

INSULET CORP
Form 10-Q
April 29, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended March 31, 2016

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

Commission File Number 001-33462

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

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

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

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

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

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

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

Large accelerated filer Accelerated filer

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

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

As of April 27, 2016, the registrant had 57,159,581 shares of common stock outstanding.

INSULET CORPORATION

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PART I - FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements (Unaudited)

INSULET CORPORATION

CONSOLIDATED BALANCE SHEETS (UNAUDITED)

| | March 31, 2016 | December 31, 2015 |
|---|-------------------|----------------------|
| (In thousands, except share and per share data) | | |
| ASSETS | | |
| Current Assets | | |
| Cash and cash equivalents | \$ 111,635 | \$ 122,672 |
| Accounts receivable, net | 40,474 | 42,530 |
| Inventories, net | 14,024 | 12,024 |
| Prepaid expenses and other current assets | 5,712 | 4,283 |
| Current assets of discontinued operations (Note 3) | — | 9,252 |
| Total current assets | 171,845 | 190,761 |
| Property and equipment, net | 41,695 | 41,793 |
| Other intangible assets, net | 885 | 933 |
| Goodwill | 39,761 | 39,607 |
| Other assets | 588 | 76 |
| Long-term assets of discontinued operations (Note 3) | — | 1,956 |
| Total assets | \$ 254,774 | \$ 275,126 |
| LIABILITIES AND STOCKHOLDERS' EQUITY | | |
| Current Liabilities | | |
| Accounts payable | \$ 13,482 | \$ 15,213 |
| Accrued expenses and other current liabilities | 30,385 | 36,744 |
| Deferred revenue | 1,461 | 2,361 |
| Current portion of capital lease obligations | 4,447 | 5,519 |
| Current liabilities of discontinued operations (Note 3) | — | 5,319 |
| Total current liabilities | 49,775 | 65,156 |
| Capital lease obligations | — | 269 |
| Long-term debt, net of discount | 173,681 | 171,698 |
| Other long-term liabilities | 4,922 | 3,952 |
| Total liabilities | 228,378 | 241,075 |
| Commitments and contingencies (Note 12) | | |
| Stockholders' Equity | | |
| Preferred stock, \$.001 par value: | | |
| Authorized: 5,000,000 shares at March 31, 2016 and December 31, 2015. | — | — |
| Issued and outstanding: zero shares at March 31, 2016 and December 31, 2015. | — | — |
| Common stock, \$.001 par value: | | |
| Authorized: 100,000,000 shares at March 31, 2016 and December 31, 2015. | | |
| Issued and outstanding: 57,112,482 and 56,954,830 shares at March 31, 2016 and December 31, 2015, respectively. | 57 | 57 |
| Additional paid-in capital | 690,619 | 686,193 |
| Accumulated other comprehensive loss | (254) | (654) |
| Accumulated deficit | (664,026) | (651,545) |
| Total stockholders' equity | 26,396 | 34,051 |
| Total liabilities and stockholders' equity | \$ 254,774 | \$ 275,126 |

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

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CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

| (In thousands, except share and per share data) | Three Months Ended March 31, | |
|---|---------------------------------|-------------|
| | 2016 | 2015 |
| Revenue | \$81,213 | \$48,148 |
| Cost of revenue | 37,162 | 18,955 |
| Gross profit | 44,051 | 29,193 |
| Operating expenses: | | |
| Research and development | 12,989 | 8,207 |
| Sales and marketing | 24,022 | 14,710 |
| General and administrative | 14,739 | 13,542 |
| Total operating expenses | 51,750 | 36,459 |
| Operating loss | (7,699) | (7,266) |
| Interest expense | (3,096) | (3,179) |
| Other income, net | 170 | 27 |
| Interest and other expense, net | (2,926) | (3,152) |
| Loss from continuing operations before income taxes | (10,625) | (10,418) |
| Income tax expense | (64) | (24) |
| Net loss from continuing operations | \$(10,689) | \$(10,442) |
| Loss from discontinued operations, net of tax (\$408 and \$28 for three months ended March 31, 2016 and 2015, respectively) | (1,792) | (1,392) |
| Net loss | \$(12,481) | \$(11,834) |
| Net loss per share basic and diluted | | |
| Net loss from continuing operations per share basic and diluted | \$(0.19) | \$(0.18) |
| Net loss from discontinued operations per share basic and diluted | \$(0.03) | \$(0.03) |
| Weighted-average number of shares used in calculating net loss per share | 57,029,575 | 56,496,648 |

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

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INSULET CORPORATION
 CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS (UNAUDITED)

| (In thousands) | Three Months Ended | |
|---|--------------------|------------|
| | March 31, | |
| | 2016 | 2015 |
| Net loss | \$(12,481) | \$(11,834) |
| Other comprehensive income, net of tax | | |
| Foreign currency translation adjustment, net of tax | 400 | 3 |
| Total other comprehensive income, net of tax | 400 | 3 |
| Total comprehensive loss | \$(12,081) | \$(11,831) |

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

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INSULET CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

| (In thousands) | Three Months Ended | |
|---|--------------------|-------------|
| | March 31, 2016 | 2015 |
| Cash flows from operating activities | | |
| Net loss | \$(12,481) | \$(11,834) |
| Adjustments to reconcile net loss to net cash used in operating activities | | |
| Depreciation and amortization | 3,422 | 3,433 |
| Non-cash interest | 1,984 | 1,883 |
| Stock-based compensation expense | 5,271 | 5,305 |
| Provision for bad debts | 655 | 328 |
| Other | 139 | — |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | 2,306 | 3,461 |
| Inventories | (2,649) | (6,966) |
| Deferred revenue | (882) | 313 |
| Prepaid expenses and other assets | (462) | 384 |
| Accounts payable, accrued expenses and other current liabilities | (8,776) | (59) |
| Other long-term liabilities | 956 | 264 |
| Net cash used in operating activities | (10,517) | (3,488) |
| Cash flows from investing activities | | |
| Purchases of property and equipment | (3,160) | (4,346) |
| Proceeds from divestiture of business, net (Note 3) | 4,614 | — |
| Net cash provided by (used in) investing activities | 1,454 | (4,346) |
| Cash flows from financing activities | | |
| Principal payments of capital lease obligations | (1,340) | (1,193) |
| Proceeds from issuance of common stock, net of offering costs | 796 | 4,876 |
| Payment of withholding taxes in connection with vesting of restricted stock units | (1,640) | (1,434) |
| Net cash (used in) provided by financing activities | (2,184) | 2,249 |
| Effect of exchange rate changes on cash | 210 | — |
| Net decrease in cash and cash equivalents | (11,037) | (5,585) |
| Cash and cash equivalents, beginning of period | 122,672 | 151,193 |
| Cash and cash equivalents, end of period | \$111,635 | \$145,608 |
| Non-cash investing and financing activities | | |
| Purchases of property and equipment under capital lease | \$— | \$5,721 |

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

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INSULET CORPORATION

CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(UNAUDITED)

Note 1. Nature of the Business

Insulet Corporation, the "Company," is primarily engaged in the development, manufacturing and sale of its proprietary OmniPod Insulin Management System (the "OmniPod System"), an innovative, discreet and easy-to-use insulin infusion system for people with insulin-dependent diabetes. The OmniPod System features a unique disposable tubeless OmniPod which is worn on the body for approximately three days at a time and the handheld, wireless Personal Diabetes Manager ("PDM"). Conventional insulin pumps require people with insulin-dependent diabetes to learn to use, manage and wear a number of cumbersome components, including up to 42 inches of tubing. In contrast, the OmniPod System features two discreet, easy-to-use devices that eliminate the need for a bulky pump, tubing and separate blood glucose meter, provides for virtually pain-free automated cannula insertion, communicates wirelessly and integrates a blood glucose meter.

The Company acquired Neighborhood Holdings, Inc. and its wholly-owned subsidiaries (collectively, "Neighborhood Diabetes") in June 2011. Through Neighborhood Diabetes, the Company provided customers with blood glucose testing supplies, traditional insulin pumps, pump supplies and pharmaceuticals and had the ability to process claims as either durable medical equipment or through pharmacy benefits. In February 2016, the Company sold Neighborhood Diabetes to Liberty Medical LLC ("Liberty Medical"). Additional information regarding the disposition and treatment of the Neighborhood Diabetes business as discontinued operations is provided in note 3 to the consolidated financial statements included in this Form 10-Q.

Commercial sales of the OmniPod System began in the United States in 2005. The Company sells the OmniPod System and other diabetes management supplies in the United States through direct sales to customers or through its distribution partners. The OmniPod System is currently available in multiple countries in Europe, Canada and Israel. In addition to using the Pod for insulin delivery, the Company also partners with global pharmaceutical and biotechnology companies to tailor the OmniPod technology platform for the delivery of subcutaneous drugs across multiple therapeutic areas.

In July 2015, the Company executed an asset purchase agreement whereby it acquired the Canadian OmniPod distribution operations from GlaxoSmithKline ("GSK"). With the acquisition, the Company assumed all distribution, sales, marketing, training and support activities for the OmniPod system in Canada.

Note 2. Summary of Significant Accounting Policies

Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions in the application of certain of its significant accounting policies that may materially affect the reported amounts of assets, liabilities, equity, revenue and expenses. The most significant estimates used in these financial statements include the valuation of stock-based compensation expense, acquired businesses, accounts receivable, inventories, goodwill, deferred revenue, equity instruments, the lives of property and equipment and intangible assets, as well as warranty and doubtful accounts allowance reserve calculations. Actual results may differ from those estimates.

Foreign Currency Translation

For foreign operations, asset and liability accounts are translated at exchange rates as of the balance sheet date; income and expenses are translated using weighted average exchange rates for the reporting period. Resulting translation adjustments are reported in accumulated other comprehensive loss, a separate component of stockholders' equity. Gains and losses arising from transactions and translation of period-end balances denominated in currencies other than the functional currency, primarily the Canadian dollar, are included in other expense, net, and were not material in the three months ending March 31, 2016 and 2015.

Principles of Consolidation

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

Cash and Cash Equivalents

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For the purpose of the financial statement classification, the Company considers all highly liquid investment instruments with original maturities of 90 days or less, when purchased, to be cash equivalents. Cash equivalents include money market accounts, which are carried at cost which approximates their fair value. Outstanding letters of credit, related to security deposits for lease obligations, totaled \$1.2 million as of March 31, 2016 and December 31, 2015.

Property and Equipment

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

Segment Reporting

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

Goodwill

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

The majority of the Company's goodwill resulted from the acquisition of Neighborhood Diabetes in June 2011. This goodwill largely reflects operational synergies and expansion of product offerings across markets complementary to the existing core OmniPod offerings.

As the Company operates in one segment, the Company has considered whether that segment contains multiple reporting units. The Company has concluded that there is a single reporting unit as the Company does not have segment managers and discrete financial information below consolidated results is not reviewed on a regular basis. Based on this conclusion, goodwill was tested for impairment at the enterprise level. The Company performs an annual goodwill impairment test unless interim indicators of impairment exist. The Company has the option to first assess the qualitative factors to determine whether it is more likely than not that the fair value of its sole reporting unit is less than its carrying amount. This qualitative analysis is used as a basis for determining whether it is necessary to perform the two-step goodwill impairment analysis. If the Company determines that it is more likely than not that its fair value is less than its carrying amount, then the two-step goodwill impairment test will be performed. The first step compares the carrying value of the reporting unit to its fair value using a discounted cash flow analysis. If the reporting unit's carrying value exceeds its fair value, the Company would record an impairment loss to the extent that the carrying value of goodwill exceeds its implied fair value. There was no impairment of goodwill during the three months ended March 31, 2016 or 2015. As a result of the sale of Neighborhood Diabetes, goodwill was allocated to the discontinued business using the relative fair value approach.

Revenue Recognition

The Company generates most of its revenue from global sales of the OmniPod System. Revenue also includes sales of devices based on the OmniPod technology platform to global pharmaceutical and biotechnology companies for the delivery of subcutaneous drugs across multiple therapeutic areas.

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

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

Transfer of title and risk and rewards of ownership are passed to the patient or third-party distributor upon shipment of the products.

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

The Company offers a 45-day right of return for sales of its OmniPod System in the United States, and a 90-day right of return for sales of its OmniPod System in Canada to new patients and defers revenue to reflect estimated sales returns in the same period that the related product sales are recorded. Returns are estimated through a comparison of the Company's historical return data to its related sales. Historical rates of return are adjusted for known or expected changes in the marketplace when appropriate. When doubt exists about reasonable assuredness of collectability from specific customers, the Company defers revenue from sales of products to those customers until payment is received. As of March 31, 2016 and December 31, 2015, the Company had deferred revenue of \$1.7 million and \$2.5 million, respectively, which included \$0.2 million classified in other long-term liabilities in each period. Deferred revenue primarily relates to undelivered elements on certain arrangements within the Company's developmental arrangements and other instances where the Company not yet met the revenue recognition criteria.

International OmniPod revenue accounted for approximately 19% and 8% of total revenue in the three months ended March 31, 2016 and 2015, respectively.

Shipping and Handling Costs

The Company does not typically charge its customers for shipping and handling costs associated with shipping its product to its customers. These shipping and handling costs are included in general and administrative expenses.

Concentration of Credit Risk

Financial instruments that subject the Company to credit risk primarily consist of cash and cash equivalents. The Company maintains the majority of its cash with two financial institutions.

The Company purchases OmniPods from Flextronics International Ltd., its single source supplier. As of March 31, 2016 and December 31, 2015, liabilities to this vendor represented approximately 29% and 28% of the combined balance of accounts payable, accrued expenses and other current liabilities, respectively.

In the three months ended March 31, 2016, three customers represented 17%, 15% and 10% of total revenue, respectively. In the three months ended March 31, 2015, one customer represented 12% of total revenue.

Reclassification of Prior Period Balance

Certain reclassifications have been made to prior periods amounts to conform to the current period financial statement presentation including adjusting footnotes within to reflect the presentation of discontinued operations. These reclassifications have no effect on previously reported net income.

Recent Accounting Pronouncements

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers ("ASU 2014-09"). ASU 2014-09 requires that a company will recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the company expects to be entitled in exchange for those goods or services. Under this guidance, a company makes additional estimates regarding performance conditions and the allocation of variable consideration. The guidance is effective in fiscal years beginning January 1, 2018, with early adoption permitted. The Company is currently evaluating the impact of ASU 2014-09. The Company has not yet selected a transition method nor has it determined the effect of the standard on its consolidated financial position and results of operations.

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In June 2014, the FASB issued ASU No. 2014-12, Compensation - Stock Compensation (Topic 718), Accounting for Share-Based Payments when the terms of an award provide that a performance target could be achieved after the requisite service period ("ASU 2014-12"). ASU 2014-12 clarifies the period over which compensation cost would be recognized in awards with a performance target that affects vesting and that could be achieved after the requisite service period. Compensation cost would be recognized over the required service period, if it is probable that the performance condition will be achieved. The guidance is effective in fiscal years beginning after January 1, 2016, with early adoption permitted. As of March 31, 2016, the Company has adopted ASU 2014-12, which did not have an impact on the consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements- Going Concern ("ASU 2014-15"). ASU No. 2014-15 requires management to evaluate whether there is substantial doubt about the entity's ability to continue as a going concern within one year after the date that the financial statements are issued. The new standard is effective for fiscal years ending after December 15, 2016 and interim periods within annual periods beginning after 15 December 2016. Early adoption is permitted. The Company concluded, that if this standard had been adopted as of March 31, 2016 substantial doubt about the Company's ability to continue as a going concern would not exist.

In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory ("ASU 2015-11"). ASU 2015-11 amends existing guidance and requires entities to measure most inventory at the lower of cost and net realizable value. The guidance is effective prospectively for annual reporting periods beginning after December 15, 2016. Early adoption is permitted. Upon adoption, entities must disclose the nature of and reason for the accounting change. The Company is currently evaluating the impact of ASU 2015-11.

In September 2015, the FASB issued ASU No. 2015-16, Business Combinations, Simplifying the Accounting for Measurement Period Adjustments ("ASU 2015-16"). ASU 2015-16 eliminates the requirement that an acquirer in a business combination account for measurement-period adjustments retrospectively. Instead, an acquirer will recognize a measurement period adjustment during the period in which it determines the amount of the adjustment, including the effect on earnings of any amounts it would have recorded in previous periods if the accounting had been completed at the acquisition date. The guidance is effective in 2016 for calendar year-end public entities. Early adoption is permitted. As of March 31, 2016, the Company has adopted ASU 2014-12, which did not have an impact on the consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases ("ASU 2016-02"). ASU 2016-02 requires lessees to recognize the assets and liabilities on their balance sheet for the rights and obligations created by most leases and continue to recognize expenses on their income statements over the lease term. It will also require disclosures designed to give financial statement users information on the amount, timing, and uncertainty of cash flows arising from leases. The guidance is effective for annual reporting periods beginning after December 15, 2018, and interim periods within those years. Early adoption is permitted for all entities. The Company is currently evaluating the impact of ASU 2016-02.

In March 2016, the FASB issued ASU 2016-09, Compensation - Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09"). ASU 2016-09 simplifies several aspects of the accounting for employee share-based payment transactions for both public and nonpublic entities, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The guidance is effective for annual reporting periods beginning after December 15, 2016, and interim periods within those years. Early adoption is permitted for all entities. The Company is currently evaluating the impact of ASU 2016-09.

Other Significant Policies:

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

Fair Value Measurements Note 4 Page 12

Accounts Receivable and Allowance for Doubtful Accounts Note 8 Page 17

| | |
|--|------------------------|
| <u>Inventories</u> | Note 9 Page <u>17</u> |
| <u>Intangibles and Other Long-Lived Assets</u> | Note 10 Page <u>18</u> |
| <u>Warranty</u> | Note 11 Page <u>19</u> |
| <u>Stock-Based Compensation</u> | Note 13 Page <u>21</u> |
| <u>Income Taxes</u> | Note 14 Page <u>23</u> |

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Note 3. Discontinued Operations

Beginning in the first quarter of 2016, the results of operations, assets, and liabilities of Neighborhood Diabetes, are classified as discontinued operations for all periods presented, except for certain corporate overhead costs which remain in continuing operations.

In February 2016, the Company sold Neighborhood Diabetes to Liberty Medical for approximately \$5 million in cash, subject to certain customary closing adjustments. These adjustments are expected to be finalized by June 30, 2016.

In connection with the 2016 disposition, the Company entered into a transition services agreement pursuant to which Insulet is providing various services to Liberty Medical on an interim transitional basis. The services generally commenced on the separation date and terminate up to six months following the closing. Services provided by Insulet include certain information technology and back office support. The charges for such services are generally intended to allow the service provider to recover all out-of-pocket costs. Billings by Insulet under the transition services agreement are recorded as a reduction of the costs to provide the respective service in the applicable expense category in the consolidated statements of operations. This transitional support is to provide Liberty Medical the time required to establish its stand-alone processes for such activities that were previously provided by Insulet as described above and does not constitute significant continuing support of Liberty Medical's operations. Total expenses incurred for such transition services, which will be reimbursed in full, were \$0.3 million for the three months ending March 31, 2016.

Following the disposition, the Company entered into a distribution agreement with the Neighborhood Diabetes subsidiary of Liberty Medical to continue to act as a distributor for the Company's products. For the three months ended March 31, 2016 and 2015, revenue from continued operations as presented in the consolidated statement of operations include \$0.3 million and \$0.5 million, respectively of OmniPod sales transacted through Neighborhood Diabetes prior to the divestiture that were previously eliminated in consolidation. These amounts were historically reported in the Neighborhood Diabetes revenue results and are being presented based on current market terms of products sold to the Neighborhood Diabetes subsidiary of Liberty Medical.

Post divestiture, OmniPod sales to the Neighborhood Diabetes subsidiary of Liberty Medical were \$0.4 million for the three months ending March 31, 2016.

The following is a summary of the operating results of Neighborhood Diabetes included in discontinued operations for the three months ending March 31, 2016 and 2015:

| (In thousands) | Three Months Ended March 31, | |
|--|---------------------------------|-----------|
| | 2016 | 2015 |
| Discontinued operations: | | |
| Revenue ⁽¹⁾ | \$7,730 | \$13,067 |
| Cost of revenue | 5,369 | 9,453 |
| Gross profit | 2,361 | 3,614 |
| Operating and other expenses | 2,481 | 4,978 |
| Loss on sale of Neighborhood Diabetes | 1,264 | — |
| Loss from discontinued operations before taxes | (1,384) | (1,364) |
| Income tax expense | (408) | (28) |
| Net loss from discontinued operations | \$(1,792) | \$(1,392) |

⁽¹⁾ Revenue for the three months ending March 31, 2016 includes revenue from the operations of Neighborhood Diabetes through date of sale in February 2016.

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The following is a summary of the Neighborhood Diabetes assets and liabilities presented as discontinued operations as of December 31, 2015:

| | December 31, 2015 |
|--|-------------------------|
| (In thousands) | |
| ASSETS | |
| Accounts receivable, net | \$ 5,857 |
| Inventories, net | 2,019 |
| Prepaid expenses and other current assets | 1,376 |
| Current assets of discontinued operations | 9,252 |
| Intangible assets, net | 1,788 |
| Goodwill | 140 |
| Other non-current assets | 28 |
| Long-term assets of discontinued operations | 1,956 |
| Total assets of discontinued operations | \$ 11,208 |
| LIABILITIES | |
| Accounts payable | \$ 3,436 |
| Accrued expenses and other current liabilities | 1,883 |
| Current liabilities of discontinued operations | 5,319 |
| Total liabilities of discontinued operations | \$ 5,319 |

Total operating cash flows used in discontinued operations in the three months ended March 31, 2016 and 2015 were \$2.0 million and \$1.4 million, respectively.

Note 4. Fair Value Measurements

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

- Market approach, which is based on market prices and other information from market transactions involving identical or comparable assets or liabilities.
- Cost approach, which is based on the cost to acquire or construct comparable assets less an allowance for functional and/or economic obsolescence.
- Income approach, which is based on the present value of the future stream of net cash flows.

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

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

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

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

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

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The following table provides a summary of assets that are measured at fair value as of March 31, 2016 and December 31, 2015, aggregated by the level in the fair value hierarchy within which those measurements fall (in thousands):

| | Fair Value Measurements | | | |
|--|-------------------------|----------|---------|----------|
| | Total | Level 1 | Level 2 | Level 3 |
| March 31, 2016 | | | | |
| Recurring Fair Value Measurements: | | | | |
| Cash Equivalents - Money Market Funds | \$98,305 | \$98,305 | \$ | —\$— |
| Non-Recurring Fair Value Measurements: | | | | |
| Long-lived assets held and used ⁽¹⁾ | \$— | \$— | \$ | —\$— |
| December 31, 2015 | | | | |
| Recurring Fair Value Measurements: | | | | |
| Cash Equivalents - Money Market Funds | \$98,223 | \$98,223 | \$ | —\$— |
| Non-Recurring Fair Value Measurements: | | | | |
| Long-lived assets held and used ⁽¹⁾ | \$1,788 | \$— | \$ | —\$1,788 |

Long-lived assets held and used relate to the asset group of the Neighborhood Diabetes business which consists of definite lived intangible assets and property and equipment. During the fourth quarter of 2015, the Company recognized an impairment charge on this asset group totaling \$9.1 million, which represented the difference⁽¹⁾ between the fair value of the asset group and the carrying value. As a result of the impairment, the asset group was recorded at fair value as of December 31, 2015. The fair value for the asset group was determined using the direct cash flows expected to be received from the disposition of the asset group, which was completed in February 2016 (level 3 input).

Debt

The estimated fair value of debt is based on the Level 1 quoted market prices for the same or similar issues and included the impact of the conversion features.

The carrying amounts and the estimated fair values of financial instruments as of March 31, 2016 and December 31, 2015, are as follows (in thousands):

| | March 31, 2016 | | December 31, 2015 | |
|-----------------------------|----------------|----------------------|-------------------|----------------------|
| | Carrying Value | Estimated Fair Value | Carrying Value | Estimated Fair Value |
| 2% Convertible Senior Notes | \$173,681 | \$195,915 | \$171,698 | \$207,882 |

The Company issued \$201.3 million in principal amount of 2% Notes (as defined below) in June 2014. The carrying value of the 2% Notes at March 31, 2016 includes a debt discount of \$24.0 million which is being amortized as non-cash interest expense over the term of the 2% Notes. The decrease in the estimated fair values of these liabilities from December 31, 2015 to March 31, 2016 represents the impact of the quoted bond prices at those dates.

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Note 5. Debt

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

| | As of | |
|---|----------------|-------------------|
| | March 31, 2016 | December 31, 2015 |
| Principal amount of the 2% Convertible Senior Notes | \$201,250 | \$201,250 |
| Unamortized debt discount | (24,002) | (25,704) |
| Deferred financing costs | (3,567) | (3,848) |
| Long-term debt, net of discount | \$173,681 | \$171,698 |

Interest expense related to the 3.75% Notes (as defined below) and the 2% Notes was included in interest and other expense on the consolidated statements of operations as follows (in thousands):

| | Three Months Ended March 31, | |
|-------------------------------------|------------------------------|---------|
| | 2016 | 2015 |
| Contractual coupon interest | \$1,006 | \$1,006 |
| Accretion of debt discount | 1,702 | 1,601 |
| Amortization of debt issuance costs | 282 | 282 |
| Total interest and other expense | \$2,990 | \$2,889 |

3.75% Convertible Senior Notes

In June 2011, the Company sold \$143.8 million in principal amount of 3.75% Convertible Senior Notes due June 15, 2016 (the "3.75% Notes"). The interest rate on the notes was 3.75% per annum, payable semi-annually in arrears in cash on December 15 and June 15 of each year. The 3.75% Notes were convertible into the Company's common stock at an initial conversion rate of 38.1749 shares of common stock per \$1,000 principal amount of the 3.75% Notes, which was equivalent to a conversion price of approximately \$26.20 per share.

In connection with the issuance of the 3.75% Notes, the Company repurchased \$70 million in principal amount of its 5.375% Convertible Senior Notes due June 15, 2013 (the "5.375% Notes") for \$85.1 million, a 21.5% premium on the principal amount. The investors that held the \$70 million in principal amount of repurchased 5.375% Notes purchased \$59.5 million in principal amount of the 3.75% Notes and retained approximately \$13.5 million in principal amount of the remaining 5.375% Notes. These investors' combined \$73.0 million in principal amount of convertible debt (\$13.5 million of 5.375% Notes and \$59.5 million of 3.75% Notes) was considered to be a modification of a portion of the 5.375% Notes and was accounted for separately from the issuance of the remainder of the 3.75% Notes.

The Company recorded a total debt discount of \$25.8 million related to the modified debt. This discount consisted of \$10.5 million related to the remaining debt discount on the \$70 million in principal amount of 5.375% Notes repurchased, \$15.1 million related to the premium payment in connection with the repurchase and \$0.2 million related to the increase in the value of the conversion feature. The total debt discount was being amortized as non-cash interest expense at the effective rate of 16.5% over the five year term of the modified debt. Additionally, the Company paid transaction fees of approximately \$2.0 million related to the modification, which were recorded as interest and other expense at the time of the modification.

Of the \$143.8 million in principal amount of 3.75% Notes issued in June 2011, \$84.3 million in principal amount was considered to be an issuance of new debt. The Company recorded a debt discount of \$26.6 million related to the \$84.3 million in principal amount of 3.75% Notes. The debt discount was recorded as additional paid-in capital to reflect the value of its nonconvertible debt borrowing rate of 12.4% per annum and was being amortized as non-cash interest expense over the five year term of the 3.75% Notes. The Company incurred deferred financing costs related to this offering of approximately \$2.8 million, of which \$0.9 million has been reclassified as an offset to the value of the amount allocated to equity. The remainder was recorded as other assets in the consolidated balance sheet and was being amortized as non-cash interest expense over the five year term of the 3.75% Notes.

In June 2014, in connection with the issuance of \$201.3 million in principal amount of 2% Convertible Senior Notes due June 15, 2019 (the “2% Notes”), the Company repurchased approximately \$114.9 million in principal amount of the 3.75% Notes for \$160.7 million, a premium of \$45.8 million over the principal amount. Investors that

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held approximately \$80.0 million of 3.75% Notes purchased approximately \$98.2 million in principal amount of the 2% Notes. The repurchase of the 3.75% Notes was treated as an extinguishment of debt since the fair value of the conversion feature changed by more than 10%. The extinguishment of the 3.75% Notes was accounted for separately from the issuance of the 2% Notes. The \$160.7 million paid to extinguish the debt was allocated to debt and equity based on their respective fair values immediately prior to the transaction. The Company allocated \$112.4 million of the payment to the debt and \$48.3 million to equity.

The 3.75% Notes were convertible at the option of the holder during the quarter ended June 30, 2014 since the last reported sales price per share of the Company's common stock was equal to or greater than 130% of the conversion price for at least 20 of the 30 trading days ended on March 31, 2014. The 3.75% Notes and any unpaid interest were convertible at the Company's option for cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock.

Beginning on June 20, 2014, the Company had the right to redeem the 3.75% Notes, at its option, in whole or in part, if the last reported sale price per share of the Company's common stock was at least 130% of the conversion price then in effect for at least 20 trading days during a period of 30 consecutive trading days. In June 2014, the Company met the redemption requirements and notified holders of its intent to redeem the outstanding \$28.8 million in principal amount of 3.75% Notes in July 2014. Prior to the redemption date, holders of \$28.5 million in principal amount of 3.75% Notes exercised their right to convert their outstanding 3.75% Notes. The Company settled this conversion of the 3.75% Notes in July 2014 by providing cash of \$28.5 million for the principal amount of the outstanding 3.75% Notes converted and issuing 348,535 shares of common stock for the conversion premium totaling \$12.6 million, for a total consideration paid of \$41.1 million. The Company settled the redemption of the remaining \$0.3 million in principal amount in exchange for a cash payment of \$0.3 million representing principal and accrued and unpaid interest. The Company allocated \$27.9 million of the total consideration paid to the debt and \$13.5 million to equity. The Company recorded a loss on extinguishment of debt of \$23.2 million in connection with the repurchase and redemption of the 3.75% Notes during the year ended December 31, 2014, representing the excess of the \$140.3 million allocated to the debt over its carrying value, net of deferred financing costs.

Certain features related to a portion of the 3.75% Notes, including the holders' ability to require the Company to repurchase their notes and the higher interest payments required in an event of default, were considered embedded derivatives and were required to be bifurcated and accounted for at fair value. The Company assessed the value of these embedded derivatives at each balance sheet date.

There was no cash or non-cash interest expense recorded in the three months ended March 31, 2016 and 2015 related to the 3.75% Notes.

As of December 31, 2014, no amounts remain outstanding related to the 3.75% Notes.

2% Convertible Senior Notes

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

The Company recorded a debt discount of \$35.6 million related to the 2% Notes. The debt discount was recorded as additional paid-in capital to reflect the value of the Company's nonconvertible debt borrowing rate of 6.2% per annum. This debt discount is being amortized as non-cash interest expense over the five year term of the 2% Notes. The Company incurred deferred financing costs related to this offering of approximately \$6.7 million, of which \$1.2 million has been reclassified as an offset to the value of the amount allocated to equity. The remainder is recorded as a reduction to debt in the consolidated balance sheet and is being amortized as non-cash interest expense over the five year term of the 2% Notes.

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

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

The Company determined that the higher interest and tax payments required in certain circumstances are considered embedded derivatives and should be bifurcated and accounted for at fair value. The Company

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assesses the value of the embedded derivatives at each balance sheet date. The derivatives had de minimis value at the balance sheet date.

Cash interest expense related to the 2% Notes was \$1.0 million in the three months ended March 31, 2016 and 2015. Non-cash interest expense related to the 2% Notes was \$2.0 million and \$1.9 million in the three months ended March 31, 2016 and 2015, respectively.

As of March 31, 2016, the Company included \$173.7 million on its balance sheet in long-term debt related to the 2% Notes.

Note 6. Capital Lease Obligations

As of March 31, 2016 and December 31, 2015, the Company has approximately \$13.7 million of manufacturing equipment acquired under capital leases, included in property and equipment, respectively. The obligations under the capital leases are being repaid in equal monthly installments over 24 to 36 month terms and include principal and interest payments with an effective interest rate of 13% to 17%.

The assets acquired under capital leases are being amortized on a straight-line basis over five years in accordance with the Company's policy for depreciation of manufacturing equipment. Amortization expense on assets acquired under capital leases is included with depreciation expense. Amortization expense related to these capital leased assets was \$0.7 million and \$0.5 million in the three months ended March 31, 2016 and 2015, respectively.

Assets held under capital leases consist of the following (in thousands):

| | As of | |
|--------------------------------|----------------|-------------------|
| | March 31, 2016 | December 31, 2015 |
| Manufacturing equipment | \$13,705 | \$13,705 |
| Less: Accumulated amortization | (5,030) | (4,346) |
| Total | \$8,675 | \$9,359 |

The aggregate future minimum lease payments related to these capital leases as of March 31, 2016, are as follows (in thousands):

| Years Ending December 31, | Minimum Lease Payments |
|-------------------------------------|------------------------|
| 2016 (remaining) | \$4,359 |
| 2017 | 269 |
| Total future minimum lease payments | \$4,628 |
| Interest expense | (181) |
| Total capital lease obligations | \$4,447 |

The Company recorded \$0.2 million and \$0.3 million of interest expense on capital leases in the three months ended March 31, 2016 and 2015.

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Note 7. Net Loss Per Share

Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding for the period, excluding unvested restricted common shares. Diluted net loss per share is computed using the weighted average number of common shares outstanding and, when dilutive, potential common share equivalents from options, restricted stock units and warrants (using the treasury-stock method), and potential common shares from convertible securities (using the if-converted method). Because the Company reported a net loss for the three months ended March 31, 2016 and 2015, all potential dilutive common shares have been excluded from the computation of the diluted net loss per share for all periods presented, as the effect would have been anti-dilutive.

Potential dilutive common share equivalents consist of the following:

| | Three Months Ended | |
|---------------------------------|--------------------|-----------|
| | March 31, | |
| | 2016 | 2015 |
| 2.00% Convertible Senior Notes | 4,327,257 | 4,327,257 |
| Unvested restricted stock units | 1,150,720 | 961,947 |
| Outstanding options | 3,594,297 | 2,769,259 |
| Total dilutive common shares | 9,072,274 | 8,058,463 |

Note 8. Accounts Receivable

Accounts receivable consist of amounts due from third-party payors, patients, third-party distributors and government agencies. The Company records an allowance for doubtful accounts at the time potential collection risk is identified. The Company estimates its allowance based on historical experience, assessment of specific risk, discussions with individual customers or various assumptions and estimates that are believed to be reasonable under the circumstances. The Company believes the reserve is adequate to mitigate current collection risk.

Accounts receivable from two customers represented approximately 19% and 11% of gross accounts receivable as of March 31, 2016, respectively. As of December 31, 2015 accounts receivable from two customers represented approximately 22% and 19% of gross accounts receivable, respectively.

The components of accounts receivable are as follows (in thousands) which excludes historical amounts that are now presented in current assets of discontinued operations at December 31, 2015:

| | As of | |
|--|--------------------|----------|
| | March 31, December | |
| | 2016 | 31, 2015 |
| Trade receivables | \$44,008 | \$46,668 |
| Allowance for doubtful accounts (3,534) | (4,138) | |
| Total accounts receivable | \$40,474 | \$42,530 |

Note 9. Inventories

Inventories are held at the lower of cost or market, determined under the first-in, first-out method. Inventory has been recorded at cost as of March 31, 2016 and December 31, 2015. Work in process is calculated based upon a buildup in the stage of completion using estimated labor inputs for each stage in production. The Company periodically reviews inventories for net realizable value based on quantities on hand and expectations of future use.

Inventories consist of the following (in thousands) which excludes historical amounts that are now presented in current assets of discontinued operations at December 31, 2015:

| | As of | |
|---------------------|--------------------|----------|
| | March 31, December | |
| | 2016 | 31, 2015 |
| Raw materials | \$773 | \$632 |
| Work-in-process | 2,625 | 1,960 |
| Finished goods, net | 10,626 | 9,432 |
| Total inventories | \$14,024 | \$12,024 |

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Note 10. Other Intangible Assets

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

The Company recorded \$32.9 million of other intangible assets as a result of the acquisition of Neighborhood Diabetes in 2011. In December 2015, the Company completed a long-lived asset impairment test for Neighborhood Diabetes and determined that the carrying value of the long-lived asset group, which included intangible assets, exceeded the undiscounted cash flows expected to be generated from the asset group. The Company compared the fair value of the intangible assets and the related asset group, which was estimated based on the subsequent sales price of the asset group as of February 2016. As a result, an impairment charge of \$9.0 million was recorded within general and administrative expenses for the year ended December 31, 2015. The impairment charge was allocated on a pro-rata basis based on the carrying value of the assets within the asset group. As a result, impairment charges of approximately \$7.4 million and \$1.6 million, respectively, were recorded on the customer relationship and trade name intangible assets. During the three months ended March 31, 2016, the remaining balance of the other intangible assets associated with the acquisition of Neighborhood Diabetes were removed from the balance sheet as part of the divestiture and included in the calculated loss of disposal. No further impairment was recorded upon the sale.

The Company recorded \$2.1 million of other intangible assets in 2015 as a result of the July 2015 acquisition of its Canadian distribution business. The Company determined that the estimated useful life of the contractual relationship asset is 5 years and is amortizing the asset over the estimated lives, based on the expected cash flows of the assets, accordingly. The amortization expense of other intangible assets was approximately \$0.1 million in the three months ended March 31, 2016, which was recorded in general and administration expenses on the statement of operations. Other intangible assets consist of the following (in thousands). Note that amounts presented below for the year ended December 31, 2015 have been adjusted to remove the intangible assets presented as long-term assets of discontinued operations at December 31, 2015.

| | As of March 31, 2016 | | | December 31, 2015 | | |
|--------------------------------|-----------------------------|-----------------------------|----------------------|-----------------------------|-----------------------------|----------------------|
| | Gross Carrying Amount | Accumulated Amortization | Net Book Value | Gross Carrying Amount | Accumulated Amortization | Net Book Value |
| Contractual relationships, net | \$2,067 | \$ (1,182) | \$ 885 | \$1,933 | \$ (1,000) | \$ 933 |
| Tradename | — | — | — | — | — | — |
| Total intangible assets | \$2,067 | \$ (1,182) | \$ 885 | \$1,933 | \$ (1,000) | \$ 933 |

Amortization expense was approximately \$0.1 million for the three months ended March 31, 2016. There was no amortization expense from continuing operations for the three months ended March 31, 2015.

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

| Years Ending December 31, | Contractual Relationships |
|---------------------------|---------------------------|
| 2016 (remaining) | \$ 338 |
| 2017 | 187 |
| 2018 | 160 |
| 2019 | 133 |
| 2020 | 67 |
| Thereafter | — |
| Total | \$ 885 |

As of March 31, 2016, the weighted average amortization period of the Company's intangible assets is approximately 4.8 years.

Note 11. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consist of the following (in thousands) which excludes historical amounts that are now presented in current liabilities of discontinued operations at December 31, 2015:

| | As of | |
|--|----------------|-------------------|
| | March 31, 2016 | December 31, 2015 |
| Employee compensation and related items | \$11,309 | \$ 16,856 |
| Professional and consulting services | 5,755 | 5,654 |
| Suppliers | 3,437 | 4,981 |
| Warranty reserve | 1,547 | 1,592 |
| Sales and use tax | 931 | 1,163 |
| Other | 7,406 | 6,498 |
| Total accrued expenses and other current liabilities | \$30,385 | \$ 36,744 |

Product Warranty Costs

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

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

| | Three Months Ended March 31, | |
|--|------------------------------|---------|
| | 2016 | 2015 |
| Balance at the beginning of the period | \$4,152 | \$2,614 |
| Warranty expense | 1,028 | 467 |
| Warranty claims settled | (1,020) | (420) |
| Balance at the end of the period | \$4,160 | \$2,661 |

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As of
 March 31
 2016 2015

Composition of balance:

| | | |
|------------|----------|----------|
| Short-term | \$ 1,547 | \$ 1,592 |
| Long-term | 2,613 | 2,560 |
| | \$4,160 | \$ 4,152 |

Note 12. Commitments and Contingencies

Operating Leases

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

Certain of the Company's operating lease agreements contain scheduled rent increases. Rent expense is recorded using the straight-line method and deferred rent is included in other current and long-term liabilities in the accompanying balance sheets. The Company has considered FASB ASC 840-20, Leases in accounting for these lease provisions.

The aggregate future minimum lease payments related to these leases as of March 31, 2016, are as follows (in thousands):

| Years Ending December 31, | Minimum Lease Payments |
|---------------------------|------------------------|
| 2016 (remaining) | 1,678 |
| 2017 | 2,181 |
| 2018 | 2,162 |
| 2019 | 2,169 |
| 2020 | 2,146 |
| Thereafter | 3,934 |
| Total | \$ 14,270 |

Legal Proceedings

The Company is in the process of responding to a revised audit report received in December 2015 on behalf of the Centers for Medicare and Medicaid Services and the State of New York alleging overpayment of certain Medicaid claims to Neighborhood Diabetes.

The Company is in the process of responding to a draft audit report received in June 2015 from the Connecticut Department of Social Services Office of Quality Assurance alleging overpayment of certain Medicaid claims to Neighborhood Diabetes.

As of December 31, 2015, the Company had determined that it was probable that a loss had been incurred for the two audits discussed above and recorded an aggregate liability of \$0.9 million through general and administrative expense as of that date which remains accrued as of March 31, 2016.

In April 2016, the Company reached a settlement agreement for \$0.5 million with the Massachusetts Department of Revenue for sales and use tax audits related to Insulet Corporation, which resulted in a \$0.2 million reduction of the previously recorded liability and a credit to general and administrative expenses during the three months ending March 31, 2016.

Between May 5, 2015 and June 16, 2015, three class action lawsuits were filed by shareholders in the U.S. District Court, Massachusetts, against the Company and certain individual current and former executives of the Company. Two suits subsequently were voluntarily dismissed. Arkansas Teacher Retirement System v. Insulet, et al., 1:15-cv-12345, which remains outstanding, alleges that the Company (and certain executives) committed violations of Sections 10(b) and 20(a) and Rule 10b-5 of the Securities Exchange Act of 1934 by making allegedly false and misleading statements about the Company's business, operations, and prospects. The lawsuit seeks, among other things, compensatory damages in connection with the Company's allegedly inflated stock price between May 7, 2013 and April 30, 2015, as well as attorneys' fees and costs. Due in part to the preliminary nature

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of this matter, the Company currently cannot reasonably estimate a possible loss, or range of loss, in connection with this matter.

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

Note 13. Equity

The Company accounts for stock-based compensation under the provisions of FASB ASC 718-10, Compensation — Stock Compensation (“ASC 718-10”), which requires all share-based payments to employees, including grants of employee stock options and restricted stock units, to be recognized in the income statement based on their fair values. Share-based payments that contain performance conditions are recognized when such conditions are probable of being achieved.

The Company uses the Black-Scholes option pricing model to determine the weighted-average fair value of options granted. The Company determines the intrinsic value of restricted stock and restricted stock units based on the closing price of its common stock on the date of grant. The Company recognizes the compensation expense of share-based awards on a straight-line basis for awards with only service conditions and on an accelerated method for awards with performance conditions. Compensation expense is recognized over the vesting period of the awards.

The determination of the fair value of share-based payment awards utilizing the Black-Scholes model is affected by the stock price and the following assumptions, including expected volatility, expected life of the awards, the risk-free interest rate, and the dividend yield. The expected volatility is computed over expected terms based upon the historical volatility of the Company's stock. The expected life of the awards is estimated based on the midpoint scenario, which combines historical exercise data with hypothetical exercise data for outstanding options. The risk-free interest rate assumption is based on observed interest rates appropriate for the terms of the awards. The dividend yield assumption is based on Company history and expectation of paying no dividends. Forfeitures are estimated at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. Stock-based compensation expense recognized in the financial statements is based on awards that are ultimately expected to vest. The Company evaluates the assumptions used to value the awards on a quarterly basis and if factors change and different assumptions are utilized, stock-based compensation expense may differ significantly from what has been recorded in the past. If there are any modifications or cancellations of the underlying unvested securities, the Company may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense.

Stock-based compensation expense related to share-based awards recognized in the three months ended March 31, 2016 and 2015 was \$5.3 million and calculated on awards ultimately expected to vest. At March 31, 2016, the Company had \$55.0 million of total unrecognized compensation expense related to unvested stock options and restricted stock units.

Stock Options

In May 2007, in conjunction with the Company's initial public offering, the Company adopted its 2007 Stock Option and Incentive Plan (the "2007 Plan"). The 2007 Plan was amended and restated in November 2008, May 2012 and May 2015 to provide for the issuance of additional shares and to amend certain other provisions. Under the 2007 Plan, awards may be granted to persons who are, at the time of grant, employees, officers, non-employee directors or key persons (including consultants and prospective employees) of the Company. The 2007 Plan provides for the granting of stock options, restricted stock units, stock appreciation rights, deferred stock awards, restricted stock, unrestricted stock, cash-based awards, performance share awards or dividend equivalent rights. Options granted under the 2007 Plan generally vest over a period of four years and expire ten years from the date of grant. As of March 31, 2016, 4,505,202 shares remain available for future issuance under the 2007 Plan.

The Company awarded 194,500 shares of performance-based incentive stock options in 2015. The stock options were granted under the 2007 Plan and vest over a four year period from the grant date with the potential of an accelerated vesting period pursuant to the achievement of certain performance conditions.

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The following summarizes the activity under the Company's stock option plans in the three months ended March 31, 2016:

| | Number of Options (#) | Weighted Average Exercise Price (\$) | Aggregate Intrinsic Value (\$) |
|---|-----------------------------|---|--------------------------------------|
| | | | (In thousands) |
| Balance, December 31, 2015 | 2,999,199 | \$ 31.37 | |
| Granted | 679,882 | 29.94 | |
| Exercised ⁽¹⁾ | (49,137) | 16.20 | \$ 777 |
| Canceled | (35,647) | 31.76 | |
| Balance, March 31, 2016 | 3,594,297 | \$ 31.31 | \$ 12,708 |
| Vested, March 31, 2016 ⁽²⁾ | 1,160,154 | \$ 29.65 | \$ 6,707 |
| Vested and expected to vest, March 31, 2016 ⁽²⁾⁽³⁾ | 3,197,410 | | \$ 11,689 |

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

(2) The aggregate intrinsic value was calculated based on the positive difference between the estimated fair value of the Company's common stock as of March 31, 2016, and the exercise price of the underlying options.

(3) Represents the number of vested options as of March 31, 2016, plus the number of unvested options expected to vest as of March 31, 2016, based on the unvested options outstanding at March 31, 2016, adjusted for the estimated forfeiture.

At March 31, 2016 there were 3,594,297 options outstanding with a weighted average exercise price of \$31.31 and a weighted average remaining contractual life of 8.6 years. At March 31, 2016 there were 1,160,154 options exercisable with a weighted average exercise price of \$29.65 and a weighted average remaining contractual life of 7.2 years.

Employee stock-based compensation expense related to stock options in the three months ended March 31, 2016 and 2015 was \$2.3 million and \$3.0 million, respectively, and was based on awards ultimately expected to vest. At March 31, 2016, the Company had \$25.4 million of total unrecognized compensation expense related to stock options that will be recognized over a weighted average vesting period of 1.5 years.

Restricted Stock Units

In the three months ended March 31, 2016, the Company awarded 518,092 restricted stock units to certain employees and non-employee members of the Board of Directors, which included 149,256 restricted stock units subject to the achievement of performance conditions (performance-based restricted stock units). The number of performance-based restricted stock units granted during the three months ended March 31, 2016 that are expected to vest may vary based on the Company's quarterly evaluation of the probability of the performance criteria being achieved. The Company recognized stock compensation expense of \$0.6 million in the three months ended March 31, 2016 as it expects a portion of the performance-based restricted stock units granted will be earned based on its evaluation of the performance criteria at March 31, 2016. Performance awards are amortized over the service period using an accelerated attribution method. The restricted stock units were granted under the 2007 Plan and vest over a three year period from the grant date.

The restricted stock units granted during the three months ended March 31, 2016 have a weighted average fair value of \$29.42 per share based on the closing price of the Company's common stock on the date of grant and were valued at approximately \$15.2 million on their grant date. The Company is recognizing the compensation expense over the vesting period. Approximately \$2.3 million and of stock-based compensation expense related to the vesting of non-performance based restricted stock units was recognized in the three months ended March 31, 2016 and 2015 using the straight line method. Approximately \$29.5 million of the fair value of the restricted stock units remained unrecognized as of March 31, 2016 and will be recognized over a weighted average period of 1.5 years. Under the terms of the awards, the Company will issue shares of common stock on each of the vesting dates.

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The following table summarizes the status of the Company's restricted stock units in the three months ended March 31, 2016:

| | Number of Shares (#) | Weighted Average Fair Value (\$) |
|----------------------------|-------------------------|--|
| Balance, December 31, 2015 | 811,965 | \$ 32.30 |
| Granted | 518,092 | 29.42 |
| Vested | (160,253) | 31.60 |
| Forfeited | (19,084) | 33.35 |
| Balance, March 31, 2016 | 1,150,720 | \$ 31.08 |

Employee Stock Purchase Plan

As of March 31, 2016 and 2015, the Company had no shares contingently issued under the Employee Stock Purchase Plan ("ESPP"). In the three months ended March 31, 2016 and 2015, the Company recorded no significant stock-based compensation expense related to the ESPP.

Note 14. Income Taxes

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

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

The Company files federal, state and foreign tax returns. These returns are generally open to examination by the relevant tax authorities from three to four years from the date they are filed. The tax filings relating to the Company's federal and state tax returns are currently open to examination for tax years 2011 through 2014 and 2010 through 2014, respectively. In addition, the Company has generated tax losses since its inception in 2000. These years may be subject to examination if the losses are carried forward and utilized in future years.

At March 31, 2016 and December 31, 2015, the Company provided a valuation allowance for the full amount of its net deferred tax asset because it is not more likely than not that the future tax benefit will be realized.

Income tax expense consists of the following (in thousands):

| | | |
|----------|---|-------|
| | Three Months Ended March 31, 2016 | 2015 |
| Current | \$75 | \$ 24 |
| Deferred | (11) | — |
| Total | \$64 | \$ 24 |

The Company has generated deferred tax liabilities related to its amortization of acquired goodwill for tax purposes because the goodwill is not amortized for financial reporting purposes. The tax amortization gives rise to a temporary difference and a tax liability, which will only reverse at the time of ultimate disposition or impairment of the underlying goodwill. Due to the uncertain timing of this reversal, the temporary difference cannot be considered as a

source of future taxable income for purposes of determining a valuation allowance; therefore, the tax liability cannot be used to offset deferred tax assets.

The Company had no unrecognized tax benefits at March 31, 2016.

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

FORWARD-LOOKING STATEMENTS

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

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

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

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

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

product liability lawsuits that may be brought against us;

reduced retention rates of our customer base;

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

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

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

our ability to attract and retain personnel;

our ability to manage our growth;

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

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

the expansion of our distribution network;

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

the volatility of the price of our common stock;

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

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

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

anti-takeover provisions in our organizational documents.

The factors discussed above are not intended to be a complete statement of all risks and uncertainties and should be evaluated with all other risks described in our Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on February 29, 2016 in the section entitled “Risk Factors,” and in our other filings from time to time with the Securities and Exchange Commission. Should one or more of these risks or uncertainties materialize, or should any of our assumptions prove incorrect, actual results may vary in material respects from those projected in these forward-looking statements. We undertake no obligation to publicly update or revise any forward-looking statements.

Executive Level Overview

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

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We began commercial sale of the OmniPod System in the United States in 2005. We sell the OmniPod System and other diabetes management supplies in the United States through direct sales to customers or through our distribution partners. The OmniPod System is currently available in multiple countries in Europe, Canada and Israel. In July 2015, we executed an asset purchase agreement with GSK whereby we acquired assets associated with the Canadian distribution of our products and we assumed the distribution, sales, marketing, training and support activities for the OmniPod system in Canada.

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

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

First Quarter 2016 Revenue Results:

• Total revenue of \$81.2 million

U.S. OmniPod revenue of \$50.7 million

International OmniPod revenue of \$15.4 million

Drug Delivery revenue of \$15.1 million

Our long-term financial objective is to achieve and sustain profitable growth. Our efforts in 2016 will be focused primarily on the expansion of our customer base in the United States and internationally and increasing our profitability. Achieving these objectives is expected to require additional investments in certain personnel and initiatives, as well as enhancements to our manufacturing efficiency and effectiveness. We believe that we will continue to incur net losses in the near term in order to achieve these objectives. However, we believe that the accomplishment of our near term objectives will have a positive impact on our financial condition in the future.

Components of Financial Operations

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

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

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

Sales and marketing. Sales and marketing expenses consist primarily of personnel costs within our sales, marketing, reimbursement support, customer care and training functions, sales commissions paid to our sales representatives and costs associated with participation in medical conferences, physician symposia and promotional activities.

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

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Results of Operations

This section discusses our consolidated results of operations for the first quarter of 2016 compared to the first quarter of 2015, and should be read in conjunction with the consolidated financial statements and accompanying condensed notes included in this Form 10-Q.

TABLE 1: RESULTS OF OPERATIONS

| (Unaudited) (In Thousands) | Three Months Ended March 31, | | | |
|---|------------------------------|------------|-----------|----------|
| | 2016 | 2015 | \$ Change | % Change |
| Revenue: | | | | |
| U.S. OmniPod | \$50,712 | \$39,695 | \$11,017 | 28 % |
| International OmniPod | 15,380 | 3,780 | 11,600 | 307 % |
| Drug Delivery | 15,121 | 4,673 | 10,448 | 224 % |
| Total revenue | 81,213 | 48,148 | 33,065 | 69 % |
| Cost of revenue | 37,162 | 18,955 | 18,207 | 96 % |
| Gross profit | 44,051 | 29,193 | 14,858 | 51 % |
| Gross margin | 54.2 | % 60.6 | % | |
| Operating expenses: | | | | |
| Research and development | 12,989 | 8,207 | 4,782 | 58 % |
| Sales and marketing | 24,022 | 14,710 | 9,312 | 63 % |
| General and administrative | 14,739 | 13,542 | 1,197 | 9 % |
| Total operating expenses | 51,750 | 36,459 | 15,291 | 42 % |
| Operating loss | (7,699) | (7,266) | 433 | 6 % |
| Interest and other expense, net | (2,926) | (3,152) | (226) | (7)% |
| Income tax expense | (64) | (24) | 40 | 167 % |
| Loss on discontinued operations, net of tax (\$408 and \$28 for three months ended March 31, 2016 and 2015, respectively) | (1,792) | (1,392) | 400 | 29 % |
| Net loss | \$(12,481) | \$(11,834) | \$647 | 5 % |

Revenue

Our total revenue increased to \$81.2 million, up \$33.1 million, or 69%, in the first quarter of 2016 compared to the first quarter of 2015, led by growth in our international OmniPod revenue, U.S. OmniPod revenue and our on-body injection device for drug delivery. Our U.S. OmniPod revenue increased due to growth in our installed base of OmniPod users, as well as higher distributor sales, which were partially driven by unfavorable distributor ordering patterns in the first quarter of 2015. Our drug delivery revenue increased due to strong growth in demand for our drug delivery device following regulatory approval in December 2014. Our international OmniPod revenue increased due to higher distributor sales, which were partially driven by unfavorable distributor ordering patterns in the first quarter of 2015.

For the year ending December 31, 2016 we expect strong revenue growth in our continuing operations from all of our product lines as we continue our expansion in the United States and internationally. We continue to expect strong growth of approximately 20% in our worldwide OmniPod installed base. We also expect that the revenue from our drug delivery devices will be a higher relative percentage of our overall growth as we increase commercial sales. Increased revenue is dependent upon the success of our sales efforts, our customer retention and our ability to produce our products in sufficient volumes as our patient base grows and is subject to other risks and uncertainties.

Cost of Revenue

Cost of revenue increased \$18.2 million in the first quarter of 2016 compared to the same period in 2015 primarily due to an increase in sales volumes and \$1.9 million of costs indirectly attributable to a voluntary Field Safety Notification we initiated in November 2015. The increase also reflects an increased investment in product quality and related policies and procedures, which contributed to a \$0.6 million increase in warranty expense year over year.

Gross Margin

Gross margin in the first quarter of 2016 decreased by approximately six points compared to the same period in 2015 primarily driven by the increase in cost of revenue discussed above and the unfavorable impact on gross margin of product mix year over year, largely attributable to the level of increased international OmniPod sales.

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For the year ending December 31, 2016, we expect gross margin to increase primarily from enhancements to our manufacturing efficiency and effectiveness.

Research and Development

Research and development expenses increased \$4.8 million to \$13.0 million for the three months ended March 31, 2016, compared to \$8.2 million for the same period in 2015. The increase was the result of expenses related to our development projects, including our artificial pancreas program, mobile application development, development efforts with Eli Lilly and Company for the use of concentrated insulin for patients with higher insulin-resistance and other OmniPod product improvement initiatives.

For the year ending December 31, 2016, we expect overall research and development spending to increase due to the development efforts on our on-going projects including our artificial pancreas program, development efforts with Eli Lilly for the use of concentrated insulin, mobile application development, integration with continuous glucose monitoring technology, and the continued investment to support the use our technology as a delivery platform for other pharmaceuticals.

Sales and Marketing

Sales and marketing expenses increased \$9.3 million to \$24.0 million for the three months ended March 31, 2016, compared to \$14.7 million for the same period in 2015. The increase was mainly the result of a \$7.0 million increase in employee related expenses associated with the expansion in 2015 of our sales force and customer support personnel. Additionally, there was an increase in costs associated with marketing efforts, new market opportunities and other strategic initiatives introduced in mid-2015 as we continue to expand awareness of the OmniPod System and our on-body injection devices for drug delivery.

We expect sales and marketing expenses in the year ending December 31, 2016 to increase as we see the full-year impact of the 2015 commercial team expansion and invest in initiatives that will enhance awareness, customer satisfaction and drive increased adoption of the OmniPod System, as well as increased adoption of our technology as a delivery platform for other pharmaceuticals.

General and Administrative

General and administrative expenses increased \$1.2 million to \$14.7 million for the three months ended March 31, 2016, compared to \$13.5 million for the same period in 2015, mainly the result of a \$0.5 million increase in shipping costs and a \$0.3 million increase in allowance for doubtful accounts expenses.

For the year ending December 31, 2016, we expect overall general and administrative expenses to increase as compared to 2015 as we continue to grow the business and make investments in our operating structure to support this continued growth.

Interest and Other Expense, Net

Interest and other expense, net was \$2.9 million for the three months ended March 31, 2016, compared to \$3.2 million in 2015. The slight decrease is driven by declining interest on our capital leases.

Liquidity and Capital Resources

As of March 31, 2016, we had \$111.6 million in cash and cash equivalents. We believe that our current cash and cash equivalents, together with the cash expected to be generated from sales, will be sufficient to meet our projected operating and debt service requirements for at least the next twelve months.

Debt

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

Cash interest expense related to the 2% Notes was \$1.0 million in the three months ended March 31, 2016 and 2015.

Non-cash interest expense related to the 2% Notes was \$2.0 million and \$1.9 million in the three months ended March 31, 2016 and 2015, respectively.

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As of March 31, 2016, we included \$173.7 million on the balance sheet in long-term debt related to the 2% Notes, which represents the principal amount of the notes, less unamortized debt discount and deferred financing costs. Additional information regarding our debt issuances is provided in note 5 to the consolidated financial statements included in this Form 10-Q.

Capital Leases

As of March 31, 2016 and December 31, 2015, we have approximately \$13.7 million of manufacturing equipment acquired under capital leases. The obligations under the capital leases are being repaid in equal monthly installments over 24 to 36 month terms and include principal and interest payments with an effective interest rate of 13% to 17%. At March 31, 2016, \$4.4 million was included in current liabilities on our balance sheet related to these capital leases. Additional information regarding our capital leases is provided in note 6 to the consolidated financial statements included in this Form 10-Q.

Summary of Cash Flows

| (In thousands) | Three Months | |
|--|-----------------|-----------|
| | Ended March 31, | |
| | 2016 | 2015 |
| Cash (used in) provided by: | | |
| Operating activities | \$(10,517) | \$(3,488) |
| Investing activities | 1,454 | (4,346) |
| Financing activities | (2,184) | 2,249 |
| Effect of exchange rate changes on cash | 210 | — |
| Net (decrease) increase in cash and cash equivalents | \$(11,037) | \$(5,585) |

Operating Activities

Our net cash used in operating activities for the three months ended March 31, 2016 was \$10.5 million compared to \$3.5 million in the same period of 2015. The increase was primarily due to the increased investment in business operations in 2016 to support the growth of the business.

Investing Activities

Our net cash provided by investing activities in the three months ended March 31, 2016 was \$1.5 million compared to net cash used in investing activities of \$4.3 million in 2015. The increase primarily related to the divestiture of our Neighborhood Diabetes business in February 2016 and lower capital purchases in the first quarter of 2016 compared to 2015.

Financing Activities

We had net cash used in financing activities for the three months ended March 31, 2016 of \$2.2 million compared to \$2.2 million in net cash provided by financing activities in 2015. The decrease was primarily attributable to a decrease in proceeds from the exercise of employee stock options.

Commitments and Contingencies

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

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The following table summarizes our principal obligations as of March 31, 2016 (in thousands):

| Contractual Obligations | Total | 2016 (remaining) | 2017 | 2018 | 2019 | 2020 | Later |
|--|-----------|---------------------|---------|---------|-----------|---------|---------|
| Operating lease obligations | \$14,270 | \$ 1,678 | \$2,181 | \$2,162 | \$2,169 | \$2,146 | \$3,934 |
| Debt obligations ⁽¹⁾ | 215,170 | 4,025 | 4,025 | 4,025 | 203,095 | — | — |
| Capital lease obligations ⁽²⁾ | 4,628 | 4,359 | 269 | — | — | — | — |
| Purchase obligations | 1,676 | 1,676 | — | — | — | — | — |
| Total contractual obligations | \$235,744 | \$ 11,738 | \$6,475 | \$6,187 | \$205,264 | \$2,146 | \$3,934 |

(1) The interest rate on the convertible debt is 2% per annum. We have included future payments of interest on the long-term debt in our obligations.

(2) The effective interest rate on the capital lease obligations is 13-17%. We have included future payments of interest on the capital leases in our obligations.

Legal Proceedings

The significant estimates and judgments related with establishing litigation reserves are discussed under "Legal Proceedings" in note 12 of the consolidated financial statements included under Item 8 of this Form 10-K.

Off-Balance Sheet Arrangements

As of March 31, 2016, we did not have any off-balance sheet financing arrangements.

Critical Accounting Policies and Estimates

Our financial statements are based on the selection and application of generally accepted accounting principles, which require us to make estimates and assumptions about future events that affect the amounts reported in our financial statements and the accompanying condensed notes. Future events and their effects cannot be determined with certainty. Therefore, the determination of estimates requires the exercise of judgment. Actual results could differ from those estimates, and any such differences may be material to our financial statements. We have reviewed our policies and estimates to determine our critical accounting policies for the three months ended March 31, 2016. We have made no material changes to the critical accounting policies described in our Annual Report on Form 10-K for the year ended December 31, 2015.

Recent Accounting Pronouncements

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

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Item 3. Quantitative and Qualitative Disclosures about Market Risk

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

As of March 31, 2016, we had outstanding debt recorded on our consolidated balance sheet of \$201.3 million related to our 2% Notes and \$4.4 million related to capital lease obligations. As the interest rates are fixed, changes in interest rates do not affect the value of our debt or capital lease obligations.

Foreign Currency Exchange Risk. Our business is subject to risks, including, but not limited to: unique economic conditions, changes in political climate, differing tax structures, other regulations and restrictions, and foreign exchange rate volatility. We are primarily exposed to currency exchange rate fluctuations related to our subsidiary operation in Canada.

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

Item 4. Controls and Procedures

Disclosure Controls and Procedures

As of March 31, 2016, our management conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, (as such term is defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended (the “Exchange Act”)) under the supervision and with the participation of our chief executive officer and chief financial officer. In designing and evaluating our disclosure controls and procedures, we and our management recognize that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and our management necessarily was required to apply its judgment in evaluating and implementing possible controls and procedures. Based upon that evaluation of our disclosure controls and procedures as of March 31, 2016, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective to provide reasonable assurance that material information required to be disclosed in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the Securities and Exchange Commission’s rules and forms, including ensuring that such material information is accumulated and communicated to our management, including our chief executive officer and our chief financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control Over Financial Reporting

There were no changes in our internal control over financial reporting that occurred during the three months ended March 31, 2016 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II - OTHER INFORMATION

Item 1. Legal Proceedings

Information regarding our legal proceedings is provided in note 12 to the consolidated financial statements in this Form 10-Q.

Item 1A. Risk Factors

In addition to the other information set forth in this report, you should carefully consider the factors discussed in Part I, Item 1A. “Risk Factors” in our Annual Report on Form 10-K for the year ended December 31, 2015, which could materially affect our business, financial condition or future results. These risks are not the only risks we face. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition and/or operating results. There have been no material

changes in our risk factors from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015.

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

None.

Item 3. Defaults Upon Senior Securities

None.

Item 4. Mine Safety Disclosures

Not applicable.

Item 5. Other Information

None.

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Item 6. Exhibits

Number Description

| | |
|------|--|
| 10.1 | Form of Section 16 Officer Performance Vesting Restricted Stock Unit Agreement under the Insulet Corporation Third Amended and Restated 2007 Stock Option and Incentive Plan |
| 10.2 | Form of Vice President Performance Vesting Restricted Stock Unit Agreement under the Insulet Corporation Third Amended and Restated 2007 Stock Option and Incentive Plan |
| 10.3 | Insulet Corporation Amended and Restated Executive Severance Plan |
| 10.4 | Insulet Corporation Third Amended and Restated 2007 Employee Stock Purchase Plan |
| 31.1 | Certification of Patrick J. Sullivan, President and Chief Executive Officer, pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 31.2 | Certification of Michael L. Levitz, Chief Financial Officer, pursuant to Rule 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002. |
| 32.1 | Certification of Patrick J. Sullivan, President and Chief Executive Officer, and Michael L. Levitz, Chief Financial Officer, pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002. |
| 101 | The following materials from Insulet Corporation's Quarterly Report on Form 10-Q for the quarter ended March 31, 2016, formatted in XBRL (eXtensible Business Reporting Language), as follows: <ul style="list-style-type: none"> (i) Consolidated Balance Sheets as of March 31, 2016 (Unaudited) and December 31, 2015 (ii) Consolidated Statements of Operations for the Three Months Ended March 31, 2016 and March 31, 2015 (Unaudited) (iii) Consolidated Statements of Comprehensive Loss for the Three Months Ended March 31, 2016 and March 31, 2015 (Unaudited) (iv) Consolidated Statements of Cash Flows for the Three Months Ended March 31, 2016 and March 31, 2015 (Unaudited) (iv) Condensed Notes to Consolidated Financial Statements (Unaudited) |

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SIGNATURES

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

INSULET CORPORATION

(Registrant)

Date: April 29, 2016 /s/ Patrick J. Sullivan

Patrick J. Sullivan

President and Chief Executive Officer

(Principal Executive Officer)

Date: April 29, 2016 /s/ Michael L. Levitz

Michael L. Levitz

Chief Financial Officer

(Principal Financial and Accounting Officer)