016. Non-operating income for the three months ended July 1, 2017 consisted of approximately $0.3 million of net realized and unrealized gains on foreign currency denominated transactions and approximately $0.7 million in net interest income. Non-operating income for the three months ended July 2, 2016 consisted of approximately $1.1 million of interest expense, which was offset by approximately $1.5 million of net realized and unrealized gains on foreign currency denominated transactions.

Provision for Income Taxes. Our provision for income taxes for the three months ended July 1, 2017 and July 2, 2016 was as follows (dollars in thousands)

Provision for Income Taxes

Three Months Ended July 1, 2017	Percentage of Net Revenues	Three Months Ended July 2, 2016	Percentage of Net Revenues	Increase/ (Decrease)	Percentage Change
$346	0.2%	$6,877	4.0%	$(6,531)	(95.0)%

For the three months ended July 1, 2017, we recorded a provision for income taxes of approximately $0.3 million, or an effective tax rate of 0.7%, as compared to a provision for income taxes of approximately $6.9 million, or an effective tax rate of 18.6%, for the three months ended July 2, 2016. The decrease in the provision for income taxes for the three months ended July 1, 2017 resulted primarily from a discrete tax benefit of approximately $15.1 million related to excess tax benefits realized from stock-based compensation pursuant to Accounting Standards Update No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting (ASU 2016-09), which substantially exceeded the discrete tax benefit of approximately $4.1 million recorded for such excess tax benefits during the three months ended July 2, 2016. Partially offsetting this discrete tax benefit was an increase in our effective tax rate resulting from differences in our expected fiscal 2017 geographic composition of our pre-tax income compared to our expected fiscal 2016 geographic composition as of July 2, 2016.

Comparison of the Six Months ended July 1, 2017 to the Six Months ended July 2, 2016

Revenue. Total revenue increased $35.4 million, or 10.3%, to $379.2 million for the six months ended July 1, 2017 from $343.8 million for the six months ended July 2, 2016. The following table details our total product revenues by the geographic area to which the products were shipped for each of the six months ended July 1, 2017 and July 2, 2016 (dollars in thousands):

	Six Months Ended					
	July 1, 2017		July 2, 2016		Increase/ (Decrease)	Percentage Change
United States	$251,137	69.6 %	$230,549	70.3 %	$ 20,588	8.9 %
Europe, Middle East and Africa	64,195	17.8	57,958	17.7	6,237	10.8
Asia and Australia	33,724	9.3	30,184	9.2	3,540	11.7
North and South America (excluding United States)	11,843	3.3	9,206	2.8	2,637	28.6
Total product revenue	$360,899	100.0%	$327,897	100.0%	$ 33,002	10.1 %
Royalty and other revenue	18,336		15,906		2,430	26.2
Total revenue	$379,235		$343,803		$ 35,432	10.3 %

34

Table of Contents

Product revenue increased $33.0 million or 10.1%, to $360.9 million for the six months ended July 1, 2017 from $327.9 million for the six months ended July 2, 2016. This increase was primarily due to higher sales of consumables and monitors, which was partially offset by the impact of approximately $2.0 million in unfavorable foreign exchange rate movements from the prior year period that reduced the U.S. Dollar translation of foreign sales that were denominated in various foreign currencies, primarily in Europe and Asia. We estimate that our installed base of circuit boards and pulse oximeters increased to approximately 1,545,000 units at July 1, 2017 as compared to 1,459,000 units at July 2, 2016.

Product revenue generated through our direct and distribution sales channels increased $33.5 million, or 11.9%, to $315.3 million for the six months ended July 1, 2017, compared to $281.9 million for the six months ended July 2, 2016. Revenues from our OEM channel decreased $0.5 million, or 1.0%, to $45.6 million for the six months ended July 1, 2017 as compared to $46.0 million for the six months ended July 2, 2016. Total rainbow® product revenue decreased by $0.9 million, or 2.6%, to $31.0 million for the six months ended July 1, 2017, compared to $31.9 million for the six months ended July 2, 2016.

Royalty and other revenue primarily consists of royalties received from Medtronic plc (Medtronic, formerly Covidien Ltd.) related to its U.S. sales pursuant to the terms of our settlement agreement and revenue from NRE services for certain OEM customers.

Gross Profit. Gross profit consists of total revenue less cost of goods sold. Our gross profit for the six months ended July 1, 2017 and July 2, 2016 was as follows (dollars in thousands):

	Six Months Ended							
	July 1, 2017	Gross Profit Percentage		July 2, 2016	Gross Profit Percentage		Increase/ (Decrease)	Percentage Change
Product gross profit	$234,301	64.9	%	$213,442	65.1	%	$ 20,859	9.8 %
Royalty and other revenue gross profit	18,270	99.6		15,906	100.0		2,364	14.9
Total gross profit	$252,571	66.6	%	$229,348	66.7	%	$ 23,223	10.1 %

Cost of goods sold includes labor, material, overhead and other similar costs related to the production, supply, distribution and support of our products. Cost of goods sold increased $12.2 million for the six months ended July 1, 2017 compared to the six months ended July 2, 2016, primarily due to higher product revenue and slightly higher production costs associated with the expansion of our manufacturing capacity. Product gross margins decreased slightly to 64.9% for the six months ended July 1, 2017 compared to 65.1% for the six months ended July 2, 2016, primarily due to unfavorable production variances related to our ramp up of additional manufacturing capacity.

Selling, General and Administrative. Selling, general and administrative expenses consist primarily of salaries and related expenses for sales, marketing and administrative personnel, sales commissions, advertising and promotion costs, professional fees related to legal, accounting and other outside services, public company costs and other corporate expenses. Selling, general and administrative expenses for the six months ended July 1, 2017 and July 2, 2016 were as follows (dollars in thousands):

Selling, General and Administrative					
Six Months Ended July 1, 2017	Percentage of Net Revenues	Six Months Ended July 2, 2016	Percentage of Net Revenues	Increase/ (Decrease)	Percentage Change
$131,949	34.8%	$126,399	36.8%	$5,550	4.4%

Selling, general and administrative expenses increased $5.6 million, or 4.4%, for the six months ended July 1, 2017 compared to the six months ended July 2, 2016. This increase was primarily attributable to higher payroll and employee-related expenses of approximately $5.0 million, higher marketing-related costs of approximately $2.8 million and higher occupancy costs of approximately $1.2 million, which were partially offset by approximately $4.0 million of lower legal fees. Stock-based compensation expense of approximately $4.6 million and $4.8 million was included in selling, general and administrative expenses for the six months ended July 1, 2017 and July 2, 2016, respectively.

Research and Development. Research and development expenses consist primarily of salaries and related expenses for engineers and other personnel engaged in the design and development of our products. These expenses also include

third-party fees paid to consultants, prototype and engineering supply expenses and the costs of clinical trials. Research and development expenses for the six months ended July 1, 2017 and July 2, 2016 were as follows (dollars in thousands):

Table of Contents

Research and Development

Six Months Ended July 1, 2017	Percentage of Net Revenues	Six Months Ended July 2, 2016	Percentage of Net Revenues	Increase/ (Decrease)	Percentage Change
$30,559	8.1%	$29,183	8.5%	$1,376	4.7%

Research and development expenses increased $1.4 million, or 4.7%, for the six months ended July 1, 2017 compared to the six months ended July 2, 2016, primarily due to higher payroll-related costs of approximately $2.4 million and higher engineering project costs of approximately $0.5 million, which were partially offset by capitalized costs related to customer NRE services of approximately $2.0 million. Included in research and development expenses was approximately $1.3 million of stock-based compensation expense for each of the six months ended July 1, 2017 and July 2, 2016.

Non-operating Income. Non-operating income consists primarily of interest income, interest expense and foreign exchange losses. Non-operating income for the six months ended July 1, 2017 and July 2, 2016 was as follows (dollars in thousands):

Non-operating Income

Six Months Ended July 1, 2017	Percentage of Net Revenues	Six Months Ended July 2, 2016	Percentage of Net Revenues	Increase/ (Decrease)	Percentage Change
$1,032	0.3%	$969	0.3%	$63	6.5%

Non-operating income increased by $0.1 million for the six months ended July 1, 2017 compared to the six months ended July 2, 2016. Non-operating income for the six months ended July 1, 2017 consisted of approximately $0.1 million of net realized and unrealized gains on foreign currency denominated transactions and approximately $1.2 million in net interest income. Non-operating income for the six months ended July 2, 2016 consisted of $1.8 million of interest expense offset by $2.3 million of net realized and unrealized gains on foreign currency denominated transactions and a $0.3 million gain resulting from our deconsolidation of Cercacor.

(Benefit) Provision for Income Taxes. Our provision for income taxes for the six months ended July 1, 2017 and July 2, 2016 was as follows (dollars in thousands):

(Benefit) Provision for Income Taxes

Six Months Ended July 1, 2017	Percentage of Net Revenues	Six Months Ended July 2, 2016	Percentage of Net Revenues	Increase/ (Decrease)	Percentage Change
$(919)	(0.2)%	$17,135	5.0%	$(18,054)	(105.4)%

For the six months ended July 1, 2017, we recorded a benefit for income taxes of approximately $0.9 million, or an effective tax benefit rate of 1.0%, as compared to a provision for income taxes of approximately $17.1 million, or an effective tax rate of 22.9%, for the six months ended July 2, 2016. The benefit for income taxes for the six months ended July 1, 2017 resulted primarily from a discrete tax benefit of approximately $30.2 million related to excess tax benefits realized from stock-based compensation pursuant to ASU 2016-09, which substantially exceeded the discrete tax benefit of approximately $5.1 million recorded for such excess tax benefits during the six months ended July 2, 2016. Partially offsetting this discrete tax benefit was an increase in our effective tax rate resulting from differences in our expected fiscal 2017 geographic composition of our pre-tax income compared to our expected fiscal 2016 geographic composition as of July 2, 2016.

Table of Contents

Liquidity and Capital Resources

Our principal sources of liquidity consist of our existing cash and cash equivalent balances, funds expected to be generated from operations and funds available under our revolving credit agreement. At July 1, 2017, we had approximately $420.7 million in working capital and approximately $331.4 million in cash and cash equivalents as compared to approximately $286.9 million in working capital and approximately $306.0 million in cash and cash equivalents at December 31, 2016. We carry cash equivalents at cost that approximates fair value. We currently do not maintain an investment portfolio but have the ability to invest in various security holdings, types and maturities that meet credit quality standards in accordance with our investment guidelines.

As of July 1, 2017, we had cash totaling $169.3 million held outside of the U.S., of which approximately $17.7 million was accessible without additional tax cost and approximately $151.6 million was accessible at an incremental estimated tax cost of approximately $45.9 million. In managing our day-to-day liquidity and capital structure, we do not rely on foreign earnings as a source of funds. We currently have sufficient funds on-hand and available under our line of credit to fund our domestic operations and do not anticipate the need to repatriate funds associated with our permanently reinvested foreign earnings. In the event funds that are treated as permanently reinvested are repatriated, we may be required to accrue and pay additional U.S. taxes with respect to any such repatriation.

Our Amended and Restated Credit Agreement (Restated Credit Facility) with JPMorgan Chase Bank, N.A., as Administrative Agent and a Lender, Bank of America, N.A., as Syndication Agent and a Lender, Citibank, N.A., as Documentation Agent and a Lender, and various other Lenders (collectively, the Lenders) provides for up to $250.0 million in borrowings in multiple currencies, with an option, subject to certain conditions, for us to increase the aggregate borrowing capacity to up to $550.0 million in the future. The Restated Credit Facility also provides for a sublimit of up to $50.0 million for the issuance of letters of credit and a sublimit of $125.0 million in specified foreign currencies. All unpaid principal under the Restated Credit Facility will become due and payable on January 8, 2021. See Note 10 to the condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional information.

Cash Flows

The following table summarizes our cash flows (in thousands):

	Six Months Ended	
	July 1, 2017	July 2, 2016
Net cash (used in) provided by:		
Operating activities	$(14,409)	$56,691
Investing activities	(10,086)	(12,846)
Financing activities	48,148	(59,911)
Effect of foreign currency exchange rates on cash	1,825	(196)

Increase (decrease) in cash and cash equivalents	$25,478	$(16,262)

Operating Activities. Cash used in operating activities was approximately $14.4 million for the six months ended July 1, 2017. Net income from operations was $92.0 million, which was offset by non-cash activity including depreciation and amortization of $9.5 million and stock-based compensation of $6.1 million. In addition, during the six months ended July 1, 2017, accounts payable increased by $3.1 million due to the timing of payments. These sources of cash were offset by other changes in operating assets and liabilities, including a decrease in accrued liabilities of $67.6 million, primarily related to tax payments for the year ended December 31, 2016, an increases in inventories and deferred cost of goods sold of $15.6 million and $13.7 million, respectively, an increase in other current assets of $14.7 million, primarily related to estimated tax payments for the current fiscal year, a decrease in accrued compensation of $11.7 million, primarily due to the timing of payments, and an increase in accounts receivable of $2.1 million, primarily due to the timing of cash receipts.

Cash provided by operating activities was approximately $56.7 million for the six months ended July 2, 2016, arising primarily from net income of $57.6 million. Non-cash activity included depreciation and amortization of $8.1 million, stock-based compensation of $6.2 million and deferred income taxes of $5.0 million. In addition, accounts payable, deferred revenue and other liabilities increased by $7.9 million, $5.3 million and $3.9 million, respectively, during the six months ended July 2, 2016. These sources of cash were primarily offset by other changes in operating assets and liabilities including a decrease in accrued liabilities of $13.8 million and accrued compensation of $3.9 million, as well as an increase in other current assets of $7.5 million, all due to the timing of related payments; an increase in other assets of $6.6 million; and an increase in accounts receivable of $3.7 million due to the timing of collections.

Table of Contents

Investing Activities. Cash used in investing activities for the six months ended July 1, 2017 was $10.1 million, consisting of $8.5 million for purchases of property and equipment and $1.6 million of intangible assets related primarily to capitalized patent and trademark costs. Cash used in investing activities for the six months ended July 2, 2016 was $12.8 million, consisting of $10.7 million for purchases of property and equipment, $1.3 million of intangible assets related to capitalized patent and trademark costs and $0.8 million related to the deconsolidation of Cercacor. See Note 3 to the condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for additional information related to the deconsolidation of Cercacor.

Financing Activities. Cash provided by financing activities for the six months ended July 1, 2017 was $48.1 million, primarily driven by proceeds from the exercise of employee options totaling $48.2 million. Cash used in financing activities for the six months ended July 2, 2016 was $59.9 million, primarily driven by common stock repurchase transactions during the six month period totaling $68.2 million and repayments under our Restated Credit Facility of $10.0 million, offset by proceeds from the exercise of employee stock options totaling $19.0 million.

Capital Resources and Prospective Capital Requirements

As of July 1, 2017, we did not have any outstanding loan draws and had $0.3 million in outstanding letters of credit under our Restated Credit Facility, leaving available borrowing capacity of $249.7 million. We also had outstanding capital lease obligations of less than $0.1 million related primarily to office and computer equipment. We had no other debt obligations and were in compliance with all bank covenants.

In September 2015, the Board authorized a stock repurchase program for the repurchase of up to 5.0 million shares of our common stock over a period of up to three years. The stock repurchase program may be carried out at the discretion of a committee comprised of our Chief Executive Officer and Chief Financial Officer through open market purchases, one or more Rule 10b5-1 trading plans, block trades and in privately negotiated transactions. As of July 1, 2017, approximately 2.9 million shares remained authorized for repurchase under this stock repurchase program. For additional information regarding our stock repurchase program, see Note 12 to the condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q.

We expect to fund our future operating, investing and financing activities through our available cash, future cash from operations, funds available under our Restated Credit Facility and other potential sources of capital. In addition to funding our normal working capital requirements, we anticipate additional capital purchases related to renovating our new corporate headquarters. We also anticipate that we will continue to repurchase stock under our authorized stock repurchase program subject to the availability of our stock, general market conditions, the trading price of our stock, available capital, alternative uses for capital and our financial performance. Possible additional uses of cash may include the acquisition of technologies or technology companies.

The amount and timing of our actual investing activities will vary significantly depending on numerous factors, including the timing and amount of costs related to the renovation of our new corporate headquarters facility and other capital expenditures, costs of product development efforts, stock repurchase activity and costs related to our domestic and international regulatory requirements. Despite these investment requirements, we anticipate that our existing cash and cash equivalents, as well as amounts available under the Restated Credit Facility, will be sufficient to meet our working capital requirements, capital expenditures and other operational funding needs for at least the next 12 months.

Off-Balance Sheet Arrangements

We do not currently have, nor have we ever had, any relationships with unconsolidated entities or financial partnerships, such as entities referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or for other contractually narrow or limited purposes. In addition, we do not engage in trading activities involving non-exchange traded contracts. As a result, we are not materially exposed to any financing, liquidity, market or credit risk that could arise if we engaged in these relationships. As of July 1, 2017, we did not have any off-balance sheet arrangements, as defined in Item 303(a)(4)(ii) of Regulation S-K promulgated by the SEC.

Critical Accounting Policies and Estimates

The discussion and analysis of our financial condition and results of operations is based on our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States of America. The preparation of these condensed consolidated financial statements

requires management to make estimates and judgments that affect the reported amounts of net revenues, expenses, assets and liabilities. We regularly evaluate our estimates and assumptions related to our critical accounting policies, including revenue recognition and deferred revenue, inventory and related reserves for excess or obsolete inventory, allowance for doubtful accounts, stock-based compensation,

Table of Contents

goodwill, deferred taxes and related valuation allowances, uncertain tax positions, tax contingencies, litigation costs and loss contingencies. We base our estimates and assumptions on current facts, historical experience and various other factors that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities and the recording of revenue, costs and expenses that are not readily apparent from other sources. Changes in judgments and uncertainties relating to these estimates could potentially result in materially different results under different assumptions and conditions. If these estimates differ significantly from actual results, the impact on our condensed consolidated financial statements and future results of operations may be material. For a description of our critical accounting policies, please refer to "Critical Accounting Estimates" in Part II, Item 7, "Management's Discussion and Analysis of Financial Condition and Results of Operations" of our Annual Report on Form 10-K for the fiscal year ended December 31, 2016, filed with the SEC on February 15, 2017. There have been no material changes to any of our critical accounting policies during the six months ended July 1, 2017.

Recent Accounting Pronouncements

See Note 2 to the condensed consolidated financial statements included in Part I, Item 1 of this Quarterly Report on Form 10-Q for a description of recently issued or adopted accounting standards.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Market risk represents the risk of changes in the value of market risk sensitive instruments caused by fluctuations in interest rates, foreign exchange rates and commodity prices. We are exposed to various market risks that may arise from adverse changes in market rates and prices, such as interest rates, foreign exchange fluctuations and inflation. We do not enter into derivatives, including forward contracts, or other financial instruments for trading or speculative purposes.

Interest Rate Risk

Our exposure to market risk for changes in interest rates relates to the increase or decrease in the amount of interest income we can earn on our investment portfolio and on the increase or decrease in the amount of interest expense we must pay with respect to our various outstanding debt instruments. Our risk associated with fluctuations in interest expense is limited to interest associated with our outstanding capital lease arrangements, which have fixed interest rates, and any borrowings under our Restated Credit Facility and any amendments thereto. Under our current policies, we do not use interest rate derivative instruments to manage exposure to interest rate changes. We ensure the safety and preservation of our invested principal funds by limiting default risk, market risk and reinvestment risk. We reduce default risk by investing in investment grade securities. A hypothetical 100 basis point change in interest rates along the entire interest rate yield curve would not significantly affect the fair value of our interest-sensitive financial instruments at July 1, 2017. Declines in interest rates over time will, however, reduce our interest income and expense while increases in interest rates will increase our interest income and expense.

Foreign Currency Exchange Rate Risk

A majority of our assets and liabilities are maintained in the United States in U.S. Dollars and a majority of our sales and expenditures are transacted in U.S. Dollars. However, we also transact with foreign customers in currencies other than the U.S. Dollar. These foreign currency revenues, when converted into U.S. Dollars, can vary depending on average exchange rates during a respective period. In addition, certain of our foreign subsidiaries transact in their respective country's local currency, which is also their functional currency. As a result, expenses of these foreign subsidiaries, when converted into U.S. Dollars, can vary depending on the average exchange rates during a respective period.

We are exposed to foreign currency gains or losses on outstanding foreign currency denominated receivables and payables, as well as intercompany transactions. Realized and unrealized foreign currency gains or losses on these transactions are included in our statements of comprehensive income as incurred. Furthermore, other transactions between us or our subsidiaries and a third-party, denominated in a currency different from the functional currency, are foreign currency transactions. Realized and unrealized foreign currency gains or losses on these transactions are included in our statements of comprehensive income as incurred, and are converted to U.S. Dollars at the average exchange rates for a respective period.

The balance sheets of each of our foreign subsidiaries whose functional currency is not the U.S. Dollar are translated into U.S. Dollars at the rate of exchange at the balance sheet date and the statements of comprehensive income and cash flows are translated into U.S. Dollars using the average monthly exchange rate during the period. Any foreign exchange gain or loss as a result of translating the balance sheets of our foreign subsidiaries whose functional currency is not the U.S. Dollar is included in equity as a component of accumulated other comprehensive income.

Our primary foreign currency exchange rate exposures are with the Euro, Japanese Yen, Swedish Krona, Canadian Dollar, British Pound, Mexican Peso and Australian Dollar, against the U.S. Dollar. Foreign currency exchange rates have experienced significant movements recently, particularly when compared to the same prior year period, and such volatility may continue in

Table of Contents

the future. Specifically, during the three and six months ended July 1, 2017, we estimate that changes in the exchange rates of the U.S. Dollar, relative primarily to the Euro and British Pound, unfavorably impacted our revenues by $1.3 million and $2.0 million, respectively, when compared to foreign exchange rates from the prior year period. We currently do not enter into forward exchange contracts to hedge exposures denominated in foreign currencies and do not use derivative financial instruments for trading or speculative purposes. The effect of additional changes in foreign currency exchange rates could have a material effect on our future operating results or cash flows, depending on which foreign currency exchange rates change and depending on the directional change (either a strengthening or weakening against the U.S. Dollar). We estimate that the potential impact of a hypothetical 10% adverse change in all applicable foreign currency exchange rates from the rates in effect as of July 1, 2017 would have resulted in an estimated reduction of $8.3 million in reported pre-tax income for the six months ended July 1, 2017. As our foreign operations continue to grow, our exposure to foreign currency exchange rate risk may become more significant.

Inflation Risk

We do not believe that inflation has had a material effect on our business, financial condition or results of operations during the periods presented. If our costs were to become subject to significant inflationary pressures, we may not be able to fully offset such higher costs through price increases. Our inability or failure to do so could have a material adverse effect on our business, financial condition and results of operations.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports filed under the Securities Exchange Act of 1934, as amended (the Exchange Act), is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission's (SEC) regulations, rules and forms and that such information is accumulated and communicated to our management, including our Chief Executive Officer and Chief Financial Officer, as appropriate, to allow for timely decisions regarding required disclosure.

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures. As required by Rule 13a-15(b) or Rule 15d-15(b) promulgated by the SEC under the Exchange Act, we carried out an evaluation, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report on Form 10-Q. Based on the foregoing, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were effective as of the end of the period covered by this Quarterly Report on Form 10-Q.

There has been no change in our internal control over financial reporting during the quarter ended July 1, 2017 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. Legal Proceedings

The information set forth in Note 14 to the condensed consolidated financial statements under the caption "Litigation" included in Part I, Item 1 of this Quarterly Report on Form 10-Q is incorporated herein by reference.

Item 1A. Risk Factors

Before you decide to invest or maintain an interest in our common stock, you should consider carefully the risks described below, which have been updated since the filing of our Annual Report on Form 10-K for the fiscal year ended December 31, 2016, filed with the Securities and Exchange Commission (SEC) on February 15, 2017, together with the other information contained in this Quarterly Report on Form 10-Q, and any recent Current Reports on Form 8-K. We believe the risks described below are the risks that are material to us as of the date of this Quarterly Report on Form 10-Q. Other risks and uncertainties, including those not presently known to us or that we do not currently consider material, may also impair our business operations. If any of the following risks comes to fruition, our business, financial condition, results of operations and growth prospects would likely be materially and adversely affected. In these circumstances, the market price of our common stock could decline, and you could lose all or part of your investment or interest.

Risk factors marked with an asterisk (*) below include a substantive change from or an update to the risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016, filed with the SEC on February 15, 2017.

Table of Contents

Risks Related to Our Revenues

We currently derive the majority of our revenue from our Masimo SET® platform, Masimo rainbow SET™ platform and related products. If these technologies and related products do not continue to achieve market acceptance, our business, financial condition and results of operations would be adversely affected.

We are highly dependent upon the continued success and market acceptance of our proprietary Masimo SET® technology that serves as the basis of our primary product offerings. Continued market acceptance of products incorporating Masimo SET® will depend upon us continuing to provide evidence to the medical community that our products are cost-effective and offer significantly improved performance compared to conventional pulse oximeters. Health care providers that currently have significant investments in competitive pulse oximetry products may be reluctant to purchase our products. If hospitals and other health care providers do not believe our Masimo SET® platform is cost-effective, safe or more accurate or reliable than competitive pulse oximetry products, they may not buy our products in sufficient quantities to enable us to generate revenue growth from the sale of these products. In addition, allegations regarding the safety and effectiveness of our products, whether or not substantiated, may impair or impede the acceptance of our products. If we are unable to achieve additional market acceptance of our core technology or products incorporating Masimo SET®, we will not generate significant revenue growth from the sale of our products, which would adversely affect our business, financial condition and results of operations.

*Some of our products are in development or have been recently introduced into the market and may not achieve market acceptance, which could limit our growth and adversely affect our business, financial condition and results of operations.

Products that we have introduced into the market in recent years may not be accepted in the market. In general, our recent noninvasive measurement technologies are considered disruptive. These recent technologies have performance levels that we believe are acceptable for many clinical environments but may be insufficient in others. In addition, these technologies may perform better in some patients and settings than others. Over time, we hope to continue to improve the performance of these technologies and educate the clinical community on how to properly evaluate them. If we are successful in these endeavors, we expect these technologies will become more useful in more environments and will become more widely adopted. While this is the adoption pattern experienced historically with other new noninvasive measurements, such as regional oximetry, we are unable to guarantee that such adoption pattern will apply to our recent and future technologies.

Even if our customers recognize the benefits of our products, we cannot assure you that our customers will purchase them in quantities sufficient for us to be profitable or successful. We are continuing to invest in significant sales and marketing resources to achieve market acceptance of these products with no assurance of success.

The degree of market acceptance of these products will depend on a number of factors, including:

- perceived clinical benefits from our products;
- perceived cost effectiveness of our products;
- perceived safety and effectiveness of our products;
- reimbursement available through Centers for Medicare and Medicaid Services (CMS) programs for using some of our products; and
- introduction and acceptance of competing products or technologies.

If our products do not gain market acceptance or if our customers prefer our competitors' products, our potential revenue growth would be limited, which would adversely affect our business, financial condition and results of operations.

*Our ability to commercialize new products, new or improved technologies and additional applications for Masimo SET® and our licensed rainbow® technology is limited to certain markets by our Cross-Licensing Agreement with Cercacor Laboratories, Inc. (Cercacor), which may impair our growth and adversely affect our business, financial condition and results of operations.

We are party to a cross-licensing agreement with Cercacor, which has been amended several times, most recently in an Amended and Restated Cross-Licensing Agreement, effective January 1, 2007 (the Cross-Licensing Agreement). Under the Cross-Licensing Agreement, we granted Cercacor:

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an exclusive, perpetual and worldwide license, with sublicense rights, to use all Masimo SET® owned by us, including all improvements on this technology, for the monitoring of non-vital signs parameters and to develop and sell devices incorporating Masimo SET® for monitoring non-vital signs parameters in any product market in which a product is intended to be used by a patient or pharmacist rather than by a professional medical caregiver, which we refer to as the Cercacor Market; and

Table of Contents

- a non-exclusive, perpetual and worldwide license, with sublicense rights, to use all Masimo SET® for measurement of vital signs in the Cercacor Market.

Non-vital signs measurements consist of body fluid constituents other than vital signs measurements, including, but not limited to, carbon monoxide, methemoglobin, blood glucose, hemoglobin and bilirubin. Under the Cross-Licensing Agreement, we are only permitted to sell devices utilizing Masimo SET® for the monitoring of non-vital signs parameters in markets where the product is intended to be used by a professional medical caregiver, including, but not limited to, hospital caregivers and alternate care facility caregivers, rather than by a patient or pharmacist, which we refer to as the Masimo Market. Accordingly, our ability to commercialize new products, new or improved technologies and additional applications for Masimo SET® is limited. In particular, our inability to expand beyond the Masimo Market may limit our ability to maintain or increase our revenue and impair our growth.

Pursuant to the Cross-Licensing Agreement, we have licensed from Cercacor the right to make and distribute products in the Masimo Market that utilize rainbow® technology for certain noninvasive measurements. As a result, the opportunity to expand the market for our products incorporating rainbow® technology is also limited, which could limit our ability to maintain or increase our revenue and impair our growth.

*We face competition from other companies, many of which have substantially greater resources than we do. If we do not successfully develop and commercialize enhanced or new products that remain competitive with products or alternative technologies developed by others, we could lose revenue opportunities and customers, and our ability to grow our business would be impaired, adversely affecting our financial condition and results of operations.

The medical device industry is intensely competitive and is significantly affected by new product introductions and other market activities of industry participants. A number of our competitors have substantially greater capital resources, larger product portfolios, larger customer bases, larger sales forces and greater geographic presence, have established stronger reputations with specific customers, and have built relationships with Group Purchasing Organizations (GPOs) that may be more effective than ours. Our Masimo SET® platform faces additional competition from companies developing products for use with third-party monitoring systems, as well as from companies that currently market their own pulse oximetry monitors. In addition, competitors with larger product portfolios than ours may offer increased discounts to hospitals that purchase their requirements for a variety of different products from the competitor, including products that we do not offer.

Rapid product development and technological advances within the medical device industry place our products at risk of obsolescence. Our long-term success depends upon the development and successful commercialization of new products, new or improved technologies and additional applications for Masimo SET® and licensed rainbow® technology. The research and development process is time-consuming and costly and may not result in products or applications that we can successfully commercialize. In particular, we may not be able to successfully commercialize our products for applications other than arterial blood oxygen saturation and pulse rate monitoring, such as for respiration rate, hemoglobin, carboxyhemoglobin and methemoglobin monitoring.

If we do not successfully adapt our products and applications both within and outside these measurements, we could lose revenue opportunities and customers. Furthermore, one or more of our competitors may develop products that are substantially equivalent to our U.S. Food and Drug Administration (FDA) cleared products, or those of our original equipment manufacturer (OEM) partners, in which case a competitor of ours may use our products or those of our OEM partners as predicate devices to more quickly obtain FDA clearance of their competing products. Competition could result in pressure from our customers to reduce the price of our products and in fewer orders for our products, which could, in turn, cause a reduction in our revenues and product gross margins, thereby adversely impacting our business, financial condition and results of operations.

We depend on our domestic and international OEM partners for a portion of our revenue. If they do not devote sufficient resources to the promotion of products that use Masimo SET® and licensed rainbow® technology, our business would be harmed.

We are, and will continue to be, dependent upon our domestic and international OEM partners for a portion of our revenue through their marketing, selling and distribution of certain of their products that incorporate Masimo SET® and licensed rainbow® technology. Although we expect that our OEM partners will accept and actively market, sell and distribute products that incorporate licensed rainbow® technology, they may not elect, and have no contractual

obligation, to do so. Because products that incorporate our technologies may represent a relatively small percentage of business for some of our OEM partners, they may have less incentive to promote these products over other products that do not incorporate these technologies. In addition, some of our OEM partners offer products that compete with ours and also may be involved in intellectual property disputes with us. Therefore, we cannot guarantee that our OEM partners, or any company that may acquire any of our OEM partners, will vigorously promote products incorporating Masimo SET® and licensed rainbow® technology. The failure of our OEM partners to successfully market, sell or distribute products incorporating these technologies, the termination of OEM

Table of Contents

agreements, the loss of OEM partners or the inability to enter into future OEM partnership agreements would have a material adverse effect on our business, financial condition and results of operations.

*If we fail to maintain or develop relationships with GPOs, sales of our products would decline.

Our ability to sell our products to U.S. hospitals depends, in part, on our relationships with GPOs. Many existing and potential customers for our products are members of GPOs. GPOs negotiate beneficial pricing arrangements and contracts, which are sometimes exclusive, with medical supply manufacturers and distributors.

These negotiated prices are made available to a GPO's affiliated hospitals and other members. If we are not one of the providers selected by a GPO, the GPO's affiliated hospitals and other members may be less likely or unlikely to purchase our products. If a GPO has negotiated a strict sole source, market share compliance or bundling contract for another manufacturer's products, we may be prohibited from making sales to members of such GPO for the duration of such contractual arrangement. For the six months ended July 1, 2017 and July 2, 2016, shipments of our pulse oximetry products to customers that are members of GPOs represented approximately $205.3 million and $185.3 million, respectively, of our revenue from sales to U.S. hospitals. Our failure to renew our contracts with GPOs may cause us to lose market share and could have a material adverse effect on our business, financial condition and results of operations. In addition, if we are unable to develop new relationships with GPOs, our competitive position would likely suffer and our opportunities to grow our revenues and business would be harmed.

Certain GPOs are creating, coordinating and facilitating regional purchasing coalition (RPC) supply chain networks that include anti-competitive practices such as sole sourcing and bundling. These RPCs circumvent and potentially violate rules of conduct for GPOs and have the effect of reducing product purchasing decisions available to the hospitals that belong to these regional organizations. If the GPOs and RPCs are permitted to continue practices that limit, reduce or eliminate competition, we could lose customers who are no longer able to choose to purchase our products, resulting in lower sales that could adversely affect our business, financial condition and results of operations.

*Inadequate levels of coverage or reimbursement from governmental or other third-party payers for our products, or for procedures using our products, may cause our revenue to decline.

Sales of our products depend in part on the reimbursement and coverage policies of governmental and private health care payers. The ability of our health care provider customers, including hospitals, to obtain adequate coverage and reimbursement for our products or the procedures in which our products are used may impact our customers' purchasing decisions. Therefore, our customers' inability to obtain adequate coverage and reimbursement for our products or reimbursement for the procedures in which our products are used would have a material adverse effect on our business.

Third-party payers have adopted, and are continuing to adopt, health care policies intended to curb rising health care costs. These policies include, among others:

- controls on reimbursement for health care services and price controls on medical products and services;
- limitations on coverage and reimbursement for new medical technologies and procedures; and
- the introduction of managed care and prospective payment systems in which health care providers contract to provide comprehensive health care for a fixed reimbursement amount per person or per procedure.

We cannot guarantee that governmental or third-party payers will reimburse, or continue to reimburse, a customer for the cost of our products or the procedures in which our products are used. In fact, some payers have indicated that they are not willing to reimburse for certain of our products or for certain of the procedures in which our products are used. For example, some insurance carriers have issued policies denying coverage for transcutaneous hemoglobin measurement on the grounds that the technology is investigational in the outpatient setting. Other payers are continuing to investigate our products to determine if they will provide reimbursement to our customers. These trends could lead to pressure to reduce prices for our current and future products and could cause a decrease in the size of the market or a potential increase in competition that could have a material adverse effect on our business, financial condition and results of operations.

We do not control payor decision-making with respect to coverage and payment levels for our products. Additionally, we expect many payors to continue to explore cost-containment strategies (e.g., comparative and cost-effectiveness

analyses, so-called ”pay-for-performance” programs implemented by various public government health care programs and private third-party payors, and expansion of payment bundling initiatives, and other such methods that shift medical cost risk to providers) that may potentially impact coverage and/or payment levels for our current products or products we develop in the future.

Table of Contents

Our customers may reduce, delay or cancel purchases due to a variety of factors, such as lower hospital census levels or third-party guidelines, or may require that we reduce the price of our products, which could adversely affect our business, financial condition and results of operations.

Our customers are facing growing levels of uncertainties, including variations in overall hospital census for paying patients and the impact of such census variations on hospital budgets. As a result, many hospitals are reevaluating their entire cost structure, including the amount of capital they allocate to medical device technologies and products. Such developments could have a significant negative impact on our OEM customers who, due to their traditionally larger capital equipment sales model, could see declines in purchases from their hospital customers. This, in turn, could reduce our board sales to our OEM customers.

In addition, certain of our products, including our rainbow® measurements such as carbon monoxide, methemoglobin and hemoglobin, that are sold with upfront license fees and more complex and expensive sensors, could also be impacted by hospital budget reductions.

States and other local regulatory authorities may issue guidelines regarding the appropriate scope and use of our products from time to time. For example, some of our noninvasive monitoring devices may be subject to authorization by individual states as part of the Emergency Medical Services scope of practice procedures. Although a lack of inclusion into scope of practice procedures does not prohibit usage, it may limit adoption.

Additionally, as a result of the continued consolidation in the health care industry, we may experience decreasing prices for our products due to the potential increased market pricing power of our health care provider customers. If these and other competitive forces drive down the price of our products, and we are not able to counter that pressure with cost reductions to our existing products or the introduction of new higher priced products, our product gross profit margins will decline. This, in turn, could have a material adverse effect on our business, financial condition and results of operations.

*The loss of any large customer or distributor, or any cancellation or delay of a significant purchase by a large customer, could reduce our net sales and harm our operating results.

We have a concentration of OEM, distribution and direct customers. We cannot provide any assurance that we will retain our current customers, groups of customers or distributors, or that we will be able to attract and retain additional customers in the future. If for any reason we were to lose our ability to sell to a specific group or class of customers, or through a distributor, we could experience a significant reduction in revenue, which would adversely impact our operating results. For the six months ended July 1, 2017 and July 2, 2016, we had sales through two just-in-time distributors, which in total represented approximately 25.4% and 27.3% of our total revenue, respectively.

Our sales could also be negatively affected by any rebates, discounts or fees that are required by, or offered to, GPOs and customers, including wholesalers or distributors. Additionally, some of our just-in-time distributors have been demanding higher fees, which we may be forced to pay in order to continue to offer products to our customers or which may force us to distribute our products directly to our customers. The loss of any large customer or distributor, or an increase in distributor fees, could have a material adverse effect on our business, financial condition and results of operations.

Imitation Masimo sensors and third-party medical device reprocessors that reprocess our single-patient-use sensors may harm our reputation. Also, these imitation and third-party reprocessed sensors, as well as genuine Masimo reprocessed sensors, are sold at lower prices than new Masimo sensors and could cause our revenue to decline, which may adversely affect our business, financial condition and results of operations.

We are aware that other organizations are manufacturing and selling imitation Masimo sensors. In addition, we are aware that certain medical device reprocessors have been collecting our used single-patient-use sensors from hospitals and then reprocessing, repackaging and reselling those sensors to hospitals. These imitation and third-party reprocessed sensors are sold at lower prices than new Masimo sensors. Our experience with both these imitation sensors and third-party reprocessed sensors is that they provide inferior performance, increased sensor consumption, reduced comfort and a number of monitoring problems. Notwithstanding these limitations, some of our customers have indicated a willingness to consider purchasing some of their sensor requirements from these imitation manufacturers and third-party reprocessors in an effort to reduce their sensor costs. These imitation and reprocessed sensors have led and may continue to lead to confusion with our genuine Masimo products; have reduced and may

continue to reduce our revenue; and, in some cases, have harmed and may continue to harm our reputation if customers conclude incorrectly that these imitation or reprocessed sensors are original Masimo sensors.

In addition, we have expended a significant amount of time and expense investigating issues caused by imitation and reprocessed sensors, troubleshooting problems stemming from such sensors, educating customers about why imitation and reprocessed sensors do not perform to their expectations, enforcing our proprietary rights against the imitation manufacturers and reprocessors, and enforcing our contractual rights under our customer contracts.

Table of Contents

In response to these imitation sensors and third-party reprocessors, we offer to our customers our own Masimo reprocessed sensors, which we re-manufacture and test to ensure that they meet the same performance specifications as our new Masimo sensors. In addition, we have incorporated X-Cal® technology into certain products to ensure our customers get the performance they expect by using genuine Masimo sensors and that such sensors do not continue to be used beyond their useful life. We believe this technology will help ensure that hospitals, clinicians and, ultimately, their patients receive true Masimo measurement quality and performance, and will curtail some of the harm to us that results when customers experience performance and other problems with imitation and reprocessed sensors. However, some customers may object to the X-Cal® technology, potentially resulting in the loss of customers and revenues. In addition, reprocessed sensors sold by us are generally offered at a lower price and, therefore, may reduce certain customer demand for our new sensors. As a result, increased sales of genuine Masimo reprocessed sensors may result in lower revenues, which could negatively impact our business, financial condition and results of operations.

From time to time, we may carry out strategic initiatives that may not be viewed favorably by our customers, or that could negatively impact our business, financial condition and results of operations.

We expect to continue to carry out strategic initiatives and investments that we believe are necessary to grow our revenues and expand our business, both in the U.S. and abroad. For example, since 2013, we have made incremental investments in additional sales force resources whose primary focus is to work with hospitals to identify new opportunities for certain noninvasive measurement technologies. We also intend to continue to invest in international expansion programs designed to increase our worldwide presence and take advantage of market expansion opportunities around the world. Although we believe these initiatives and investments continue to be in the long-term best interests of Masimo and our stockholders, there are no assurances that such initiatives and investments will yield favorable results for us.

Accordingly, if these initiatives and investments are not viewed favorably by our customers, our business, financial condition and results of operations could be adversely affected.

Risks Related to Our Intellectual Property

If the patents we own or license, or our other intellectual property rights, do not adequately protect our technologies, we may lose market share to our competitors and be unable to operate our business profitably.

Our success depends significantly on our ability to protect our rights to the technologies used in our products, including Masimo SET® and licensed rainbow® technology. We rely on patent protection, trade secrets and a combination of copyright and trademark laws, as well as nondisclosure, confidentiality and other contractual arrangements, to protect our technology and rights. However, these legal means afford only limited protection and may not adequately protect our rights or permit us to gain or maintain any competitive advantage. In addition, we cannot be assured that any of our pending patent applications will result in the issuance of a patent to us. The PTO may deny or require a significant narrowing of claims in our pending patent applications, and patents issued as a result of the pending patent applications, if any, may not provide us with significant commercial protection or may not be issued in a form that is advantageous to us. We could also incur substantial costs in proceedings before the PTO.

As part of the Leahy-Smith America Invents Act (the Leahy-Smith Act), which was enacted in 2011, the PTO has introduced procedures that provide additional administrative pathways for third parties to challenge issued patents. IPR is one of these procedures. The number of IPR challenges filed is increasing, and in many cases, the PTO is canceling or significantly narrowing issued patent claims. Accordingly, even if a patent is granted by the PTO, there is a risk that it may not withstand an IPR challenge. IPR challenges could increase the uncertainties and costs associated with the maintenance, enforcement and defense of our issued and future patents and could have a material adverse effect on our business, financial condition and results of operations. In addition, recent case law has increased uncertainty regarding the availability of patent protection for certain technologies and the costs associated with obtaining patent protection for those technologies. Some of our patents related to our Masimo SET® algorithm technology began to expire in March 2011. Additionally, upon the expiration of other issued or licensed patents, we may lose some of our rights to exclude competitors from making, using, selling or importing products using the technology based on the expired patents. While we seek to offset potential losses relating to important expiring patents by securing additional patents on commercially desirable improvements, there can be no assurance that we will be successful in securing such additional patents, or that such additional patents will adequately offset the effect of

expiring patents. For example, the U.S. Supreme Court has ruled on several patent cases in recent years, either narrowing the scope of patent protection available in certain circumstances or weakening the rights of patent owners in certain situations.

Table of Contents

In addition to increasing uncertainty with regard to our ability to obtain patents in the future, this combination of events has created uncertainty with respect to the value of patents once obtained. Depending on decisions by the U.S. Congress, the federal courts and the PTO, the laws and regulations governing patents could change in unpredictable ways that would weaken our ability to obtain new patents or to enforce patents that we might obtain in the future. Additionally, there is no assurance that competitors will not be able to design around our patents.

We also rely on contractual rights with the third parties that license technology to us to protect our rights in such licensed technology. In addition, we rely on unpatented proprietary technology. We cannot assure you that we can meaningfully protect all of our rights in our unpatented proprietary technology or that others will not independently develop substantially equivalent proprietary products or processes or otherwise gain access to our unpatented proprietary technology.

We seek to protect our know-how and other unpatented proprietary technology with confidentiality agreements and intellectual property assignment agreements with our employees, OEM partners, independent distributors and consultants. However, such agreements may not be enforceable or may not provide meaningful protection for our proprietary information in the event of unauthorized use or disclosure or other breaches of the agreements or in the event that our competitors discover or independently develop similar or identical designs or other proprietary information. In addition, we rely on the use of registered and common law trademarks with respect to the brand names of some of our products. Common law trademarks provide less protection than registered trademarks. Loss of rights in our trademarks could adversely affect our business, financial condition and results of operations.

Furthermore, the laws of foreign countries may not protect our intellectual property rights to the same extent as the laws of the U.S. If we fail to apply for intellectual property protection or if we cannot adequately protect our intellectual property rights in these foreign countries, our competitors may be able to compete more effectively against us, which could adversely affect our competitive position, as well as our business, financial condition and results of operations.

If third parties claim that we infringe their intellectual property rights, we may incur liabilities and costs and may have to redesign or discontinue selling certain products.

Companies in the medical device industry have used intellectual property litigation to gain a competitive advantage in the marketplace. We face the risk of claims that we have infringed on third parties' intellectual property rights. Searching for existing intellectual property rights may not reveal important intellectual property and our competitors may also have filed for patent protection, which is not publicly-available information, or claimed trademark rights that have not been revealed through our searches. In addition, some of our employees were previously employed at other medical device companies. We may be subject to claims that our employees have disclosed, or that we have used, trade secrets or other proprietary information of our employees' former employers. Our efforts to identify and avoid infringing on third parties' intellectual property rights may not always be successful. Any claims of patent or other intellectual property infringement against us, even those without merit, could:

- increase the cost of our products;
- be expensive and time consuming to defend;
- result in us being required to pay significant damages to third parties;
- force us to cease making or selling products that incorporate the challenged intellectual property;
- require us to redesign, reengineer or rebrand our products, product candidates and technologies;
- require us to enter into royalty or licensing agreements in order to obtain the right to use a third-party's intellectual property on terms that may not be favorable or acceptable to us;
- require us to indemnify third parties pursuant to contracts in which we have agreed to provide indemnification for intellectual property infringement claims;
- divert the attention of our management and other key employees;
- result in our customers or potential customers deferring or limiting their purchase or use of the affected products impacted by the claims until the claims are resolved; and
- otherwise have a material adverse effect on our business, financial condition and results of operations.

In addition, new patents obtained by our competitors could threaten the continued commercialization of our products in the market even after they have already been introduced.

Table of Contents

*We believe competitors may currently be violating and may in the future violate our intellectual property rights, and we may bring additional litigation to protect and enforce our intellectual property rights, which may result in substantial expense and may divert management's attention from implementing our business strategy.

We believe that the success of our business depends, in significant part, on obtaining patent protection for our products and technologies, defending our patents and preserving our trade secrets. We were previously involved in significant litigation to protect our patent positions related to some of our pulse oximetry signal processing patents that resulted in various settlements in 2006, 2015 and 2016, and may be required to engage in litigation to protect our intellectual property in the future. Our ongoing and future litigation could result in significant additional costs and further divert the attention of our management and key personnel from our business operations and the implementation of our business strategy and may not be adequate to protect our intellectual property rights.

Risks Related to Our Regulatory Environment

*Our failure to obtain and maintain FDA clearances or approvals on a timely basis, or at all, would prevent us from commercializing our current or upgraded products in the U.S., which could severely harm our business.

Each medical device that we wish to market in the U.S. generally must first undergo premarket review by the FDA and receive clearance or approval pursuant to the Federal Food, Drug, and Cosmetic Act (FDCA) by receiving clearance of a 510(k) premarket notification, receiving clearance through the de novo review process, or obtaining approval of a premarket approval (PMA) application. Even if regulatory clearance or approval of a product is granted, the FDA may clear or approve our products only for limited indications for use, which would limit our ability to market the product to only such indications for use. We cannot guarantee that the FDA will grant 510(k) clearance on a timely basis, if at all, for new products or uses that we propose for Masimo SET® or licensed rainbow® technology. The traditional FDA 510(k) clearance process for our products has generally taken between three to six months. However, our more recent experience and interactions with the FDA, along with information we have received from other medical device manufacturers, suggests that, in some cases, the FDA is requiring applicants to provide additional or different information and data for 510(k) clearance than it had previously required; and that the FDA may not rely on approaches that it had previously accepted to support 510(k) clearance. These changes could lead to more review cycles or to decisions by the FDA that our products are not substantially equivalent or require greater amounts of information to demonstrate substantial equivalence. As a result, we have experienced lengthier FDA 510(k) review periods over the past few years, which have delayed the 510(k) clearance process for our products.

To support our product applications to the FDA, we frequently are required to conduct clinical testing of our products. Such clinical testing must be conducted in compliance with FDA requirements pertaining to human research. Among other requirements, we must obtain informed consent from human subjects and approval by institutional review boards before such studies may begin. We must also comply with other FDA requirements such as monitoring, record-keeping, reporting and the submission of information regarding certain clinical trials to a database maintained by the National Institutes of Health. In addition, depending on the risk posed by a study, we may be required to obtain the FDA's approval of the study under an Investigational Device Exemption (IDE). Compliance with these requirements can require significant time and resources and if the FDA determines that we have not complied with such requirements, it may refuse to consider the data to support our applications or initiate enforcement actions.

Even though 510(k) clearances have been obtained, if safety or effectiveness problems are identified with our pulse oximeters incorporating Masimo SET® and licensed rainbow® technology, patient monitor devices, sensors, cables and other products, we may need to initiate a recall of such devices. Furthermore, our new products or significantly modified marketed products could be denied 510(k) clearance and be required to undergo the more burdensome PMA or de novo review processes. The process of obtaining clearance of a de novo request or approval of a PMA is much more costly, lengthy and uncertain than the process for obtaining 510(k) clearance. Clearance of a de novo request generally takes six months to one year from the time of submission of the de novo request, although it can take longer. Approval of a PMA generally takes one to three years from the time of submission of the PMA, but may be longer.

We sell consumer versions of our $iSpO_2$® and MightySat™ pulse oximeters that are not intended for medical use. We are marketing these products in accordance with the FDA's current policy for products that are intended for wellness or fitness uses. Some of our products may also be exempted from the 510(k) process in accordance with specific FDA guidance and policies, such as the FDA guidance related to mobile medical applications. In addition, some of our

products may not be subject to regulation under Section 520(o) of the FDCA, which was enacted as part of the 21st Century Cures Act (Cures Act) in December 2016 and excludes certain software functions from the statutory definition of a device. We cannot assure you that the FDA will not change its policy regarding the regulation of these products. If the FDA changes its policy or concludes that our marketing of these products is not in accordance with its current policy and/or Section 520(o) of the FDCA, we may be required to seek clearance or approval of these devices through the 510(k), de novo or PMA processes.

Table of Contents

The failure of our OEM partners to obtain required FDA clearances or approvals for products that incorporate our technologies could have a negative impact on our revenue.

Our OEM partners are required to obtain their own FDA clearances for products incorporating Masimo SET® and licensed rainbow® technology to market these products in the U.S. We cannot guarantee that the FDA clearances we have obtained will make it easier for our OEM partners to obtain clearances of products incorporating these technologies, or that the FDA will grant clearances on a timely basis, if at all, for any future product incorporating Masimo SET® and licensed rainbow® technology that our OEM partners propose to market.

*If we or our suppliers fail to comply with ongoing regulatory requirements, or if we experience unanticipated problems with our products, these products could be subject to restrictions or withdrawal from the market.

Our products, along with the manufacturing processes, labeling and promotional activities for our products, are subject to continual review and periodic inspections by the FDA and other regulatory bodies. Among other requirements, we and our suppliers are required to comply with the FDA's Quality System Regulation (QSR), which covers the methods and documentation of the design, control testing, production, component suppliers control, quality assurance, complaint handling, labeling control, packaging, storage and shipping of our products. The FDA enforces the QSR through announced and unannounced inspections. We are also subject to similar state requirements and licenses.

In 2013, the FDA inspected our facility in Irvine, California and issued an FDA Form 483 listing observations the investigator believed may constitute violations of statutes or regulations administered by the FDA, including observations relating to complaint handling, medical device reporting and corrective and preventative action (CAPA) procedures. We submitted responses to the Form 483. In August 2014, we received a warning letter (the Warning Letter) related to the Irvine inspection. We submitted a response (the Response Letter) to the Warning Letter and attended a regulatory meeting with the FDA in September 2014. At the meeting, in addition to discussing our Response Letter, the FDA raised issues beyond the scope of the Warning Letter in the areas of Good Manufacturing Practices, quality, bioresearch monitoring and labeling/promotion. In January 2016, the FDA issued certificates to foreign governments (CFGs) for products manufactured in our Irvine, California facility, which allows us to continue to register and import products into certain countries that require CFGs. In early May 2017, the FDA inspected the Irvine facility and evaluated our corrective actions in response to the Warning Letter. At the close of that inspection, the FDA did not issue a Form 483. On May 26, 2017, we received a letter from the FDA indicating that, based on the FDA's evaluation, it appeared that we had addressed the violations contained in the Warning Letter. The letter indicated that future FDA inspections and regulatory activities will further assess the adequacy and sustainability of the corrections.

In addition to the FDA, from time to time we are subject to inspections by the California Food and Drug Branch, international regulatory authorities, and other similar governmental agencies. The standards used by these regulatory authorities are complex and may differ from those used by the FDA.

Failure by us or one of our suppliers to comply with statutes and regulations administered by the FDA and other regulatory bodies or failure to adequately respond to any FDA Form 483 observations, any Food and Drug Branch notices of violation or any similar reports could result in, among other things, any of the following items:

- warning letters or untitled letters issued by the FDA;
- fines, civil penalties, in rem forfeiture proceedings, injunctions, consent decrees and criminal prosecution;
- import alerts;
- unanticipated expenditures to address or defend such actions;
- delays in clearing or approving, or refusal to clear or approve, our products;
- withdrawal or suspension of clearance or approval of our products or those of our third-party suppliers by the FDA or other regulatory bodies;
- product recall or seizure;
- orders for physician notification or device repair, replacement or refund;
- interruption of production or inability to export to certain foreign countries; and

- operating restrictions.

If any of these items were to occur, it would harm our reputation and adversely affect our business, financial condition and results of operations.

Table of Contents

Failure to obtain regulatory authorizations in foreign jurisdictions may prevent us from marketing our products abroad.

We currently market and intend to continue to market our products internationally. Outside of the U.S., we can market a product only if we receive a marketing authorization and, in some cases, pricing approval, from the appropriate regulatory authorities. The regulatory registration/licensing process varies among international jurisdictions, may require additional product testing, and may differ from that required for obtaining FDA clearance. FDA clearance does not ensure new product registration/licensing by foreign regulatory authorities and we may be unable to obtain foreign regulatory registration/licensing on a timely basis, if at all. In addition, clearance by one foreign regulatory authority does not ensure clearance by any other foreign regulatory authority or by the FDA. If we fail to receive necessary approvals to commercialize our products in foreign jurisdictions on a timely basis, or at all, our business, financial condition and results of operations could be adversely affected.

Modifications to our marketed devices may require new regulatory clearances or premarket approvals, or may require us to cease marketing or to recall the modified devices until clearances or approvals are obtained.

We have made modifications to our devices in the past and we may make additional modifications in the future. Any modifications to an FDA-cleared device that could significantly affect its safety or effectiveness or that would constitute a major change in its intended use would require a new 510(k) clearance or possibly a de novo review or PMA. We may not be able to obtain such clearances or approvals in a timely fashion, or at all. Delays in obtaining future clearances would adversely affect our ability to introduce new or enhanced products in a timely manner, which in turn would have an adverse effect on our business, financial condition and results of operations. The standards for determining which modifications require a new 510(k) clearance are ambiguous, and the FDA may disagree with our conclusions. For those modifications that we conclude do not require a new 510(k), if the FDA disagrees with our conclusion and requires new clearances or approvals for the modifications, we may be required to recall and to stop marketing the modified devices, which could have an adverse effect on our business, financial condition and results of operations.

Federal regulatory reforms may make it difficult to maintain or attain approval to develop and commercialize our products and technologies.

From time to time, legislation is drafted and introduced in Congress that could significantly change the statutory provisions governing the clearance or approval, manufacture and marketing of medical devices. For example, in December 2016, Congress enacted the Cures Act, which contained several provisions related to the review and approval of new medical technologies. Along with other changes, the Cures Act established a statutory program for "breakthrough" devices, defined as a device intended to treat or diagnose a life-threatening or irreversibly debilitating disease or condition and (1) that represents a breakthrough technology, (2) that has no approved/cleared alternatives, (3) that offers significant advantages over approved/cleared alternatives or (4) the availability of the device is in the best interest of patients. The FDA will apply additional resources to help speed the approval or clearance of devices that are designated as breakthrough devices. The Cures Act also included provisions related to the "least burdensome" principle with respect to demonstrating substantial equivalence or reasonable assurance of safety and effectiveness and expanded the number of patients that could be treated by a device approved under a Humanitarian Device Exemption, among other provisions. In addition, the FDA regulations and guidance are often revised or reinterpreted by the FDA in ways that may significantly affect our business and our products. It is impossible to predict whether additional legislative changes will be enacted or whether FDA regulations, guidance or interpretations will be changed, and what the impact of such changes, if any, may be. However, any future regulatory changes could make it more difficult for us to maintain or attain approval to develop and commercialize our products and technologies.

*If our products cause or contribute to a death or serious injury, or malfunction in a way that would likely cause or contribute to a death or serious injury, we will be subject to medical device reporting regulations, which can result in voluntary corrective actions or agency enforcement actions, including recall of our products.

Under the FDA medical device reporting regulations, we are required to report to the FDA any incident in which a product of ours may have caused or contributed to a death or serious injury or in which a product of ours malfunctioned and, if the malfunction were to recur, would likely cause or contribute to death or serious injury. In addition, all manufacturers placing medical devices in the European Union (EU) are legally required to report any

serious or potentially serious incidents involving devices produced or sold by the manufacturer to the relevant authority in those jurisdictions where any such incident occurred.

The FDA and similar foreign governmental authorities have the authority to require the recall of our commercialized products in the event of material deficiencies or defects in, for example, design, labeling or manufacture. In the case of the FDA, the authority to require a recall generally must be based on an FDA finding that there is a reasonable probability that the device would cause serious adverse health consequences or death. Manufacturers may, under their own initiative, recall a product if any material deficiency in a device is found or they become aware of a safety issue involving a marketed product.

Table of Contents

A government-mandated or voluntary recall by us or by one of our distributors could occur as a result of component failures, manufacturing errors, design or labeling defects or other deficiencies and issues.

We may initiate certain field actions, such as a correction or removal of our products in the future. A correction is a repair, modification, adjustment, relabeling, destruction or inspection of a device, without its physical removal from its point of use to some other location. A removal is the physical removal of a device from its point of use to some other location for repair, modification, adjustment, relabeling, destruction or inspection. If a correction or removal is initiated to reduce a health risk posed by our device, or to remedy a violation of the FDCA caused by the device that may present a risk to health, the correction or removal must be reported to the FDA. If the FDA subsequently determines that a report was required for a correction or removal of our products that we did not believe required a report, we could be subject to enforcement actions. Any recalls of our products or enforcement actions would divert managerial and financial resources and could have an adverse effect on our financial condition and results of operations.

From time to time, we have initiated various field actions related to our products as required by applicable law and regulations, including device corrections and removals, none of which were material to our operating results. Some of these field actions involved “reportable events” that were reported to the FDA and other foreign regulatory agencies within the appropriate regulatory timeframes. Because of our dependence upon patient and physician perceptions, any negative publicity associated with these or any future voluntary recalls could materially and adversely affect our business, financial condition, results of operations and growth prospects.

*Promotion of our products using claims that are off-label, unsubstantiated, false or misleading could subject us to substantial penalties.

Obtaining 510(k) clearance permits us to promote our products for the uses cleared by the FDA. Use of a device outside its cleared or approved indications is known as “off-label” use. Physicians may use our products off-label because the FDA does not restrict or regulate a physician’s choice of treatment within the practice of medicine. While we may request additional cleared indications for our current products, the FDA may deny those requests, require additional expensive clinical data to support any additional indications or impose limitations on the intended use of any cleared product as a condition of clearance. If the FDA determines that we or our OEM partners have promoted our products for off-label use or have made false or misleading or inadequately substantiated promotional claims, it could request that we or our OEM partners modify those promotional materials or take regulatory or enforcement actions, including the issuance of an untitled letter, warning letter, injunction, seizure, civil fine and criminal penalties. It is also possible that other federal, state or foreign enforcement authorities may take action if they consider our promotional or training materials, or other communications, to constitute promotion of an uncleared or unapproved use. Although, depending on the facts and circumstances, such promotion might be protected speech under the First Amendment to the U.S. Constitution, we cannot be sure that government authorities or a court would accept such an argument. If not successfully defended, enforcement actions related to off-label promotion could result in significant fines or penalties under other statutory authorities, such as laws prohibiting false claims for reimbursement. In any such event, in addition to potential extensive fines and penalties, our reputation could be damaged and adoption of our products would be impaired. Although our policy is to refrain from statements that could be considered off-label promotion of our products, the regulatory standards regarding off-label promotion are ambiguous, and the FDA or another regulatory agency could conclude that we have engaged in off-label promotion.

In addition to promoting our products in a manner consistent with our clearances, we must have adequate substantiation for the claims we make for our products. If any of our claims are determined to be false, misleading or deceptive, our products could be considered to be misbranded under the FDCA or to violate the Federal Trade Commission Act.

We may be subject to or otherwise affected by federal and state health care laws, including fraud and abuse laws and health information privacy and security laws, and could face substantial penalties if we are unable to fully comply with these laws.

Although we do not provide health care services or receive payments directly from Medicare, Medicaid or other third-party payers for our products or the procedures in which our products are used, health care regulation by federal and state governments will impact our business. Health care fraud and abuse laws potentially applicable to our

operations include, but are not limited to:

- the federal Anti-Kickback Statute, which prohibits, among other things, knowingly and willfully offering, paying, soliciting or receiving any bribe, kickback or other remuneration intended to induce the purchase, order or recommendation of an item or service reimbursable under a federal health care program (such as the Medicare or Medicaid programs);

Table of Contents

- the federal False Claims Act and other federal laws which prohibit, among other things, knowingly and willfully presenting, or causing to be presented, claims for payment from Medicare, Medicaid or other third-party payers that are false or fraudulent;
- the provisions of the federal Health Insurance Portability and Accountability Act of 1996 (HIPAA), which established federal crimes for knowingly and willfully executing a scheme to defraud any health care benefit program or making false statements in connection with the delivery of or payment for health care benefits, items or services; and
- state laws analogous to each of the above federal laws, such as state anti-kickback and false claims laws that may apply to items or services reimbursed by governmental programs and non-governmental third-party payers, including commercial insurers, and state laws governing the privacy of certain patient identifiable health information (PHI).

Federal and state false claims laws prohibit anyone from presenting, or causing to be presented, claims for payment to third-party payers that are false or fraudulent. For example, the federal Civil False Claims Act imposes liability on any person or entity that, among other things, knowingly and willfully presents, or causes to be presented, a false or fraudulent claim for payment by a federal health care program, including Medicaid and Medicare.

Some suits filed under the Civil False Claims Act, known as “qui tam” actions, can be brought by a private individual, referred to as a “whistleblower” or “relator,” on behalf of the government, and such individuals may share in any amounts paid by the entity to the government in fines or settlement. Such complaints are filed under seal and remain sealed until the applicable court orders otherwise. In recent years, the number of suits brought by private individuals has increased dramatically. Manufacturers, like us, can be held liable under false claims laws, even if they do not submit claims to the government, if they are found to have caused medical care providers to have submitted claims to the government for payment for a service or the use of a device that is not properly covered for government reimbursement.

A number of states also have false claims laws, and some of these laws may apply to claims for items or services reimbursed under Medicaid and/or commercial insurance. Sanctions under these federal and state laws may include civil monetary penalties, exclusion of a manufacturer’s products from reimbursement under government programs and imprisonment. In particular, when an entity is determined to have violated the federal Civil False Claims Act, it may be required to pay up to three times the actual damages sustained by the government, plus civil penalties of $5,500 to $11,000 for each separate false claim.

We have certain arrangements with hospitals that may be affected by health care fraud and abuse laws. For instance, under our standard customer arrangements, we provide hospitals with free pulse oximetry monitoring devices in exchange for their agreement to purchase future pulse oximetry sensor requirements from us. In addition, we occasionally provide our customers with rebates in connection with their annual purchases. While we believe that these arrangements are structured such that we are currently in compliance with applicable federal and state health care laws, one or more of these arrangements may not meet the federal Anti-Kickback Statute’s safe harbor requirements, which may result in increased scrutiny by government authorities that are responsible for enforcing these laws.

There can be no assurance that we will not be found to be in violation of any of such laws or other similar governmental regulations to which we are directly or indirectly subject and, as a result, we may be subject to penalties, including civil and criminal penalties, damages, fines, exclusion of our products from reimbursement under Medicare, Medicaid and other federal health care programs, and the curtailment or restructuring of our operations. Any penalties could adversely affect our ability to operate our business and our financial results. Any action against us for violation of these laws, even if we successfully defend against such action, could cause us to incur significant legal expenses and divert our management’s attention from the operation of our business.

Further, we are required to comply with federal and state laws governing the transmission, security and privacy of individually identifiable PHI that we may obtain or have access to in connection with the manufacture and sale of our products. We may be required to make costly system modifications to comply with the HIPAA privacy and security requirements. In addition, if we do not properly comply with existing or new laws and regulations related to the protection of health information, we could be subject to criminal or civil sanctions, the potential enforcement of which is greater as a result of the Health Information Technology of Economic and Clinical Health Act.

Numerous other federal and state laws protect the confidentiality of PHI, including state medical information privacy laws, state social security number protection laws and state and federal consumer protection laws. In some cases, more protective state privacy and security laws are not preempted by HIPAA and may be subject to interpretation by various governmental authorities and courts, resulting in potentially complex compliance issues for us and our customers.

Table of Contents

In addition, state and federal human subject protection laws apply to our receipt of individually identifiable PHI in connection with clinical research. These laws could create liability for us if one of our research collaborators uses or discloses research subject information without authorization and in violation of applicable laws.

We may incur significant costs and potential liabilities in defending our new products and technologies in various legal and other proceedings.

Our noninvasive measurement technologies are new and not yet widely understood or accepted. These new technologies may become the subject of various legal and other proceedings. We may incur significant costs in explaining and defending our new products and technologies in these proceedings, often to non-technical audiences. The outcomes of these proceedings are unpredictable and may result in significant liabilities, regardless of the merits of the claims made in the proceedings.

*Legislative and regulatory changes in the health care industry could have a negative impact on our financial performance. Furthermore, our business, financial condition, results of operations and cash flows could be significantly and adversely affected by health care reform legislation in the U.S. or if reform programs are adopted in our key international markets.

Changes in the health care industry in the U.S. and elsewhere could adversely affect the demand for our products as well as the way in which we conduct our business. In 2010, President Obama signed health care reform legislation into law that required most individuals to have health insurance, established new regulations on health plans, created insurance pooling mechanisms and reduced Medicare spending on services provided by hospitals and other providers. Beginning in January 2013, this legislation also imposed significant new taxes on medical device makers in the form of a 2.3% excise tax on U.S. medical device sales, as well as related compliance and reporting obligations. Although President Obama signed into law a bill that included a two-year suspension of the medical device tax beginning in January 2016, such tax may be reimposed on medical device makers beginning in January 2018 if such suspension is not extended or the medical device tax is not permanently repealed.

Moreover, the Physician Payment Sunshine Act (the Sunshine Act), which was enacted by Congress as part of the Patient Protection and Affordable Care Act (the Affordable Care Act) in March 2010, requires medical device companies to track and publicly report, with limited exceptions, all payments and transfers of value to physicians and teaching hospitals in the U.S. Implementing regulations for these tracking and reporting obligations were finalized in 2013, and companies are now required to track payments made since August 2013. If we fail to comply with the data collection and reporting obligations imposed by the Sunshine Act, we may be subject to substantial civil monetary penalties.

In general, an expansion in the government’s role in the U.S. health care industry may lower reimbursements for our products, reduce demand for innovative products, reduce medical procedure volumes and adversely affect our business and results of operations, possibly in a material manner. In addition, as a result of the continued focus on health care reform, there is a risk that Congress may implement changes in laws and regulations governing health care service providers, including measures to control costs or reductions in reimbursement levels, which could result in pricing pressures, have an adverse effect on the demand for our products and/or negatively impact the prices that the market is willing to accept for our current and future products. We cannot predict the effect any future legislation or regulation will have on us or what health care initiatives, if any, will be implemented at the state level. Furthermore, many private payers look to Medicare’s coverage and reimbursement policies in setting their coverage policies and reimbursement amounts such that federal reforms could influence the private sector as well. Finally, many states also may attempt to reform their Medicaid programs such that either coverage for certain items or services may be narrowed or reimbursement for them could be reduced. These health care reforms may adversely affect our business.

Consistent with or in addition to Congressional or state reforms, CMS, the federal agency that administers the Medicare and Medicaid programs, could change its current policies that affect coverage and reimbursement for our products. For example, in 2007, CMS determined that certain uses of pulse oximetry monitoring are eligible for separate Medicare payment in the hospital outpatient setting when no separately payable hospital outpatient services are reported on the same date of service. However, CMS re-examines the reimbursement rates for hospital inpatient and outpatient and physician office settings each year and could either increase or decrease the reimbursement rate for procedures utilizing our products. We are unable to predict when legislation or regulation that affects our business

may be proposed or enacted in the future or what effect any such legislation or regulation would have on our business. Any such legislation, regulation or policies that affect the coverage and reimbursement of our current or future products, or the procedures utilizing our current or future products, could cause our sales to decrease and our revenue to decline.

Table of Contents

Our success in international markets also may depend upon the eligibility of reimbursement for our products through government-sponsored health care payment systems and other third-party payers. Outside of the U.S., reimbursement systems vary by country. These systems are often subject to the same pressures to curb rising health care costs and control health care expenditures as those in the U.S. In addition, as economies of emerging markets develop, these countries may implement changes in their health care delivery and payment systems. If adequate levels of reimbursement from third-party payers outside of the U.S. are not obtained, sales of our products outside of the U.S. may be adversely affected.

In addition, the requirements or restrictions imposed on us or our products may change, either as a result of administratively adopted policies or regulations or as a result of the enactment of new laws. Moreover, there have been recent U.S. Congressional actions to repeal and replace the Affordable Care Act and Medicare, and future actions are expected. Even if the Affordable Care Act is not amended or repealed, proposed changes impacting implementation or existing provisions of the Affordable Care Act could materially and adversely affect our financial position or operations. Although we cannot predict the ultimate content or timing of any healthcare reform legislation, potential changes resulting from any amendment, repeal or replacement of these programs, including any reduction in the future availability of healthcare insurance benefits or reimbursement rates, could adversely affect our business and future results of operations.

Our medical devices and business activities are subject to rigorous regulation by the FDA and other federal, state and international governmental authorities. These authorities and members of Congress have been increasing their scrutiny over the medical device industry. In recent years, the U.S. Congress, Department of Justice, the Office of Inspector General of the Department of Health and Human Services, and the Department of Defense have issued subpoenas and other requests for information to medical device manufacturers, primarily related to financial arrangements with health care providers, regulatory compliance and marketing and product promotional practices. Furthermore, certain state governments have enacted legislation to increase transparency of interactions with health care providers, pursuant to which we are required by law to disclose payments and other transfers for value to health care providers licensed by certain states. We anticipate that the government will continue to scrutinize our industry closely, and any new regulations or statutory provisions could result in delays or increased costs during the periods of product development, clinical trials and regulatory review and approval, as well as increased costs to assure compliance.

Risks Related to Our Business and Operations

We may experience conflicts of interest with Cercacor with respect to business opportunities and other matters.

Prior to our initial public offering in August 2007, our stockholders owned 99% of the outstanding shares of capital stock of Cercacor and we believe that, as of July 1, 2017, a number of our stockholders, including certain of our directors and executive officers, continue to own shares of Cercacor stock. Joe Kiani, our Chairman and Chief Executive Officer, is also the Chairman and Chief Executive Officer of Cercacor.

Due to the interrelated nature of Cercacor with us, conflicts of interest will arise with respect to transactions involving business dealings between us and Cercacor, potential acquisitions of businesses or products, the development and ownership of technologies and products, the sale of products, markets and other matters in which our best interests and the best interests of our stockholders may conflict with the best interests of the stockholders of Cercacor. In addition, we and Cercacor may disagree regarding the interpretation of certain terms in the Cross-Licensing Agreement. We cannot guarantee that any conflict of interest will be resolved in our favor, or that, with respect to our transactions with Cercacor, we will negotiate terms that are as favorable to us as if such transactions were with another third-party.

We will be required to assign to Cercacor and pay Cercacor for the right to use certain products and technologies we develop that relate to the monitoring of non-vital sign parameters, including improvements to Masimo SET®.

Under the Cross-Licensing Agreement, if we develop certain products or technologies that relate to the noninvasive monitoring of non-vital sign parameters, including improvements to Masimo SET® for the noninvasive monitoring of non-vital sign parameters, we would be required to assign these developments to Cercacor and then license the technology back from Cercacor in consideration for upfront payments and royalty obligations to Cercacor. Therefore, these products and technologies would be deemed to have been developed or improved exclusively by Cercacor. In addition, we will not be reimbursed by Cercacor for our expenses relating to the development or improvement of any

such products or technologies, which expenses may be significant. As a result of these terms, we may not generate any revenue from the further development of certain products and technologies for the monitoring of non-vital sign parameters, including improvements to Masimo SET®, which could adversely affect our business, financial condition and results of operations.

Table of Contents

In the event that the Cross-Licensing Agreement is terminated for any reason, or Cercacor grants a license to rainbow® technology to a third-party, our business would be materially and adversely affected.

Cercacor owns all of the proprietary rights to certain rainbow® technology developed with our proprietary Masimo SET® for products intended to be used in the Cercacor Market, and all rights to any non-vital signs measurement for which we do not exercise an option pursuant to the Cross-Licensing Agreement. In addition, Cercacor has the right to terminate the Cross-Licensing Agreement or grant licenses covering rainbow® technology to third parties if we breach certain terms of the agreement, including any failure to meet our minimum royalty payment obligations or failure to use commercially reasonable efforts to develop or market products incorporating licensed rainbow® technology. If we lose our exclusive license to rainbow® technology, we would lose the ability to prevent others from making, using, selling or importing products using rainbow® technology in our market. As a result, we would likely be subject to increased competition within our market, and Cercacor or competitors who obtain a license to rainbow® technology from Cercacor would be able to offer related products.

We may not be able to commercialize our products incorporating licensed rainbow® technology cost-effectively or successfully.

As a result of the royalties that we must pay to Cercacor, it is generally more expensive for us to make products that incorporate licensed rainbow® technology than products that do not include licensed rainbow® technology.

We cannot assure you that we will be able to sell products incorporating licensed rainbow® technology at a price the market is willing to accept. If we cannot commercialize our products incorporating licensed rainbow® technology successfully, we may not be able to generate sufficient product revenue from these products to be profitable, which could adversely affect our business, financial condition and results of operations.

Rights provided to Cercacor in the Cross-Licensing Agreement may impede a change in control of our company.

Under the Cross-Licensing Agreement, a change in control includes the resignation or termination of Joe Kiani from his position as Chief Executive Officer of either Masimo or Cercacor. A change in control also includes other customary events, such as the sale or merger of Masimo or Cercacor to a non-affiliated third-party or the acquisition of 50% or more of the voting power of Masimo or Cercacor by a non-affiliated third-party. In the event we undergo a change in control, we are required to immediately pay a $2.5 million fee to exercise an option to license technology developed by Cercacor for use in blood glucose monitoring. Additionally, our per product royalties payable to Cercacor will become subject to specified minimums, and the minimum aggregate annual royalties for licensed rainbow® measurements payable to Cercacor related to carbon monoxide, methemoglobin, fractional arterial oxygen saturation, hemoglobin and blood glucose will increase to $15.0 million, plus up to $2.0 million for other rainbow® measurements. Also, if the surviving or acquiring entity ceases to use “Masimo” as a company name and trademark following a change in control, all rights to the “Masimo” trademark will automatically be assigned to Cercacor. This could delay or discourage transactions involving an actual or potential change in control of us, including transactions in which our stockholders might otherwise receive a premium for their shares over our then-current trading price. In addition, our requirement to assign all future improvements for non-vital signs to Cercacor could impede a change in control of our company.

*We may experience significant fluctuations in our quarterly and annual results in the future, we may not maintain our current levels of profitability, and changes to existing accounting pronouncements or taxation rules may affect how we conduct our business and our results of operations.

Our operating results have fluctuated in the past and are likely to fluctuate in the future. We may experience fluctuations in our quarterly results of operations as a result of:

- delays or interruptions in manufacturing and shipping of our products;
- varying demand for and market acceptance of our technologies and products;
- delayed acceptance of our new products, negatively impacting the carrying value of our inventory;
- design, technology or other market changes that could negatively impact the carrying value of our inventory;
- the effect of competing technological and market developments resulting in lower selling prices or significant promotional costs;
- changes in the timing of product orders and the volume of sales to our OEM partners;
- actions taken by GPOs;

- delays in hospital conversions to our products and declines in hospital patient census;
- our legal expenses, particularly those related to litigation matters;
- changes in our product or customer mix;

Table of Contents

- movements in foreign currency exchange rates;
- market seasonality of our sales due to quarterly fluctuations in hospital and other alternative care admissions;
- our ability to renew existing long-term sensor contract commitments;
- changes in the total dollar amount of annual contract renewal activities;
- changes in the mix and, therefore, the related costs of products that we supply at no upfront costs to our customers as part of their long-term sensor commitments;
- changes in hospital and other alternative care admission levels;
- our inability to efficiently scale operations and establish processes to accommodate business growth;
- unanticipated delays or problems in the introduction of new products, including delays in obtaining clearance or approval from the FDA;
- high levels of returns and repairs; and
- changes in reimbursement rates for SpHb®, SpCO® and SpMet® parameters.

In addition, a change in accounting pronouncements or taxation rules or practices, or the interpretation of them by the SEC or other regulatory bodies, could have a significant effect on our reported results and may even affect our reporting of transactions completed before the change is effective. New accounting pronouncements or taxation rules and varying interpretations of accounting pronouncements or taxation practice have occurred and may occur in the future. Moreover, there have been recent public announcements by members of the U.S. Congress, President Trump and his administration regarding their plans to make substantial changes in the taxation of U.S. companies and their foreign operations, including the possible implementation of a border tax, tariff or increase in custom duties on products manufactured outside of and imported into the U.S., as well as the renegotiation of U.S. trade agreements. Certain of our manufacturing facilities are located in Mexico and Sweden, and the importation of a border tax, tariff or higher customs duties on our products imported into the U.S., or any potential corresponding actions by other countries in which we do business, could negatively impact our financial performance. Furthermore, changes to existing rules, the adoption of new rules, changes in tax laws, changes in trade policies or the expiration of existing favorable tax holidays may adversely affect our reported financial results or the way we conduct our business.

If our operating results fail to meet or exceed the expectations of securities analysts or investors, our stock price could drop suddenly and significantly. Our expense levels are based, in part, on our expectations regarding future revenue levels and are relatively fixed in the short term. As a result, if our revenue for a particular period was below our expectations, we would not be able to proportionately reduce our operating expenses for that period. Any revenue shortfall would have a disproportionately negative effect on our operating results for the period. Due to these and other factors, you should not rely on our results for any one quarter as an indication of our future performance.

*Our results of operations could be harmed if we fail to effectively manage our growth or, alternatively, our spending during economic downturns.

Our ability to offer our products and implement our business plan in evolving markets successfully requires an effective planning and management process. We must effectively manage our spending and operations to ensure our competitive position during economic downturns, and must preserve our future opportunities when the economy improves. A failure to manage our spending and operations effectively could disrupt our business and harm our operating results. A growth in sales, combined with the challenges of managing geographically dispersed operations, can place a significant strain on our management systems and resources, and growth in future operations could continue to place such a strain. The failure to manage our growth effectively could disrupt our business and harm our operating results.

*Our results of operations could vary as a result of the methods, estimates and judgments that we use in applying our accounting policies.

The methods, estimates and judgments that we use in applying our accounting policies have a significant impact on our results of operations. Such methods, estimates and judgments are, by their nature, subject to substantial risks, uncertainties and assumptions and factors may arise over time that lead us to change our methods, estimates and judgments. Changes in those methods, estimates and judgments could significantly affect our results of operations. See “Critical Accounting Estimates” contained in Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended December 31, 2016, which we filed with the SEC on February 15, 2017.

55

Table of Contents

*If we lose the services of our key personnel, or if we are unable to attract and retain other key personnel, we may not be able to manage our operations or meet our growth objectives.

We are highly dependent on our senior management, especially Joe Kiani, our Chief Executive Officer, and other key officers. We are also heavily dependent on our engineers and field sales team, including sales representatives and clinical specialists. Additionally, from time to time, some of our key personnel may hold stock options with an exercise price that is greater than our recent closing prices, which may minimize the retention value of these options. The loss of the services of members of our key personnel or the inability to attract and retain qualified personnel in the future could prevent the implementation and completion of our objectives, including the development and introduction of our products. In general, our key personnel may terminate their employment at any time and for any reason without notice, unless the individual is a participant in our 2007 Severance Protection Plan, in which case the individual has agreed to provide us with six months notice if such individual decides to voluntarily resign.

*Changes to government immigration regulations may materially affect our workforce and limit our supply of qualified professionals, or increase our cost of securing workers.

We recruit professionals on a global basis and must comply with the immigration laws in the countries in which we operate, including the U.S. Some of our employees are working under Masimo-sponsored temporary work visas, including H1-B visas. The H-1B visa classification enables U.S. employers to hire certain qualified foreign workers in positions that require an education at least equal to a four-year bachelor degree in the United States in specialty occupations such as engineering. Statutory law limits the number of new H1-B temporary work permit petitions that may be approved in a fiscal year, and if we are unable to obtain H1-B visas for our employees in sufficient quantities or at a sufficient rate for a significant period of time, our business, operating results and financial condition could be adversely affected.

The subject of H1-B visas has recently become a topic of political discussion, and there are indications that the H1-B visa program may be significantly overhauled. If a new or revised visa program is implemented, there could be elements of any new or revised visa program that may impact our ability to recruit, hire and retain qualified skilled personnel, which could adversely impact our business, operating results and financial condition.

*The risks inherent in operating internationally and the risks of selling and shipping our products and purchasing our components and products internationally may adversely impact our business, financial condition and results of operations.

We derive a portion of our net sales from international operations. For the six months ended July 1, 2017 and July 2, 2016, approximately 30.4% and 28.4%, respectively, of our product revenue was derived from our international operations. In addition, we purchase a portion of our raw materials and components on the international market. The sale and shipment of our products across international borders, as well as the purchase of materials and components from international sources, subject us to extensive U.S. and foreign governmental trade regulations. Compliance with such regulations is costly and we could be exposed to potentially significant penalties if we are found not to be in compliance with such regulations. Any failure to comply with applicable legal and regulatory obligations could impact us in a variety of ways that include, but are not limited to, significant criminal, civil and administrative penalties, including imprisonment of individuals, fines and penalties, denial of export privileges, seizure of shipments, restrictions on certain business activities, and exclusion or debarment from government contracting. Also, the failure to comply with applicable legal and regulatory obligations could result in the disruption of our shipping, manufacturing and sales activities. Any material decrease in our international sales would adversely affect our business, financial condition and results of operations.

In June 2016, the United Kingdom (UK) held a referendum pursuant to which voters elected to leave the EU, commonly referred to as Brexit. As a result of UK voters' election to leave the EU, the British government is expected to begin negotiating the terms of the UK's future relationship with the EU. Although the long-term effects of Brexit will depend on any agreements the UK makes to retain access to the EU markets, Brexit has created additional uncertainties that may ultimately result in new regulatory costs and challenges for medical device companies and increased restrictions on imports and exports throughout Europe, which could adversely affect our ability to conduct and expand our operations in Europe and which may have an adverse effect on our business, financial condition and results of operations. Additionally, Brexit may increase the possibility that other countries may decide to leave the EU

in the future.

In addition, our international sales operations expose us and our representatives, agents and distributors to risks inherent in operating in foreign jurisdictions. These risks include, but are not limited to:

- the imposition of additional U.S. and foreign governmental controls or regulations;
- the imposition of costly and lengthy new export licensing requirements;
- a shortage of high-quality sales people and distributors;

Table of Contents

- the loss of any key personnel that possess proprietary knowledge, or who are otherwise important to our success in certain international markets;
- changes in duties and tariffs, license obligations and other non-tariff barriers to trade;
- the imposition of new trade restrictions;
- the imposition of restrictions on the activities of foreign agents, representatives and distributors;
- scrutiny of foreign tax authorities which could result in significant fines, penalties and additional taxes being imposed on us;
- pricing pressure that we may experience internationally;
- changes in foreign currency exchange rates;
- laws and business practices favoring local companies;
- political instability and actual or anticipated military or political conflicts;
- financial and civil unrest worldwide;
- outbreaks of illnesses, pandemics or other local or global health issues such as the Zika virus;
- longer payment cycles; and
- difficulties in enforcing or defending intellectual property rights.

The U.S. Foreign Corrupt Practices Act and similar worldwide anti-bribery laws in non-U.S. jurisdictions generally prohibit companies and their intermediaries from promising or making improper payments to non-U.S. officials for the purpose of obtaining an advantage to secure or retain business. Because of the predominance of government-sponsored health care systems around the world, many of our customer relationships outside of the U.S. are with governmental entities and are therefore subject to such anti-bribery laws. Our policies mandate compliance with these anti-bribery laws.

Personal privacy and data security have become significant issues in the United States, Europe and in many other jurisdictions where we offer our products. The regulatory framework for privacy and security issues worldwide is rapidly evolving and is likely to remain uncertain for the foreseeable future. Future laws, regulations, standards and other obligations, and changes in the interpretation of existing laws, regulations, standards and other obligations could result in increased regulation, cost of compliance and limitations on data collection, use, disclosure and transfer. For example, in October 2015, the Court of Justice of the EU ruled that the US-EU Safe Harbor framework that had been in place since 2000, which allowed companies to meet certain European legal requirements for the transfer of personal data from the European Economic Area to the United States, was invalid. In July 2016, a new data transfer framework referred to as the EU-U.S. Privacy Shield was adopted, which may provide a new mechanism for companies to transfer EU personal data to the U.S. While we have adopted the EU-U.S. Privacy Shield framework for the transfer of personal data from the EU to the U.S., our means for transferring personal data from the EU may not be adopted by all of our customers and suppliers and may be subject to legal challenge or risk of enforcement actions by data protection authorities. Despite our training and compliance programs, our internal control policies and procedures may not always protect us from reckless or criminal acts committed by our employees or agents. Violations of these laws, or allegations of such violations, could subject us to cash and non-cash penalties, disrupt our operations, involve significant management distraction and result in a material adverse effect on our business, financial condition and results of operations.

Our operations may be adversely impacted by our exposure to risks related to foreign currency exchange rates.

We market our products in certain foreign markets through our subsidiaries and other international distributors. As a result, events that result in global economic uncertainty could significantly affect our results of operations in the form of gains and losses on foreign currency transactions and potential devaluation of the local currencies of our customers relative to the U.S. Dollar. For example, the announcement of Brexit caused significant volatility in global economic markets and currency exchange rate fluctuations that resulted in the strengthening of the U.S. Dollar relative to certain other foreign currencies in which we conduct business. While a majority of our sales are transacted in U.S. Dollars, some of our sales agreements with foreign customers provide for payment in currencies other than the U.S. Dollar. These foreign currency revenues, when converted into U.S. Dollars, can vary depending on average exchange rates during a respective period. Similarly, certain of our foreign sales support subsidiaries transact business in their respective country’s local currency, which is also their functional currency. In addition, certain production costs related

to our manufacturing operations in Mexico are denominated in Mexican Pesos. As a result, expenses of these foreign subsidiaries and certain production costs, when converted into U.S. Dollars, can vary depending on average monthly exchange rates during a respective period.

Table of Contents

We are also exposed to foreign currency gains or losses on outstanding foreign currency denominated receivables and payables. When converted to U.S. Dollars, these receivables and payables can vary depending on the monthly exchange rates at the end of the period. In addition, certain intercompany transactions may give rise to realized and unrealized foreign currency gains or losses based on the currency underlying such intercompany transactions. Accordingly, our operating results are subject to fluctuations in foreign currency exchange rates.

The balance sheets of our foreign subsidiaries whose functional currency is not the U.S. Dollar are translated into U.S. Dollars at the rate of exchange at the balance sheet date and the statements of operations and cash flows are translated into U.S. Dollars using the average monthly exchange rate during the period. Any foreign currency exchange gain or loss as a result of translating the balance sheets of our foreign subsidiaries whose functional currency is not the U.S. Dollar is included in equity as a component of accumulated other comprehensive income (loss).

We currently do not hedge our foreign currency exchange rate risk. Should we decide in the future to hedge such exchange rate risk by entering into forward contracts, these contracts may not mitigate the potential adverse impact on our financial results due to the variability of timing and amount of payments under these contracts. In addition, our failure to sufficiently hedge, forecast or otherwise manage such foreign currency risks properly could have a material adverse effect on our business, financial condition and results of operations.

*We currently manufacture our products at several locations and any disruption to or expansion of our manufacturing operations could adversely affect our business, financial condition and results of operations.

We rely on our manufacturing facilities in Mexicali and San Luis Rio Colorado, Mexico; Irvine, California; Hudson, New Hampshire; and Danderyd, Sweden. These facilities and the manufacturing equipment we use to produce our products would be difficult to replace and could require substantial time to repair. Our facilities may be affected by natural or man-made disasters. Earthquakes are of particular significance since some of our facilities are located in an earthquake-prone area. We are also vulnerable to damage from other types of disasters, including power loss, attacks from extremist or terrorist organizations, epidemics, communication failures, fire, floods and similar events. In the event that one of our facilities is affected by a natural or man-made disaster, we would be forced to rely on third-party manufacturers if we could not shift production to our other manufacturing facilities. Furthermore, our insurance for damage to our property and the disruption of our business from casualties may not be sufficient to cover all of our potential losses and may not continue to be available to us on acceptable terms, or at all. If we are forced to seek alternative facilities, or if we voluntarily expand one or more of our manufacturing operations to new locations, we may incur additional transition costs and we may experience a disruption in the supply of our products until the new facilities are available and operating.

We also purchase materials and components from international sources. Any disruption in the supply of such materials, including transportation or port delays, could adversely impact our manufacturing operations. Disruptions may also occur as a result of local, regional and worldwide health risks. Such disruptions may include the inability to manufacture and distribute our products due to the direct effects of illness on individuals or due to constraints on supply and distribution that may result from either voluntary or government imposed restrictions.

Any disruption or delay at our manufacturing facilities, any expansion of our operations to additional locations, or any changes in market conditions could create operational hurdles and have an adverse impact on our ability to produce sufficient inventory of our products or may require us to incur additional expenses in order to produce sufficient inventory, depending on changes in product demand. Furthermore, if we are unable to meet the demand of our customers, our customers may cancel orders or purchase products from our competitors, which could adversely affect our business, financial condition and results of operations. Conversely, if product demand decreases, we may be unable to timely adjust our manufacturing cost structure, resulting in excess capacity, which would lower gross product margins. Similarly, if we are unable to forecast demand accurately, we could be required to record charges related to excess or obsolete inventory, which would also lower our gross margin.

Our suppliers may not supply us with a sufficient amount of materials and components or materials and components of adequate quality.

We depend on certain sole or limited source suppliers for key materials and components of our noninvasive patient monitoring solutions, and if we are unable to obtain these materials and components on a timely basis, we will not be able to deliver our noninvasive patient monitoring solutions to customers. Also, we cannot guarantee that any of the

materials or components that we purchase, if available at all, will be of adequate quality and at acceptable price levels. From time to time, there are industry-wide shortages of several electronic components that we use in our noninvasive blood constituent patient monitoring solutions. We may also experience price increases for materials or components, with no guarantee that such increases can be passed along to our customers.

Table of Contents

We may experience delays in production of our products if we fail to identify alternate vendors for materials and components, if any parts supply is interrupted or reduced or if there is a significant increase in production costs, each of which could adversely affect our business, financial condition and results of operations. In addition, we rely on third party manufacturers to supply some of our products and components, including digital signal processor chips and analog to digital converter chips. Manufacturing problems may occur with these and other outside sources, as a supplier may fail to develop and supply products and components to us on a timely basis, or may supply us with products and components that do not meet our quality, quantity and cost requirements. If any of these problems occur, we may be unable to obtain substitute sources for these products and components on a timely basis or on terms acceptable to us, which could harm our ability to manufacture our own products and components profitably or on time.

If we fail to comply with the reporting obligations of the Securities Exchange Act of 1934, as amended, and Section 404 of the Sarbanes-Oxley Act of 2002, as amended, or if we fail to maintain adequate internal control over financial reporting, our business, results of operations and financial condition and investors' confidence in us could be materially and adversely affected.

As a public company, we are required to comply with the periodic reporting obligations of the Securities Exchange Act of 1934, as amended, including preparing annual reports, quarterly reports and current reports. Our failure to prepare and disclose this information in a timely manner and meet our reporting obligations in their entirety could subject us to penalties under federal securities laws and regulations of The NASDAQ Stock Market LLC, expose us to lawsuits and restrict our ability to access financing on favorable terms, or at all.

In addition, pursuant to Section 404 of the Sarbanes-Oxley Act of 2002, as amended (the Sarbanes-Oxley Act), we are required to evaluate and provide a management report on our systems of internal control over financial reporting, and our independent registered public accounting firm is required to attest to our internal control over financial reporting. During the course of the evaluation of our internal control over financial reporting, we may identify areas requiring improvement and may be required to design enhanced processes and controls to address issues identified through this review. This could result in significant delays and costs to us and require us to divert substantial resources, including management time, from other activities. In addition, if we fail to maintain the adequacy of our internal controls over financial reporting, we may not be able to ensure that we can conclude on an ongoing basis that we have effective internal control over financial reporting in accordance with the Sarbanes-Oxley Act. Moreover, effective internal controls are necessary for us to produce reliable financial reports and are important to help prevent fraud. Any failure to maintain compliance with the requirements of Section 404 of the Sarbanes-Oxley Act or any material weakness in our internal control environment could result in the loss of investor confidence in the reliability of our financial statements, which in turn could harm our business, negatively impact the trading price of our stock, and adversely affect investors' confidence in our company and our ability to access capital markets for financing.

Changing laws and increasingly complex corporate governance and public disclosure requirements could have an adverse effect on our business and operating results.

Changing laws, regulations and standards relating to corporate governance and public disclosure, including the Sarbanes-Oxley Act, the Dodd-Frank Wall Street Reform and Consumer Protection Act (Dodd-Frank Act), the California Transparency in Supply Chains Act, the UK Modern Slavery Act and new regulations issued by the SEC and The NASDAQ Stock Market LLC, have and will create additional compliance requirements for companies such as ours. To maintain high standards of corporate governance and public disclosure, we have invested in, and intend to continue to invest in, reasonably necessary resources to comply with evolving standards.

For example, the Dodd-Frank Act includes provisions regarding "conflict minerals" (generally tin, tantalum, tungsten and gold) that are mined in the Democratic Republic of Congo and adjoining countries (the DRC region), and in June 2016, the EU adopted its own regulation on conflict minerals that covers the sourcing of conflict minerals from anywhere in the world. The provisions of the Dodd-Frank Act require us to undertake comprehensive due diligence to determine whether conflict minerals used in our products, including any portion of our products manufactured by third parties, financed or benefited armed groups in the DRC region. The rules also require us to file conflict mineral reports with the SEC annually. We have incurred, and expect to continue to incur, additional costs to comply with these rules, including costs related to determining the source of origin of conflict minerals used in our products. Given

the complexity of our supply chain, we may face difficulties if our suppliers are unwilling or unable to verify the origin of all conflict minerals used in our products. Furthermore, our ongoing compliance with these rules could affect the pricing, sourcing and availability of minerals used in the manufacture of our products. We may also encounter challenges with our customers and stockholders if we are unable to certify that our products are free of conflict minerals. To maintain high standards of corporate governance and public disclosure, we have invested in, and intend to continue to invest in, reasonably necessary resources to comply with such evolving standards. These investments have resulted in increased general and administrative expenses and a diversion of management time and attention from revenue-generating activities and may continue to do so in the future.

Table of Contents

In addition, stockholder litigation surrounding executive compensation and disclosure of executive compensation has increased with the passage of the Dodd-Frank Act. Furthermore, in recent years, our stockholders have not approved our advisory vote on named executive officer compensation that is required to be voted on by our stockholders annually pursuant to the Dodd-Frank Act. If we are involved in a lawsuit related to compensation matters or any other matters not covered by our directors' and officers' liability insurance, we may incur significant expenses in defending against such lawsuits, or be subject to significant fines or required to take significant remedial actions, each of which could adversely affect our business, financial condition and results of operations.

*If product liability claims are brought against us, we could face substantial liability and costs.

The manufacture and sale of products using Masimo SET® and licensed rainbow® technology expose us to product liability claims and product recalls, including, but not limited to, those that may arise from unauthorized off-label use, which is use of a device in a manner outside the indications for use cleared by the FDA, malfunctions, design flaws or manufacturing defects related to our products or the use of our products with incompatible components or systems. For example, in April 2014, an amended putative class action complaint was filed against us alleging product liability and negligence claims in connection with pulse oximeters that we modified and provided at the request of the study investigators for use in a randomized trial at the University of Alabama. In August 2015, the Court granted summary judgment in favor of Masimo, rejecting the plaintiffs' claims. The plaintiffs have appealed the Court's decision. The appellate hearing before the Eleventh Circuit Court of Appeals was held on December 13, 2016. On July 7, 2017, the Eleventh Circuit Court of Appeals (Eleventh Circuit) issued a Certification to the Supreme Court of Alabama seeking guidance on a legal question. In that Certification, the Eleventh Circuit stated that the plaintiffs failed to establish that participation in the clinical study caused any injuries, and that the negligence, negligence per se, breach of fiduciary duty, and products liability claims, which includes the claims currently alleged against us, were properly dismissed. While we believe we have good and substantial defenses to the claims, there is no guarantee that we will ultimately prevail. In addition, we cannot be certain that our product liability insurance will be sufficient to cover any or all damages or claims asserted in this case or any other product liability claims that may be brought against us in the future. Furthermore, we may not be able to obtain or maintain insurance in the future at satisfactory rates or in adequate amounts to protect us against any product liability claims.

Additionally, the laws and regulations regarding product liability are constantly evolving, both through the passage of new legislation at the state and federal levels and through new interpretations of existing legislation. For example, in February 2017, the Washington Supreme Court determined that, under the Washington Product Liability Act, medical device manufacturers have a duty to warn hospitals of any potential risks posed by their products. As the legal and regulatory landscape surrounding product liability change, we may become exposed to greater liability than currently anticipated.

Any losses that we may suffer from product liability claims, and the effect that any product liability litigation may have upon the reputation and marketability of our technology and products, together with the corresponding diversion of the attention of our key employees, may subject us to significant damages and could adversely affect our business, financial condition and results of operations.

*Future acquisitions of businesses could negatively affect our business, financial condition and results of operations if we fail to integrate the acquired businesses successfully into our existing operations or if we discover previously undisclosed liabilities.

We have acquired six businesses since our inception and we may acquire additional businesses in the future, which may be larger in magnitude than our previous acquisitions. Successful acquisitions depend upon our ability to identify, negotiate, complete and integrate suitable acquisitions and to obtain any necessary financing. Future acquisitions may require equity financing, either of which could be dilutive to our existing stockholders and our earnings per share, or debt financing, which Even if we complete acquisitions, we may experience:

- payment of above-market prices for acquisitions and incurring higher than anticipated acquisition costs;
- a need to issue shares of common stock as part of the acquisition price or a need to issue stock options or other equity to newly-hired employees of target companies, resulting in dilution of ownership to our existing stockholders;
- reduced profitability as future acquisitions may not result in accretive contributions to the business over either the short-term or the long-term;

- difficulties in integrating any acquired companies, personnel, products and other assets into our existing business;
- delays in realizing the benefits of the acquired company, products or other assets;
- regulatory challenges;
- cybersecurity and compliance related issues;

Table of Contents

- diversion of our management's time and attention from other business concerns;
- limited or no direct prior experience in new markets or countries we may enter;
- unanticipated issues dealing with unfamiliar suppliers, service providers or other collaborators of the acquired company;
- higher costs of integration than we anticipated;
- write-downs or impairments of goodwill or other intangible assets associated with the acquired company;
- difficulties in retaining key employees of the acquired business who are necessary to manage these acquisitions;
- negative impacts on our relationships with our employees, clients or collaborators;
- litigation or other claims in connection with the acquisition; and
- changes in the overall financial model as certain acquired companies may have a different revenue, gross profit margin or operating expense profile.

Further, our ability to benefit from future acquisitions depends on our ability to successfully conduct due diligence, negotiate acceptable acquisition terms, evaluate prospective acquisitions and bring acquired technologies and/or products to market at acceptable margins and operating expense levels. Our failure in any of these tasks could result in unforeseen liabilities associated with an acquired company, acquiring a company on unfavorable terms or selecting and eventually acquiring a suboptimal acquisition target. We may also discover deficiencies in internal controls, data adequacy and integrity, product quality, regulatory compliance and product liabilities that we did not uncover prior to our acquisition of such businesses, which could result in us becoming subject to penalties or other liabilities. If we do not achieve the anticipated benefits of an acquisition as rapidly as expected, or at all, investors or analysts may not perceive the same benefits of the acquisition as we do. If these risks materialize, our stock price could be materially adversely affected. Any difficulties in the integration of acquired businesses or unexpected penalties or liabilities in connection with such businesses could have a material adverse effect on our business, financial condition and results of operations.

We may incur environmental and personal injury liabilities related to certain hazardous materials used in our operations.

Our manufacturing processes involve the use, generation and disposal of certain hazardous materials and wastes, including silicone adhesives, solder and solder paste, sealants, epoxies and various solvents such as methyl ethyl ketone, acetone and isopropyl alcohol. As a result, we are subject to stringent federal, state and local laws relating to the protection of the environment, including those governing the use, handling and disposal of hazardous materials and wastes. For example, products that we sell in Europe are subject to regulation in the EU markets under the Restriction of the Use of Hazardous Substances Directive (RoHS). RoHS prohibits companies from selling products that contain certain hazardous materials, including lead, mercury, cadmium, chromium, polybrominated biphenyls and polybrominated diphenyl ethers, in EU member states. In addition, the EU's Registration, Evaluation, Authorization, and Restriction of Chemicals Directive also restricts substances of very high concern in products. Compliance with such regulations may be costly and, therefore, we may be forced to incur significant costs to comply with environmental regulations.

From time to time, new regulations are enacted and it is difficult to anticipate how such regulations will be implemented and enforced. We continue to evaluate the necessary steps for compliance with environmental regulations as they are enacted. Future environmental laws may significantly affect our operations by, for example, requiring our manufacturing processes to be altered or requiring us to use different types of materials in manufacturing our products. Any changes to our operations may increase our manufacturing costs, detrimentally impact the performance of our products, add greater testing lead-times for product introductions or have other similar effects. In our research and manufacturing activities, we use, and our employees may be exposed to, materials that are hazardous to human health, safety or the environment. These materials and various wastes resulting from their use are stored at our facility pending ultimate use and disposal.

The risk of accidental injury to our employees or contamination from these materials cannot be eliminated. In the event of such an accident, we could be held liable for any resulting damages and any such liability could exceed our reserves. Although we maintain general liability insurance, we do not specifically insure against environmental liabilities. If an enforcement action were to occur, our reputation and our business and financial condition may be

harmed, even if we were to prevail or settle the action on terms favorable to us.

Table of Contents

We rely significantly on information technology and any failure, inadequacy, interruption or security lapse of that technology, including any cybersecurity incidents, could harm our ability to operate our business effectively. Increased global cybersecurity vulnerabilities, threats and more sophisticated and targeted cybersecurity attacks pose a risk to the security of Masimo's and our customers', partners', suppliers' and third-party service providers' products, systems and networks, and the confidentiality, availability and integrity of any underlying information and data. Our ability to effectively manage and maintain our internal business information, and to ship products to customers and invoice them on a timely basis, depends significantly on our enterprise resource planning system and other information systems. Portions of our information technology systems may experience interruptions, delays or cessations of service or produce errors in connection with ongoing systems implementation work. In addition, interfaces between our products and our customers' computer network could provide additional opportunities for cybersecurity attacks on us and our customers. The techniques used to attack computer systems are sophisticated, change frequently and may originate from less regulated and remote areas of the world. Cybersecurity attacks in particular are evolving and include, but are not limited to, malicious software, attempts to gain unauthorized access to data and other electronic security breaches that could lead to disruptions in systems, misappropriation of confidential or otherwise protected information and corruption of data. As a result, there can be no assurance that our protective measures will prevent or detect security breaches that could have a significant impact on our business, reputation, financial condition and results of operations. The failure of these systems to operate or integrate effectively with other internal, customer, supplier or third-party service provider systems and to protect the underlying information technology system and data integrity, including from cyber-attacks, intrusions or other breaches or unauthorized access of these systems, or any failure by us to remediate any such attacks or breaches, may also result in damage to our reputation or competitiveness, delays in product fulfillment and reduced efficiency of our operations, and could require significant capital investments to remediate any such failure, problem or breach, all of which could adversely affect our business, financial condition and results of operations.

Our operating results may be adversely affected by unfavorable economic and market conditions.

Many of the countries in which we operate, including the U.S. and several of the members of the EU, have experienced and continue to experience uncertain economic conditions resulting from global as well as local factors, such as Brexit. Our business or financial results may be adversely impacted by these uncertain economic conditions, including: adverse changes in interest rates, foreign currency exchange rates, tax laws or tax rates; inflation; contraction in the availability of credit in the marketplace due to legislation or other economic conditions, which may potentially impair our ability to access the capital markets on terms acceptable to us or at all; and the effects of government initiatives to manage economic conditions.

In addition, we cannot predict how future economic conditions will affect our critical customers, suppliers and distributors and any negative impact on our critical customers, suppliers or distributors may also have an adverse impact on our results of operations or financial condition.

*Our Amended and Restated Credit Agreement contains certain covenants and restrictions that may limit our flexibility in operating our business.

Our Amended and Restated Credit Agreement, dated January 8, 2016 (Restated Credit Facility), with JPMorgan Chase Bank, N.A., as Administrative Agent and a Lender, Bank of America, N.A., as Syndication Agent and a Lender, Citibank, N.A., as Documentation Agent and a Lender, and various other Lenders (collectively, the Lenders), contains various affirmative covenants and restrictions that limit our ability to engage in specified types of transactions, including:

- incurring specified types of additional indebtedness (including guarantees or other contingent obligations);
- paying dividends on, repurchasing or making distributions in respect of our common stock or making other restricted payments, subject to specified exceptions;
- making specified investments (including loans and advances);
- selling or transferring certain assets;
- creating certain liens;
- consolidating, merging, selling or otherwise disposing of all or substantially all of our assets; and
- entering into certain transactions with any of our affiliates.

In addition, under our Restated Credit Facility, we are required to satisfy and maintain specified financial ratios and other affirmative covenants. Our ability to meet those financial ratios and affirmative covenants could be affected by events beyond our control and, therefore, we cannot be assured that we will be able to continue to satisfy these requirements. A breach of any of these ratios or covenants could result in a default under the Restated Credit Facility. Upon the occurrence of an event of default, the Lenders could elect to declare all amounts outstanding under the Restated Credit Facility immediately due and payable, terminate all commitments to extend further credit and pursue legal remedies for recovery, all of which could

Table of Contents

adversely affect our business and financial condition. As of July 1, 2017, we had no amounts outstanding under the Restated Credit Facility and were in compliance with all applicable covenants.

Risks Related to Our Stock

*Our stock price may be volatile, and your investment in our stock could suffer a decline in value.

There has been significant volatility in the market price and trading volume of equity securities, which is often unrelated to the financial performance of the companies issuing the securities. These broad market fluctuations may negatively affect the market price of our stock. From January 3, 2017 to July 1, 2017, our closing stock price ranged from $67.40 to $104.46 per share. You may not be able to resell your shares at or above the price you paid for them due to fluctuations in the market price of our stock caused by changes in our operating performance or prospects and other factors.

In addition to the other risk factors previously discussed above, there are many other factors that we may not be able to control that could have a significant effect on our stock price. These include, but are not limited to:

- actual or anticipated fluctuations in our operating results or future prospects;
- our announcements or our competitors' announcements of new products;
- the public's reaction to our press releases, our other public announcements and our filings with the SEC;
- strategic actions by us or our competitors, such as acquisitions or restructurings;
- new laws or regulations or new interpretations of existing laws or regulations applicable to our business;
- changes in accounting standards, policies, guidance, interpretations or principles;
- changes in our growth rates or our competitors' growth rates;
- developments regarding our patents or proprietary rights or those of our competitors;
- ongoing legal proceedings;
- our inability to raise additional capital as needed;
- concerns or allegations as to the safety or efficacy of our products;
- changes in financial markets or general economic conditions, including the effects of recession or slow economic growth in the U.S. and abroad;
- sales of stock by us or members of our management team, our Board of Directors (Board) or certain institutional stockholders; and
- changes in stock market analyst recommendations or earnings estimates regarding our stock, other comparable companies or our industry generally.

*Concentration of ownership among our existing directors, executive officers and principal stockholders may prevent new investors from influencing significant corporate decisions.

As of July 1, 2017, our current directors and executive officers and their affiliates, in the aggregate, beneficially owned approximately 12.2% of our outstanding stock. Subject to any fiduciary duties owed to our other stockholders under Delaware law, these stockholders may be able to exercise significant influence over matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions, and will have some control over our management and policies. Some of these persons or entities may have interests that are different from yours. For example, these stockholders may support proposals and actions with which you may disagree or which are not in your best interests. The concentration of ownership could delay or prevent a change in control of us, or otherwise discourage a potential acquirer from attempting to obtain control of us, which in turn could reduce the price of our stock. In addition, these stockholders could use their voting influence to maintain our existing management and directors in office or support or reject other management and Board proposals that are subject to stockholder approval, such as amendments to our employee stock plans and approvals of significant financing transactions.

*You could experience substantial dilution of your investment as a result of subsequent exercises of our outstanding options, vesting of outstanding restricted stock units (RSUs) and performance stock units (PSUs), or the grant of future equity awards by us.

As of July 1, 2017, approximately 14.5 million shares of our common stock were reserved for future issuance under our equity incentive plans, of which approximately 6.9 million shares were subject to options outstanding at such date at a weighted-

63

Table of Contents

average exercise price of $31.19 per share, approximately 2.7 million shares were subject to outstanding RSUs, approximately 0.2 million shares were subject to outstanding PSUs and approximately 4.6 million shares were available for future grant under our 2017 Equity Incentive Plan. Over the past 12 months, we have experienced higher rates of stock option exercises compared to many earlier periods, and this trend may continue. To the extent outstanding options are exercised or outstanding RSUs or PSUs vest, our existing stockholders may incur dilution. We rely on equity awards to motivate current employees and to attract new employees. The grant of future equity awards by us to our employees and other service providers may further dilute our stockholders.

Future resales of our stock, including those by our insiders and a few investment funds, may cause our stock price to decline.

A significant portion of our outstanding shares are held by our directors, our executive officers and a few investment funds. Resales by these stockholders of a substantial number of such shares, announcements of any proposed resale of substantial amounts of our stock or the perception that substantial resales may be made, could significantly reduce the market price of our stock. Some of our directors and executive officers have entered into Rule 10b5-1 trading plans pursuant to which they have arranged to sell shares of our stock from time to time in the future. Generally, these sales require public filings. Actual or potential sales by these insiders, including those under a pre-arranged Rule 10b5-1 trading plan, could be interpreted by the market as an indication that the insider has lost confidence in our stock and reduce the market price of our stock.

We have registered and expect to continue to register shares reserved under our equity plans pursuant to Registration Statements on Form S-8. All shares issued pursuant to a Registration Statement on Form S-8 can be freely sold in the public market upon issuance, subject to restrictions on our affiliates under Rule 144. If a large number of these shares are sold in the public market, the sales could reduce the trading price of our stock.

Our corporate documents and Delaware law contain provisions that could discourage, delay or prevent a change in control of our company, prevent attempts to replace or remove current management and reduce the market price of our stock.

Provisions in our amended and restated certificate of incorporation and amended and restated bylaws may discourage, delay or prevent a merger or acquisition involving us that our stockholders may consider favorable. For example, our amended and restated certificate of incorporation authorizes our Board to issue up to 5.0 million shares of “blank check” preferred stock. As a result, without further stockholder approval, our Board has the authority to attach special rights, including voting and dividend rights, to this preferred stock, including pursuant to a stockholder rights plan. With these rights, preferred stockholders could make it more difficult for a third-party to acquire us. In addition, our amended and restated certificate of incorporation provides for a staggered board of directors, whereby directors serve for three year terms, with one-third of the directors coming up for reelection each year. A staggered Board will make it more difficult for a third-party to obtain control of our Board through a proxy contest, which may be a necessary step in an acquisition of us that is not favored by our Board.

We are also subject to anti-takeover provisions under the General Corporation Law of the State of Delaware. Under these provisions, if anyone becomes an “interested stockholder,” we may not enter into a “business combination” with that person for three years without special approval, which could discourage a third-party from making a takeover offer and could delay or prevent a change in control of us. For purposes of these provisions, an “interested stockholder” generally means someone owning 15% or more of our outstanding voting stock or an affiliate of ours that owned 15% or more of our outstanding voting stock during the past three years, subject to certain exceptions as described in the General Corporation Law of the State of Delaware.

*We may elect not to declare cash dividends on our stock, may elect to only pay dividends on an infrequent or irregular basis, or may elect not to make any additional stock repurchases. As a result, any return on your investment may be limited to the value of our stock. In addition, the payment of any future dividends or the repurchase of our stock might limit our ability to pursue other growth opportunities.

Our Board may from time to time declare, and we may pay, dividends on our outstanding shares in the manner and upon the terms and conditions provided by law. However, we may elect to retain all future earnings for the operation and expansion of our business, rather than paying cash dividends on our stock. Any payment of cash dividends on our stock will be at the discretion of our Board and will depend upon our results of operations, earnings, capital

requirements, financial condition, business prospects, contractual restrictions and other factors deemed relevant by our Board. In addition, under certain circumstances, our Restated Credit Facility may limit or restrict our ability to pay cash dividends. In the event our Board declares any dividends, there is no assurance with respect to the amount, timing or frequency of any such dividends.

In September 2015, our Board authorized a stock repurchase program, whereby we may purchase up to 5.0 million shares of our common stock over a period of up to three years. As of July 1, 2017, approximately 2.9 million shares remained available

Table of Contents

for repurchase under this program. Any repurchase of our common stock will be at the discretion of a committee comprised of our Chief Executive Officer and Chief Financial Officer, and will depend on several factors, including, but not limited to, results of operations, capital requirements, financial conditions, available capital from operations or other sources and the market price of our common stock. Therefore, there is no assurance with respect to the amount, price or timing of any such repurchases. We may elect to retain all future earnings for the operation and expansion of our business, rather than repurchasing additional outstanding shares. In addition, under certain circumstances, our Restated Credit Facility may limit or restrict our ability to repurchase our stock. In the event we pay dividends, or make any stock repurchases in the future, our ability to finance any material expansion of our business, including through acquisitions, investments or increased capital spending, or to fund our operations, may be limited. In addition, any repurchases we may make in the future may not prove to be at optimal prices. Our Board may modify or amend our stock repurchase program at any time at its discretion without stockholder approval.

Item 6. Exhibits

The exhibits listed in the Exhibit Index immediately preceding the exhibits are filed as part of this Quarterly Report on Form 10-Q and such Exhibit Index is incorporated herein by reference.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned, thereunto duly authorized.

MASIMO CORPORATION

Date: August 2, 2017	By:	/s/ JOE KIANI Joe Kiani Chief Executive Officer and Chairman
Date: August 2, 2017	By:	/s/ MARK P. DE RAAD Mark P. de Raad Executive Vice President and Chief Financial Officer

Table of Contents

EXHIBIT INDEX

Exhibit Number		Description of Document
3.1	(1)	Amended and Restated Certificate of Incorporation (Exhibit 3.1)
3.2	(2)	Amended and Restated Bylaws adopted on October 20, 2011 (Exhibit 3.2)
4.1	(1)	Form of Common Stock Certificate (Exhibit 4.1)
4.2	(1)	Fifth Amended and Restated Registration Rights Agreement made and entered into as of September 14, 1999, between Masimo Corporation and certain of its stockholders (Exhibit 4.2)
4.3#	(3)	Masimo Retirement Savings Plan (Exhibit 4.7)
10.1#	(4)	Masimo Corporation 2017 Equity Incentive Plan
10.2#	(5)	Masimo Corporation Executive Bonus Incentive Plan
10.3	(6)	First Amendment to November 4, 2015 Amended and Restated Employment Agreement, dated July 27, 2017, by and between Masimo Corporation and Joe Kiani.
12.1*		Statement Regarding the Computation of Ratio of Earnings to Fixed Charges
31.1*		Certification of Joe Kiani, Chief Executive Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as amended
31.2*		Certification of Mark P. de Raad, Chief Financial Officer, pursuant to Section 302 of the Sarbanes-Oxley Act of 2002, as amended
32.1*		Certification of Joe Kiani, Chief Executive Officer, and Mark P. de Raad, Chief Financial Officer, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, as amended
101.INS*		XBRL Instance Document
101.SCH*		XBRL Taxonomy Extension Schema Document
101.CAL*		XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF*		XBRL Taxonomy Extension Definition Linkbase Document
101.LAB*		XBRL Taxonomy Extension Label Linkbase Document
101.PRE*		XBRL Taxonomy Extension Presentation Linkbase Document

Attached as Exhibit 101 to this report are the following formatted in XBRL (Extensible Business Reporting Language): (i) Condensed Consolidated Balance Sheets as of July 1, 2017 and December 31, 2016, (ii) Condensed Consolidated Statements of Income for the six months ended July 1, 2017 and July 2, 2016, (iii) Condensed Consolidated Statements of Comprehensive Income for the six months ended July 1, 2017 and July 2, 2016, (iv) Condensed Consolidated Statements of Cash Flows for the six months ended July 1, 2017 and July 2, 2016, and (v) Notes to Condensed Consolidated Financial Statements.

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(1) Incorporated by reference to the exhibits to the Company's Registration Statement on Form S-1 (No. 333-142171), originally filed on April 17, 2007. The number given in parentheses indicates the corresponding exhibit number in such Form S-1, as amended.

(2) Incorporated by reference to the exhibit to the Company's Current Report on Form 8-K filed on October 26, 2011. The number given in parentheses indicates the corresponding exhibit number in such Form 8-K.

(3) Incorporated by reference to the exhibit to the Company's Registration Statement on Form S-8 filed on February 11, 2008. The number given in parentheses indicates the corresponding exhibit number in such Form S-8.

(4) Incorporated by reference to Appendix B to the Company's Definitive Proxy Statement on Schedule 14A (File No. 001-33642) filed on April 12, 2017.

(5) Incorporated by reference to Appendix C to the Company's Definitive Proxy Statement on Schedule 14A (File No. 001-33642) filed on April 12, 2017.

(6) Incorporated by reference to the exhibit to the Company's Current Report on Form 8-K filed on August 2, 2017. The number given in parentheses indicates the corresponding exhibit number in such Form 8-K.

#Indicates management or compensatory plan.

*Filed herewith.