

INSULET CORP  
Form 10-Q  
August 07, 2014  
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UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 20549

Form 10-Q

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

For the quarterly period ended June 30, 2014  
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 04-3523891  
(State or Other Jurisdiction of (I.R.S. Employer  
Incorporation or Organization) Identification No.)

9 Oak Park Drive 01730  
Bedford, Massachusetts (Zip Code)  
(Address of Principal Executive Offices)  
Registrant's Telephone Number, Including Area Code: (781) 457-5000

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 August 1, 2014, the registrant had 55,881,647 shares of common stock outstanding.

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## PART I — FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements  
INSULET CORPORATION  
CONSOLIDATED BALANCE SHEETS

	As of June 30, 2014 (Unaudited) (In thousands, except share and per share data)	As of December 31, 2013
<b>ASSETS</b>		
Current Assets		
Cash and cash equivalents	\$ 175,545	\$ 149,727
Accounts receivable, net	41,797	33,067
Inventories	8,765	9,464
Prepaid expenses and other current assets	5,725	5,940
Total current assets	231,832	198,198
Property and equipment, net	34,159	32,356
Intangible assets, net	15,882	18,040
Goodwill	37,536	37,536
Other assets	5,919	1,825
Total assets	\$ 325,328	\$ 287,955
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
Current Liabilities		
Accounts payable	\$ 18,610	\$ 19,359
Accrued expenses and other current liabilities	24,588	19,478
Deferred revenue	1,255	900
Current portion of capital lease obligations	2,872	2,637
Current portion of long-term debt	23,874	—
Total current liabilities	71,199	42,374
Capital lease obligations	3,893	5,390
Long-term debt	165,870	113,651
Other long-term liabilities	1,521	1,943
Total liabilities	242,483	163,358
Commitments and contingencies (Note 11)		
Redeemable convertible debt	4,961	—
Stockholders' Equity		
Preferred stock, \$.001 par value:		
Authorized: 5,000,000 shares at June 30, 2014 and December 31, 2013.	—	—
Issued and outstanding: zero shares at June 30, 2014 and December 31, 2013.	—	—
Common stock, \$.001 par value:		
Authorized: 100,000,000 shares at June 30, 2014 and December 31, 2013.		
Issued and outstanding: 55,495,352 and 54,870,424 shares at June 30, 2014 and December 31, 2013, respectively.	55	55
Additional paid-in capital	639,609	651,067
Accumulated deficit	(561,780	) (526,525 )
Total stockholders' equity	77,884	124,597
Total liabilities, redeemable convertible debt and stockholders' equity	\$ 325,328	\$ 287,955

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

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CONSOLIDATED STATEMENTS OF OPERATIONS

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
	(Unaudited)			
	(In thousands, except share and per share data)			
Revenue	\$72,013	\$60,092	\$141,174	\$117,448
Cost of revenue	36,248	33,259	72,601	65,460
Gross profit	35,765	26,833	68,573	51,988
Operating expenses:				
Research and development	6,677	5,174	13,456	9,570
General and administrative	19,512	13,901	33,771	26,995
Sales and marketing	14,856	13,580	28,512	27,451
Total operating expenses	41,045	32,655	75,739	64,016
Operating loss	(5,280)	) (5,822)	) (7,166)	) (12,028)
Interest income	29	37	60	64
Interest expense	(3,975)	) (4,291)	) (8,464)	) (8,646)
Other expense, net	(890)	) —	(625)	) —
Loss on extinguishment of long-term debt	(18,943)	) (325)	) (18,943)	) (325)
Interest and other expense, net	(23,779)	) (4,579)	) (27,972)	) (8,907)
Loss before income taxes	(29,059)	) (10,401)	) (35,138)	) (20,935)
Income tax expense	(52)	) (118)	) (117)	) (249)
Net loss	\$(29,111)	) \$(10,519)	) \$(35,255)	) \$(21,184)
Net loss per share basic and diluted	\$(0.53)	) \$(0.20)	) \$(0.64)	) \$(0.40)
Weighted-average number of shares used in calculating net loss per share	55,425,949	53,834,707	55,258,419	53,445,715

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

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CONSOLIDATED STATEMENTS OF CASH FLOWS

	Six Months Ended June 30,	
	2014	2013
	(Unaudited)	
	(In thousands)	
Cash flows from operating activities		
Net loss	\$(35,255	) \$(21,184
Adjustments to reconcile net loss to net cash provided by (used in) operating activities		
Depreciation and amortization	6,100	5,763
Non-cash interest and other expense	5,869	5,808
Stock-based compensation expense	8,577	6,844
Loss on extinguishment of debt	18,943	325
Provision for bad debts	1,804	2,568
Changes in operating assets and liabilities:		
Accounts receivable	(10,534	) (2,924
Inventories	699	8,888
Deferred revenue	355	(4,545
Prepaid expenses and other assets	(1,006	) (2,055
Accounts payable, accrued expenses and other current liabilities	4,361	3,305
Other long-term liabilities	(422	) 379
Net cash provided by (used in) operating activities	(509	) 3,172
Cash flows from investing activities		
Purchases of property and equipment	(5,745	) (2,695
Net cash used in investing activities	(5,745	) (2,695
Cash flows from financing activities		
Principal payments of capital lease obligations	(1,262	) —
Proceeds from issuance of long-term debt, net of issuance costs	194,570	—
Repayment of long-term debt	(160,685	) (2,000
Proceeds from issuance of common stock, net of offering costs	5,339	97,605
Payment of withholding taxes in connection with vesting of restricted stock units	(5,890	) (2,431
Net cash provided by financing activities	32,072	93,174
Net increase in cash and cash equivalents	25,818	93,651
Cash and cash equivalents, beginning of period	149,727	57,293
Cash and cash equivalents, end of period	\$175,545	\$150,944
Non-cash investing and financing activities		
Allocation to equity for conversion feature for the 2% Notes	\$35,638	\$—
Common stock issued in exchange for 5.375% Convertible Senior Notes	\$—	\$13,000
Purchases of property and equipment under capital lease	\$—	\$4,284

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

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INSULET CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

1. Nature of the Business

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 is the only commercially-available insulin infusion system of its kind. 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. In June 2011, the Company acquired Neighborhood Holdings, Inc. and its wholly-owned subsidiaries (collectively, “Neighborhood Diabetes”) in order to expand the Company’s full suite diabetes management product offerings and obtain access to a larger number of insulin dependent patients. Through Neighborhood Diabetes, the Company is able to provide customers with blood glucose testing supplies, traditional insulin pumps, pump supplies and pharmaceuticals and has the ability to process claims as either durable medical equipment or through pharmacy benefits.

The Company began commercial sale of the OmniPod System in the United States in October 2005. The Company has also expanded the availability of the OmniPod System internationally through its partnerships with Ypsomed Distribution AG (“Ypsomed”) and GlaxoSmithKline (“GSK”). In August 2011, the Company received CE Mark approval, and in December 2012, the Company received 510(k) clearance for the new OmniPod System from the FDA. The Company began selling its new OmniPod System in 2013. The new OmniPod System is more than one-third smaller and one-quarter lighter than the original model, while maintaining the same features and operating capabilities.

2. Summary of Significant Accounting Policies

Basis of Presentation

The unaudited consolidated financial statements in this Quarterly Report on Form 10-Q have been prepared in accordance with generally accepted accounting principles (“GAAP”) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, these unaudited consolidated financial statements do not include all of the information and footnotes required by GAAP for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring adjustments, considered necessary for a fair presentation have been included. Operating results for the three and six month periods ended June 30, 2014 are not necessarily indicative of the results that may be expected for the full year ending December 31, 2014, or for any other subsequent interim period.

The unaudited consolidated financial statements in this Quarterly Report on Form 10-Q should be read in conjunction with the Company’s consolidated financial statements and notes thereto contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013.

Use of Estimates in Preparation of Financial Statements

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of revenue and expense during the reporting periods. The most significant estimates used in these financial statements include the valuation of stock-based compensation expense, accounts receivable, inventories, goodwill, deferred revenue, debt instruments, and 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.

Principles of Consolidation

The unaudited consolidated financial statements in this Quarterly Report on Form 10-Q include the accounts of the Company and its wholly-owned subsidiaries. All material intercompany balances and transactions have been

eliminated in consolidation.

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### 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 assets 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.

ASC 820 also describes three levels of inputs that may be used to measure the fair value:

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

The only assets and liabilities subject to fair value measurement standards at June 30, 2014 and December 31, 2013 are cash equivalents, consisting of money market accounts, and long-term debt which are both based on Level 1 inputs and the June 2014 call feature of the modified portion of the 3.75% Notes (as defined below) which is based on Level 3 inputs.

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.

### Accounts Receivable and Allowance for Doubtful Accounts

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

### 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 June 30, 2014 and December 31, 2013. Work in process is calculated based upon a build up in the stage of completion using estimated labor inputs for each stage in production. The Company periodically reviews inventories for potential impairment based on quantities on hand and expectations of future use.

### 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 or life of the lease, and the amortization is included with depreciation expense. Maintenance and repair costs are expensed as incurred.

### Intangibles and Other Long-Lived 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 long-lived assets if the carrying amount of the 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 estimated life of the acquired tradename asset is 15 years. The

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estimated life of the acquired customer relationship asset is 10 years. Intangible assets with determinable estimated lives are amortized over these lives.

### Goodwill

Goodwill represents the excess of the cost of the acquired Neighborhood Diabetes businesses over the fair value of identifiable net assets acquired. The company follows the provisions of FASB ASC 350-20, Intangibles - Goodwill and Other (“ASC 350-20”). ASC 350-20 requires companies to use the purchase method of accounting for all business combinations initiated after June 30, 2001, and establishes specific criteria for the recognition of intangible assets separately from goodwill. 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 continues to operate in one segment, which is considered to be the sole reporting unit and therefore, goodwill was tested for impairment at the enterprise level. To test for impairment, the Company has elected 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. No goodwill impairment was recorded in the three and six months ended June 30, 2014.

### Warranty

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

### Revenue Recognition

The Company generates nearly all of its revenue from sales of its OmniPod System and other diabetes related products including blood glucose testing supplies, traditional insulin pumps, pump supplies and pharmaceuticals to customers and third-party distributors who resell the products to patients with diabetes.

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 and rebates 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 its OmniPod System sales 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 their 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.

In June 2011, the Company entered into a development agreement with a U.S. based pharmaceutical company (the "Development Agreement"). Under the Development Agreement, the Company was required to perform design, development,

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regulatory and other services to support the pharmaceutical company as it works to obtain regulatory approval to use the Company's drug delivery technology as a delivery method for its pharmaceutical. Over the term of the Development Agreement, the Company has invoiced amounts based upon meeting certain deliverable milestones. Revenue from the Development Agreement was recognized using a proportional performance methodology based on efforts incurred and total payments under the agreement. The impact of any changes in the expected total effort or contract payments was recognized as a change in estimate using the cumulative catch-up method. As of December 31, 2013, the Company met all required deliverables under the Development Agreement.

The Company deferred revenue of \$1.3 million and \$0.9 million as of June 30, 2014 and December 31, 2013, respectively. The deferred revenue recorded at June 30, 2014 was mainly comprised of product-related revenue.

### 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 accredited financial institutions.

The Company purchases complete OmniPods from Flextronics International Ltd., its single source supplier. As of June 30, 2014 and December 31, 2013, approximately 29% and 36%, respectively, of the combined balance of accounts payable, accrued expenses, and other current liabilities, related to amounts owed to this vendor.

### 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, or decision-making group, in deciding how to allocate resources to an individual segment and in assessing performance of the segment. The Company's current product offering consists of diabetes supplies, including the OmniPod System as well as other diabetes related products and supplies such as blood glucose testing supplies, traditional insulin pumps, pump supplies and pharmaceuticals. The Company's current product offering is marketed to a single customer type, people with diabetes. As the Company sells a single product type, management operates the business as a single entity.

### 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. A valuation allowance is required to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. 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 the 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, and disclosure and transition. The Company recognizes estimated interest and penalties for uncertain tax positions in income tax expense. Interest and penalties were immaterial to the consolidated financial statements in the three and six months ended June 30, 2014 and 2013.

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 returns are currently open to examination for tax years 2010 through 2012 and 2009 through 2012, 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.

### Stock-Based Compensation

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

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stock options, 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 fair value of options granted. The Company determines the intrinsic value of restricted stock units based on the closing price of its common stock on the date of grant. The Company recognizes the compensation expense of share-based awards on a straight-line basis for awards with only service conditions and on an accelerated method for awards with performance conditions.

Compensation expense is recognized over the respective vesting periods 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 a number of assumptions, including expected volatility, expected life, risk-free interest rate and expected dividends. The expected life of the awards is estimated based on the midpoint between the vesting date and the end of the contractual term. 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.

### Recent Accounting Pronouncements Not Yet Adopted

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 may make additional estimates regarding performance conditions and the allocation of variable consideration. The guidance is effective in fiscal years beginning after January 1, 2017, with early adoption permitted. The Company is evaluating the impact of ASU 2014-09, however the adoption of the guidance is not expected to have a material impact on the Company's financial statements.

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. The Company is evaluating the impact of ASU 2014-12, however the adoption of the guidance is not expected to have a material impact on the Company's financial statements.

### 3. Fair Value Measurements

ASC 820, which defines fair value, establishes a framework for measuring fair value, and expands disclosures about fair value measurements. ASC 820 defines fair value as the exit price that would be received to sell an asset or paid to transfer a liability. Fair value is a market-based measurement that should be determined using assumptions that market participants would use in pricing an asset or liability. Valuation techniques used to measure fair value should maximize the use of observable inputs and minimize the use of unobservable inputs. To measure fair value, the Company uses the following fair value hierarchy based on three levels of inputs, 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

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Fair value under ASC 820 is principally applied to financial assets which consist of investments in money market funds and the call feature on the modified portion of the 3.75% Notes. The following table provides a summary of financial assets that are measured at fair value on a recurring basis as of June 30, 2014, 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
Assets				
Cash Equivalents - Money Market Funds	\$123,129	\$123,129	\$—	\$—
Other Asset - Call feature on the modified portion of the 3.75%	\$702	\$—	\$—	\$702
Notes				

The following table provides a summary of financial assets that are measured at fair value on a recurring basis as of December 31, 2013, aggregated by the level in the fair value hierarchy within those those measurements fall (in thousands):

	Fair Value Measurements			
	Total	Level 1	Level 2	Level 3
Assets				
Cash Equivalents - Money Market Funds	\$128,308	\$128,308	\$—	\$—
Other Asset - Call feature on the modified portion of the 3.75%	\$1,351	\$—	\$—	\$1,351
Notes				

**Cash and Cash Equivalents**

The fair value of cash and cash equivalents is estimated based on the quoted market price of the investments. The carrying amount of the Company's cash equivalents approximates their fair value due to the short-term maturity of these instruments.

**Other Asset**

The Company's financial assets include a call feature on the outstanding principal amount of the modified portion of the 3.75% Notes which was valued at June 30, 2014 and December 31, 2013 using Level 3 inputs. Gains and losses recognized on changes in fair value of the asset are reported in other income (expense). The valuation of this feature was measured at fair value using a trinomial lattice model which incorporates the terms and conditions of the modified portion of the 3.75% Notes and estimates the fair value based on changes in the price of the underlying equity over successive periods of time. This lattice model is considered to be a single-factor model, in that it solely incorporates uncertainty related to the Company's stock price and values the option to convert the note into common stock using a trinomial structure. The \$0.9 million and \$0.6 million decrease in the valuation of this feature in the three and six months ended June 30, 2014, respectively, was a result of the repurchase of a portion of the outstanding principal amount of the modified portion of the 3.75% Notes offset by an increase in the valuation per note. The decrease was recorded as other expense in the three and six months ended June 30, 2014.

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The key assumptions used in the lattice model valuation for the call feature were as follows:

	As of June 30, 2014	December 31, 2013
Term to Maturity (years)	2.03	2.46
<b>Bond Inputs:</b>		
Bond Yield	4.91%	8.61%
Coupon Rate	3.75%	3.75%
Conversion Price	\$26.20	\$26.20
Bond Call Strike Price	\$100.00	\$100.00
<b>Stock Inputs:</b>		
Stock Price	\$39.67	\$37.10
Risk Free Rate	0.41%	0.56%
Volatility	35.30%	38.00%
Dividend Yield	—%	—%

The estimated yield is based on a trinomial single-factor convertible bond model which takes into account the conversion option and the call option. The risk free interest rate is based on United States Treasury rates with maturity dates approximating the expected term to maturity of the 3.75% Notes. The expected volatility considers the Company's historical volatility with a lookback period commensurate with years to maturity of the notes and the implied volatility using call option contracts on the Company's stock. The Company's stock price increased 7% from \$37.10 at December 31, 2013 to \$39.67 at June 30, 2014.

**Debt**

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

The carrying amounts and the estimated fair values of financial instruments as of June 30, 2014 and December 31, 2013, are as follows (in thousands):

	June 30, 2014		December 31, 2013	
	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Debt	\$ 189,744	\$ 266,529	\$ 113,651	\$ 211,370

The carrying value of the 3.75% Notes at June 30, 2014 and December 31, 2013 includes a debt discount of \$5.0 million and \$30.1 million, respectively, which is being amortized as non-cash interest expense over the term of the 3.75% Notes. The carrying value of the 2% Notes (as defined below) at June 30, 2014 includes a debt discount of \$35.4 million which is being amortized as non-cash interest expense over the term of the 2% Notes. The increase in the estimated fair values of these liabilities from December 31, 2013 to June 30, 2014 is largely related to the issuance of the 2% Notes and an increase in the quoted bond prices.

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## 4. Debt

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

	As of June 30, 2014	December 31, 2013
Principal amount of the 3.75% Convertible Senior Notes	\$28,836	\$143,750
Principal amount of the 2% Convertible Senior Notes	201,250	—
Unamortized debt discount	(40,342	) (30,099
Total long-term debt	\$189,744	\$113,651
Current portion of long-term debt	23,874	—
Long-term debt	\$165,870	\$113,651
Deferred financing costs	\$5,638	\$1,414

Interest expense related to the 5.375% Notes (as defined below), the 3.75% Notes and the 2% Notes was included in interest expense on the consolidated statements of operations as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Contractual coupon interest	\$1,273	\$1,460	\$2,621	\$3,009
Accretion of debt discount	2,258	2,751	4,883	5,511
Amortization of debt issuance costs	192	149	338	297
Loss on extinguishment of long-term debt	18,943	325	18,943	325
Total interest and other expense	\$22,666	\$4,685	\$26,785	\$9,142

## 5.375% Convertible Senior Notes

In June 2008, the Company sold \$85 million in principal amount of 5.375% Convertible Senior Notes due June 15, 2013 (the "5.375% Notes"). The interest rate on the notes was 5.375% per annum on the principal amount from June 16, 2008, payable semi-annually in arrears in cash on December 15 and June 15 of each year. The 5.375% Notes were convertible into the Company's common stock at an initial conversion rate of 46.8467 shares of common stock per \$1,000 principal amount of the 5.375% Notes. The 5.375% Notes were convertible for cash up to their principal amount and shares of the Company's common stock for the remainder of the conversion value in excess of the principal amount.

In June 2011, in connection with the issuance of \$143.8 million in principal amount of 3.75% Convertible Notes due June 15, 2016 (the "3.75% Notes"), the Company repurchased \$70 million in principal amount of 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. See "3.75% Convertible Senior Notes" below for additional detail on the modification accounting.

In May 2013, the Company entered into an Exchange Agreement with a holder of its 5.375% Notes. Under the Exchange Agreement, the Company purchased \$13 million in principal amount of the 5.375% Notes in exchange for 620,122 shares of the Company's common stock and a cash payment of \$0.3 million, representing the accrued and unpaid interest. In June 2013, the Company repaid the remaining outstanding principal and accrued interest on the 5.375% Notes in accordance with the terms. In addition to a cash payment of \$2.1 million, representing principal and accrued and unpaid interest, the Company issued 26,523 shares of its common stock to the holders, representing the

conversion value in excess of the principal amount as per the original terms of the 5.375% Notes.

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No cash interest expense was recorded related to the 5.375% Notes in the three and six month periods ended June 30, 2014. Cash interest expense related to the 5.375% Notes was \$0.1 million and \$0.3 million in the three and six month periods ended June 30, 2013.

As of June 30, 2014, no amounts remain outstanding related to the 5.375% Notes.

**3.75% Convertible Senior Notes**

In June 2011, the Company sold \$143.8 million in principal amount of the 3.75% Notes. The interest rate on the notes is 3.75% per annum, payable semi-annually in arrears in cash on December 15 and June 15 of each year. The 3.75% Notes are 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 is 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 the 5.375% Notes for \$85.1 million. 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. This transaction was treated as a modification of a portion of the 5.375% Notes. The Company accounted for this modification of existing debt separately from the issuance of the remainder of the 3.75% Notes.

Prior to the transaction, the \$70 million in principal amount of repurchased 5.375% Notes had a debt discount of \$10.5 million. This amount remained in debt discount related to the \$73 million in principal amount of modified debt. The Company recorded additional debt discount of \$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 debt discount of \$25.8 million related to the modified portion of the 3.75% Notes is being amortized as non-cash interest expense at the effective rate of 16.5% over the five year term of the modified debt. The Company paid transaction fees of approximately \$2.0 million related to the modification, which were recorded as interest 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. This debt discount is 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 is recorded as other assets in the consolidated balance sheet and is 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 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. A loss on extinguishment of debt of \$18.9 million was recorded in the three and six months ended June 30, 2014, representing the excess of the \$112.4 million allocated to the debt over its carrying value, net of deferred financing costs.

At June 30, 2014, approximately \$28.8 million in principal amount of 3.75% Notes remain outstanding.

The 3.75% Notes are convertible prior to March 15, 2016 only upon the occurrence of certain circumstances. 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 are

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.

The Company was not entitled to redeem the outstanding 3.75% Notes prior to June 20, 2014. 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 notified the Company that they exercised their

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right to convert their outstanding 3.75% Notes. In July 2014, the Company settled this conversion of the 3.75% Notes by providing cash for the principal amount of the outstanding 3.75% Notes converted and 348,535 shares of common stock representing the conversion premium. 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 identified 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, which are considered embedded derivatives and should be bifurcated and accounted for at fair value. The Company assesses the value of each of these embedded derivatives at each balance sheet date. The Company separately accounted for the call feature related to the possibility that it can redeem the outstanding 3.75% Notes, at the Company's option, beginning June 20, 2014. The Company determined that the fair value of this feature was approximately \$0.7 million and \$1.4 million at June 30, 2014 and December 31, 2013, respectively. The Company determined that the remaining derivatives had de minimis value at the balance sheet dates.

Cash interest expense related to the outstanding 3.75% Notes was \$1.1 million and \$1.4 million in the three month periods ended June 30, 2014 and 2013, respectively, and \$2.4 million and \$2.7 million in the six month periods ended June 30, 2014 and 2013, respectively. Non-cash interest expense related to the outstanding 3.75% Notes was \$2.1 million and \$2.9 million in the three month periods ended June 30, 2014 and 2013, respectively, and \$4.9 million and \$5.5 million in the six month periods ended June 30, 2014 and 2013, respectively.

As of June 30, 2014, the Company included \$23.9 million on its balance sheet in current portion of long-term debt and \$5.0 million in temporary equity related to the outstanding 3.75% Notes. The total balance represents the principal to be repaid in cash upon conversion.

2% Convertible Senior Notes

In June 2014, the Company sold \$201.3 million in principal amount of the 2% Notes. The interest rate on the notes is 2% per annum, payable semi-annually in arrears in cash on December 15 and June 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.

In June 2014, in connection with the issuance of 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 held approximately \$80.0 million in repurchased 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. See 3.75% Senior Convertible Notes above for additional detail on the extinguishment accounting.

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 other assets in the consolidated balance sheet and is being amortized as non-cash interest expense over the five year term 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 assesses the value of the embedded derivatives at each balance sheet date. The Company determined that the derivatives had de minimis value at the balance sheet date.

Cash interest expense related to the 2% Notes was \$0.2 million in the three and six month periods ended June 30, 2014, respectively. Non-cash interest expense related to the 2% Notes was \$0.3 million in the three and six month periods ended June 30, 2014, respectively.

As of June 30, 2014, the Company included \$165.9 million on its balance sheet in long-term debt related to the 2% Notes.



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## 5. Capital Lease Obligations

In the year ended December 31, 2013, the Company acquired \$9.0 million of manufacturing equipment under capital leases. The \$9.0 million obligation under the capital leases is being repaid in equal monthly installments over the 36 month terms of the leases and includes principal and interest payments with an effective interest rate of 17%. In the year ended December 31, 2013, the Company recorded a \$2.5 million charge to expense the value of certain equipment as it was no longer expected to be used in its manufacturing process. The remaining underlying assets have been recorded at their fair value of \$6.5 million and are included in property and equipment on the Company's balance sheet as of June 30, 2014. The assets acquired under capital leases are being amortized on a straight-line basis over 5 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 \$0.4 million and \$0.7 million in the three and six months ended June 30, 2014. No amortization expense was recorded on the capital leased assets in the three and six months ended June 30, 2013. Assets held under capital leases consist of the following (in thousands):

	As of	
	June 30, 2014	December 31, 2013
Manufacturing equipment	\$6,510	\$6,510
Less: Accumulated depreciation	(1,233	) (582
Total	\$5,277	\$5,928

The aggregate future minimum lease payments related to these capital leases as of June 30, 2014, are as follows (in thousands):

Year Ending December 31,	Minimum Lease Payments
2014 (remaining)	\$ 1,907
2015	3,815
2016	2,409
Total future minimum lease payments	\$ 8,131
Interest expense	(1,366
Total capital lease obligations	) \$ 6,765

The Company recorded \$0.3 million and \$0.6 million of interest expense on the capital leases in the three and six months ended June 30, 2014, respectively. No interest expense was recorded on capital leases in the three and six months ended June 30, 2013.

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## 6. Net Loss Per Share

Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding for the period, excluding unvested restricted common shares. Diluted net loss per share is computed using the weighted average number of common shares outstanding and, when dilutive, potential common share equivalents from options, restricted stock units and warrants (using the treasury-stock method), and potential common shares from convertible securities (using the if-converted method). Because the Company reported a net loss for the three and six months ended June 30, 2014 and 2013, all potential 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. Such potentially dilutive common share equivalents consist of the following:

	Three and Six Months Ended June 30,	
	2014	2013
5.375% Convertible Senior Notes	—	702,701
3.75% Convertible Senior Notes	1,100,811	5,487,642
2.00% Convertible Senior Notes	4,327,257	—
Unvested restricted stock units	968,083	1,058,032
Outstanding options	1,634,584	2,283,054
Outstanding warrants	—	62,752
Total dilutive common shares	8,030,735	9,594,181

## 7. 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.

As of June 30, 2014 accounts receivable from two customers represented 16% and 15% of gross accounts receivable, respectively. As of December 31, 2013 accounts receivable from two customers represented approximately 12% and 10% of gross accounts receivable, respectively.

The components of accounts receivable are as follows (in thousands):

	As of	
	June 30, 2014	December 31, 2013
Trade receivables	\$48,542	\$40,200
Allowance for doubtful accounts	(6,745	) (7,133
Total accounts receivable	\$41,797	\$33,067

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## 8. Inventories

Inventories consist of the following (in thousands):

	As of June 30, 2014	December 31, 2013
Raw materials	\$917	\$399
Work-in-process	856	1,671
Finished goods	6,992	7,394
Total inventories	\$8,765	\$9,464

## 9. Other Intangible Assets

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

	As of June 30, 2014			December 31, 2013		
	Cost	Accumulated Amortization	Net Book Value	Cost	Accumulated Amortization	Net Book Value
Customer relationships	\$30,100	\$ (16,443 )	\$ 13,657	\$30,100	\$ (14,378 )	\$ 15,722
Tradename	2,800	(575 )	2,225	2,800	(482 )	2,318
Total intangible assets	\$32,900	\$ (17,018 )	\$ 15,882	\$32,900	(14,860 )	\$ 18,040

The Company recorded \$32.9 million of other intangible assets in the year ended December 31, 2011 as a result of the acquisition of Neighborhood Diabetes. The Company determined that the estimated useful life of the customer relationships asset is 10 years and is amortizing the asset over that period using an estimated cash flow pattern. The Company determined that the useful life of the Neighborhood Diabetes tradename is 15 years and is amortizing the asset over that period on a straight-line basis. Amortization expense was approximately \$1.1 million and \$1.3 million for the three months ended June 30, 2014 and 2013, respectively. Amortization expense was approximately \$2.2 million and \$2.7 million for the six months ended June 30, 2014 and 2013, respectively.

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

Year Ending	Amortization Expense		
	Customer Relationships	Tradename	Total
December 31, 2014 (remaining)	\$1,725	\$94	\$1,819
2015	3,064	187	3,251
2016	2,478	187	2,665
2017	2,003	187	2,190
2018	1,619	187	1,806
Thereafter	2,768	1,383	4,151
Total	\$13,657	\$2,225	\$15,882

As of June 30, 2014, the weighted average amortization period of the Company's intangible assets is approximately 8 years.

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## 10. Product Warranty Costs

The Company provides a four-year warranty on its PDMs and may replace any OmniPods that do not function in accordance with product specifications. Warranty expense is estimated and recorded in the period that shipment occurs. The expense, or any required adjustment to expense is based on the Company's historical experience and the estimated cost to service the claims. A reconciliation of the changes in the Company's product warranty liability is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Balance at the beginning of the period	\$3,100	\$2,249	\$3,090	\$1,992
Warranty expense	(150	) 785	542	1,661
Warranty claims settled	(445	) (633	) (1,127	) (1,252
Balance at the end of the period	\$2,505	\$2,401	\$2,505	\$2,401

	As of June 30, 2014	December 31, 2013
Composition of balance:		
Short-term	\$994	\$1,173
Long-term	1,511	1,917
	\$2,505	\$3,090

## 11. Commitments and Contingencies

## Operating Leases

The Company leases its facilities in Massachusetts, New York, Florida, 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. The leases in Bedford, Massachusetts expire in September 2014. The leases for Bedford contain escalating payments over the life of the lease. During the year ended December 31, 2013, the Company extended the leases related to its Woburn, Massachusetts, Florida, and Singapore locations. Following the extensions, both the Woburn, Massachusetts and Florida leases expire in December 2014 and the Singapore lease expires in July 2015. The lease in New York expires in April 2015. During the year ended December 31, 2013, the Company entered into a new lease agreement for approximately 90,000 square feet of laboratory and office space in Billerica, Massachusetts. The lease term begins in August 2014 and expires in October 2022. During the six months ended June 30, 2014, the Company amended its existing lease for warehouse space in Billerica, Massachusetts. In addition to extending the term, the lease increased the approximate square footage to 18,000. Following the amendment, the lease now expires in September 2019. The execution of these leases did not result in any material impact to the financial statements for the three and six month periods ended June 30, 2014.

Certain of the Company's operating lease agreements contain scheduled rent increases, which are being amortized over the terms of the agreements using the straight-line method and are included in other liabilities in the accompanying consolidated balance sheet. The aggregate future minimum lease payments related to these leases as of June 30, 2014, are as follows (in thousands):

Year Ending	Minimum Lease Payments
December 31, 2014 (remaining)	\$776
2015	2,096
2016	2,057
2017	2,139
2018	2,144
Thereafter	8,249

Total

\$17,461

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Legal Proceedings

In June 2014, the Company entered into a Settlement and License Agreement (the "Settlement Agreement") with Becton, Dickinson and Company ("BD") resolving the lawsuit filed by BD against the Company in the United States District Court for the District of New Jersey alleging that the OmniPod System infringes two of its patents. The Settlement Agreement provides for a one-time cash payment by the Company to BD and a cross-license of certain patent claims. The Company has recorded approximately \$7 million of expense related to the one-time cash payment and associated legal fees in connection with the lawsuit. The lawsuit was dismissed with prejudice on July 15, 2014.

In October 2013, the Company received a letter from the Office of the Massachusetts Attorney General contending that prior to September 2012 Neighborhood Diabetes engaged in improper sales practices by automatically refilling certain prescriptions for MassHealth patients. The Company responded to this letter, stating that Neighborhood Diabetes' refill practices during the period in question were appropriate and consistent with applicable laws. In light of the preliminary nature of this matter, the Company is unable to reasonably assess its ultimate outcome. However, the Company does not believe it has any material financial exposure at June 30, 2014.

Indemnifications

In the normal course of business, the Company enters into contracts and agreements that contain a variety of representations and warranties and provide for general indemnifications. The Company's exposure under these agreements is unknown because it involves claims that may be made against the Company in the future, but have not yet been made. To date, the Company has not paid any claims or been required to defend any action related to its indemnification obligations. However, the Company may record charges in the future as a result of these indemnification obligations.

In accordance with its bylaws, the Company has indemnification obligations to its officers and directors for certain events or occurrences, subject to certain limits, while they are serving at the Company's request in such capacity. There have been no claims to date, and the Company has a director and officer insurance policy that enables it to recover a portion of any amounts paid for future claims.

At June 30, 2014, the Company is subject to an on-going sales and use tax audit by the Massachusetts Department of Revenue related to Neighborhood Diabetes for a period prior to the acquisition. Under the Merger Agreement, the Company has been indemnified by the former stockholders of Neighborhood Diabetes for any liability resulting from or related to any tax attributable to pre-acquisition periods. The Company has recorded a contingent liability in current liabilities and a corresponding indemnification asset in current assets related to the estimated sales tax payable to the state of Massachusetts for the period under audit.

12. Equity

In January 2013, in a public offering, the Company issued and sold 4,715,000 shares of its common stock at a price of \$20.75 per share. In connection with the offering, the Company received total gross proceeds of \$97.8 million, or approximately \$92.8 million in net proceeds after deducting underwriting discounts and offering expenses.

In May 2013, the Company entered into an Exchange Agreement with a holder of its 5.375% Notes. Under the Exchange Agreement, the Company issued 620,122 shares of its common stock to the holder in exchange for the extinguishment of \$13 million in principal amount of the 5.375% Notes. In June 2013, in connection with the repayment of the remaining \$2 million in principal amount of the 5.375% Notes, the Company issued 26,523 shares of its common stock to the holders representing the conversion value in excess of the principal amount as per the conversion terms of the 5.375% Notes.

In November 2013, the Company issued 47,392 shares of its common stock as a result of the exercise of warrants. The Company grants share-based awards to employees in the form of options to purchase the Company's common stock, the ability to purchase stock at a discounted price under the employee stock purchase plan and restricted stock units. Stock-based compensation expense related to share-based awards recognized in the three month periods ended June 30, 2014 and 2013 was \$4.2 million and \$3.8 million, respectively, and was calculated based on awards ultimately expected to vest. Stock-based compensation expense related to share-based awards recognized in the six month periods ended June 30, 2014 and 2013 was \$8.6 million and \$6.8 million, respectively, and was calculated

based on awards ultimately expected to vest. At June 30, 2014, the Company had \$36.5 million of total unrecognized compensation expense related to stock options and restricted stock units.

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## 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 and May 2012 to provide for the issuance of additional shares and to amend certain other provisions. As of June 30, 2014, 2,544,999 shares remain available for future issuance under the 2007 Plan.

The following summarizes the activity under the Company's stock option plans:

	Number of Options (#)	Weighted Average Exercise Price (\$)	Aggregate Intrinsic Value (\$)	
			(In thousands)	
Balance, December 31, 2013	1,828,613	\$ 16.46		
Granted	227,500	42.67		
Exercised	(403,371 )	12.70	\$ 11,615	(1 )
Canceled	(18,158 )	23.09		
Balance, June 30, 2014	1,634,584	\$ 20.97	\$ 31,509	
Vested, June 30, 2014	923,061	\$ 15.27	\$ 22,523	(2 )
Vested and expected to vest, June 30, 2014 (3)	1,370,909		\$ 27,826	(2 )

(1) The aggregate intrinsic value was calculated based on the positive difference between the fair market 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 fair market value of the Company's common stock as of June 30, 2014 and the exercise price of the underlying options.

Represents the number of vested options as of June 30, 2014, plus the number of unvested options expected to vest (3) as of June 30, 2014, based on the unvested options outstanding as of June 30, 2014, adjusted for the estimated forfeiture rate of 16%.

At June 30, 2014 there were 1,634,584 options outstanding with a weighted average exercise price of \$20.97 per share and a weighted average remaining contractual life of 7.0 years. At June 30, 2014 there were 923,061 options exercisable with a weighted average exercise price of \$15.27 per share and a weighted average remaining contractual life of 5.7 years.

Employee stock-based compensation expense related to stock options in each of the three month periods ended June 30, 2014 and 2013 was \$1.3 million and was based on awards ultimately expected to vest. Employee stock-based compensation expense related to stock options in the six month periods ended June 30, 2014 and 2013 was \$2.9 million and \$2.5 million, respectively, and was based on awards ultimately expected to vest. At June 30, 2014, the Company had \$10.7 million of total unrecognized compensation expense related to stock options that will be recognized over a weighted average period of 1.3 years.

## Employee Stock Purchase Plan

As of June 30, 2014 and 2013 the Company had 6,898 and 6,390 shares contingently issued under the employee stock purchase plan ("ESPP"), respectively. In the three and six months ended June 30, 2014 and 2013, the Company recorded no significant stock-based compensation charges related to the ESPP.

## Restricted Stock Units

In the six months ended June 30, 2014, the Company awarded 321,375 restricted stock units to certain employees and directors, which include 34,500 restricted stock units subject to the achievement of performance conditions (performance-based restricted stock units). The restricted stock units were granted under the 2007 Plan and vest annually over three to four years from the grant date. For performance-based restricted stock units, if the performance conditions are achieved, these restricted stock units will then be subject to service-based vesting requirements over a three year period. The number of performance-based restricted stock units granted during the six months ended June



30, 2014 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 expects that 34,500 performance-based restricted stock units granted during the first six months of 2014 will be earned based on the

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Company's evaluation of the performance criteria at June 30, 2014. The restricted stock units granted have a weighted average fair value of \$45.51 per share based on the closing price of the Company's common stock on the date of grant. The restricted stock units granted during the six months ended June 30, 2014 were valued at approximately \$14.6 million on their grant date, and the Company is recognizing the compensation expense over the vesting period. Approximately \$2.9 million and \$2.5 million of stock-based compensation expense related to the vesting of restricted stock units was recognized in the three months ended June 30, 2014 and 2013, respectively. Approximately \$5.7 million and \$4.3 million of stock-based compensation expense related to the vesting of restricted stock units was recognized in the six months ended June 30, 2014 and 2013, respectively. Approximately \$25.8 million of the fair value of the restricted stock units remained unrecognized as of June 30, 2014 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.

The following table summarizes the status of the Company's restricted stock units:

	Number of Shares (#)	Weighted Average Fair Value (\$)
Balance, December 31, 2013	1,011,893	\$22.11
Granted	321,375	45.51
Vested	(342,990	) 21.10
Forfeited	(22,195	) 21.46
Balance, June 30, 2014	968,083	\$30.25

## 13. Income Taxes

The Company accounts for income taxes under ASC 740-10. Deferred income tax assets and liabilities are determined based upon differences between financial reporting and tax bases of assets and liabilities and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse. A valuation allowance is required to reduce the deferred tax assets reported if, based on the weight of the evidence, it is more likely than not that some portion or all of the deferred tax assets will not be realized. At June 30, 2014 and December 31, 2013, the Company provided a valuation allowance for the full amount of its net deferred tax asset because realization of any future tax benefit was not sufficiently assured.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Current	\$22	\$88	\$53	\$191
Deferred	30	30	64	58
Total	\$52	\$118	\$117	\$249

In the three and six months ended June 30, 2014 and 2013, the current portion of income tax expense primarily relates to state, local and foreign taxes, and the deferred portion primarily relates to federal and state tax amounts.

Deferred income taxes reflect the net tax effects of temporary differences between the carrying amount of assets and liabilities for financial reporting purposes and the amounts used for income tax purposes as well as federal and state net operating losses and tax credit carryforwards.

In the future, the Company will generate additional deferred tax assets and liabilities related to its amortization of acquired intangible assets for tax purposes because these long-lived intangible assets are not amortized for financial reporting purposes. The tax amortization in future years will give rise to a temporary difference and a tax liability, which will only reverse at the time of ultimate sale or further impairment of the underlying intangible assets. 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 the deferred tax asset related to the net operating loss carryforward for tax purposes that will be generated by the same

amortization.

The Company had no unrecognized tax benefits at June 30, 2014.

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

You should read the following discussion of our financial condition and results of operations in conjunction with our consolidated financial statements and the accompanying 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 the OmniPod System; our ability to 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; 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 or 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; 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 with competitors; technological change and product innovation adversely affecting our business; potential termination of our license to incorporate a blood glucose meter into the OmniPod System or our inability to enter into new license agreements; 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; failure of our contract manufacturers or component suppliers to comply with the FDA’s quality system regulations; 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; fluctuations in quarterly results of operations; 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 our common stock; risks related to future sales of our common stock or the conversion of any of our 3.75% or 2% Convertible Senior Notes; potential limitations on our ability to use our net operating loss carryforwards; anti-takeover provisions in our organizational documents; and other risks and uncertainties described in our Annual Report on Form 10-K, which was filed with the Securities and Exchange Commission on February 28, 2014 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.

Overview

We are primarily engaged in the development, manufacturing and sale of our 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 is the only commercially-available insulin infusion system of its kind. 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. We believe that the OmniPod System’s unique proprietary design offers significant lifestyle benefits to people with insulin-dependent diabetes.

In June 2011, we acquired Neighborhood Holdings, Inc. and its wholly-owned subsidiaries (collectively, "Neighborhood Diabetes") in order to support our sales of the OmniPod System, expand our full suite diabetes management product offerings and obtain access to a larger number of insulin dependent patients. Through Neighborhood Diabetes, we are

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able to provide customers with blood glucose testing supplies, traditional insulin pumps, pump supplies and pharmaceuticals and have the ability to process claims as either durable medical equipment or through pharmacy benefits.

We began commercial sale of the OmniPod System in the United States in October 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 internationally through our partnerships with Ypsomed Distribution AG (“Ypsomed”) and GlaxoSmithKline (“GSK”). In August 2011, we received CE Mark approval, and in December 2012 we received 510(k) clearance from the FDA for our new OmniPod System. The new OmniPod System is more than one-third smaller and one-quarter lighter than the original version, while maintaining the same features and operating capabilities. We began selling our new OmniPod System in 2013.

We sell our proprietary OmniPod System as well as blood glucose testing supplies, traditional insulin pumps, pump supplies, pharmaceuticals and other products for the management and treatment of diabetes to people with diabetes. Through our infrastructure in the reimbursement, billing and collection areas, we are able to provide for adjudication of claims as either durable medical equipment or through pharmacy benefits. Claims are adjudicated under private insurers, Medicaid or Medicare. As we expand our sales and marketing focus, increase our manufacturing capacity and expand to additional international markets, we will need to maintain and expand available reimbursement for our product offerings.

Our sales and marketing effort is focused on generating demand and acceptance of the OmniPod System among key diabetes practitioners, academic medical centers, clinics, people with insulin-dependent diabetes, third-party payors, government agencies, and third-party distributors. Our marketing strategy is to build awareness for the benefits of the OmniPod System through a wide range of education programs, social networking, patient demonstration programs, support materials, media advertisements and events at the national, regional and local levels. We are using third-party distributors to improve our access to managed care and government reimbursement programs, expand our commercial presence and provide access to additional potential patients. Our total revenue was \$72.0 million and \$141.2 million for the three and six months ended June 30, 2014, respectively. Our total revenue was \$60.1 million and \$117.4 million for the three and six months ended June 30, 2013, respectively.

We currently produce the OmniPod System on partially automated manufacturing lines at a facility in China operated by a subsidiary of Flextronics International Ltd. (“Flextronics”). We purchase complete OmniPods pursuant to our agreement with Flextronics. Under the agreement, Flextronics has agreed to supply us, as a non-exclusive supplier, with OmniPods at agreed upon prices per unit pursuant to a rolling forecast that we provide. The current term of the agreement expires in December 2017 and is automatically renewed for one-year terms subsequently. It may be terminated upon prior written notice given no less than a specified number of days prior to the date of termination. The specified number of days is intended to provide the parties with sufficient time to make alternative arrangements in the event of termination.

To achieve profitability, we continue to seek to increase manufacturing volume and reduce the per-unit production cost for the OmniPod. By increasing production volumes of the OmniPod, we have been able to reduce our per-unit raw material costs and improve absorption of manufacturing overhead costs. Our new OmniPod was designed to further lower the cost of the product through component sourcing, volume discounts and efficient manufacturing. The cost reductions are important as we strive to achieve profitability. We believe our current manufacturing capacity is sufficient to meet our expected 2014 demand for OmniPods.

We purchase certain other diabetes management supplies from manufacturers at contracted rates and supply these products to our customers. Based on market penetration, payor plans and other factors, certain manufacturers provide rebates based on product sold. We record these rebates as a reduction to cost of goods sold as they are earned. Since our inception in 2000, we have incurred losses every quarter. In the three and six months ended June 30, 2014, we incurred net losses of \$29.1 million and \$35.3 million, respectively. As of June 30, 2014, we had an accumulated deficit of \$561.8 million. We have financed our operations through private placements of debt and equity securities, public offerings of our common stock, issuances of convertible debt and borrowings under certain other debt agreements. As of June 30, 2014, we had \$230.1 million of convertible debt outstanding. We have notified the holders of \$28.8 million in principal amount of our 3.75% Notes of our intent to redeem such 3.75% Notes in July 2014. The

remaining \$201.3 million of outstanding matures in June 2019.

Our long-term financial objective is to achieve and sustain profitable growth. Our efforts in the remaining months of 2014 will be focused primarily on the expansion of our customer base in the United States and internationally.

Achieving this objective is expected to require additional investments in certain personnel and initiatives. We believe that we will continue to incur net losses in the near term in order to achieve our objectives. However, we believe that the accomplishment of our near term objectives will have a positive impact on our financial condition in the future.

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At June 30, 2014, we had cash and cash equivalents totaling \$175.5 million. We believe that our cash and cash equivalents, together with the cash expected to be generated from product sales, will be sufficient to meet our projected operating and debt service requirements for the next twelve months.

Financial Operations Overview

Revenue. We derive most of our revenue from the sale of the OmniPod System and other diabetes related products including blood glucose testing supplies, traditional insulin pumps, pump supplies and other pharmaceuticals to customers and third-party distributors who resell the product to customers. The OmniPod System is comprised of two devices: the OmniPod, a disposable insulin infusion device that the patient wears for up to three days and then replaces; and the PDM, a handheld device much like a personal digital assistant that wirelessly programs the OmniPod with insulin delivery instructions, assists the patient with diabetes management and incorporates a blood glucose meter.

In June 2011, we entered into a development agreement with a U.S. based pharmaceutical company (the "Development Agreement"). Under the Development Agreement, we were required to perform design, development, regulatory, and other services to support the pharmaceutical company as it works to obtain regulatory approval to use our drug delivery technology as a delivery method for its pharmaceutical. Over the term of the Development Agreement, we have invoiced amounts based upon meeting certain deliverable milestones. Revenue from the Development Agreement was recognized using a proportional performance methodology based on efforts incurred and total payments under the agreement. The impact of changes in the expected total effort or contract payments was recognized as a change in estimate using the cumulative catch-up method. As of December 31, 2013, we met all required deliverables under the Development Agreement.

As of June 30, 2014 and December 31, 2013, we had deferred revenue of \$1.3 million and \$0.9 million, respectively. These amounts mainly include product-related revenue.

For the year ending December 31, 2014 we expect our revenue to continue to increase as we gain new customers in the United States and continue expansion in Europe, Canada and certain other international markets. Increased revenue will be dependent upon the success of our sales efforts, our ability to produce OmniPods in sufficient volumes as our patient base grows, and other risks and uncertainties.

Cost of revenue. Cost of revenue consists primarily of raw material, labor, warranty and overhead costs such as freight, depreciation and other costs related to the OmniPod System as well as the cost of products we acquire from third party suppliers. Cost of revenue is expected to increase as revenue increases, however gross margin is expected to improve as we realize cost efficiencies on our manufacturing process.

Research and development. Research and development expenses consist primarily of personnel costs within our product development, regulatory and clinical functions, and the costs of market studies and product development projects. We expense all research and development costs as incurred. For the year ending December 31, 2014, we expect overall research and development spending to increase from our 2013 spend as we increase our development efforts on our on-going projects including continued improvements to the manufacturing process of the OmniPod System, the integration of our OmniPod System with the LifeScan OneTouch blood glucose monitoring technology, the incorporation of continuous sensing technology into the OmniPod, the development of a new PDM, the development of a Type 2 pump with Eli Lilly and Company ("Lilly") and the ability to use our technology as a delivery platform for other pharmaceuticals.

General and administrative. General and administrative expenses consist primarily of salaries and other related costs for personnel serving the executive, finance, information technology and human resource functions, as well as legal fees, accounting fees, insurance costs, bad debt expenses, shipping, handling and facilities-related costs. For the year ending December 31, 2014, we expect general and administrative expenses to remain consistent with 2013 levels. General and administrative expenses in the second half of 2014 are expected to decrease from the first half of 2014 as we recorded significant one-time charges related to the settlement of patent litigation with Becton, Dickinson and Co. in the six months ended June 30, 2014.

Sales and marketing. Sales and marketing expenses consist primarily of personnel costs within our sales, marketing, reimbursement support, customer support and training functions, sales commissions paid to our sales representatives



and costs associated with participation in medical conferences, physician symposia and promotional activities, including distribution of units used in our demonstration kit programs. We expect sales and marketing expenses to increase in the year ending December 31, 2014 as compared to 2013 as we expand our commercial team to enhance awareness and drive increased adoption of the new OmniPod System.

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## Results of Operations

The following table presents certain statement of operations information for the three and six month periods ended June 30, 2014 and 2013:

	Three Months Ended June 30,			Six Months Ended June 30,				
	2014	2013	% Change	2014	2013	% Change		
	(In thousands)			(In thousands)				
Revenue	\$72,013	\$60,092	20	% \$141,174	\$117,448	20	%	
Cost of revenue	36,248	33,259	9	% 72,601	65,460	11	%	
Gross profit	35,765	26,833	33	% 68,573	51,988	32	%	
Operating expenses:								
Research and development	6,677	5,174	29	% 13,456	9,570	41	%	
General and administrative	19,512	13,901	40	% 33,771	26,995	25	%	
Sales and marketing	14,856	13,580	9	% 28,512	27,451	4	%	
Total operating expenses	41,045	32,655	26	% 75,739	64,016	18	%	
Operating loss	(5,280 )	(5,822 )	9	% (7,166 )	(12,028 )	40	%	
Interest and other expense, net	(23,779 )	(4,579 )	419	% (27,972 )	(8,907 )	214	%	
Income tax expense	(52 )	(118 )	56	% (117 )	(249 )	53	%	
Net loss	\$(29,111 )	\$(10,519 )	177	% \$(35,255 )	\$(21,184 )	66	%	

## Comparison of the Three and Six Months ended June 30, 2014 and 2013

## Revenue

Our total revenue was \$72.0 million and \$141.2 million for the three and six month periods ended June 30, 2014, respectively, compared to \$60.1 million and \$117.4 million for the same periods in 2013. The \$11.9 million and \$23.7 million respective increases are largely due to continued adoption of the OmniPod System by patients in the United States and internationally. This increase was offset by a reduction in revenue related to certain mail-order diabetic testing supplies such as blood glucose testing strips and lancets to Medicare beneficiaries that we no longer are eligible to service under the Medicare Durable Medical Equipment, Prosthetics, Orthotics, and Supplies ("DMEPOS") Competitive Bidding Program, which took effect on July 1, 2013.

## Cost of Revenue

Cost of revenue was \$36.2 million and \$72.6 million for the three and six months ended June 30, 2014, respectively, compared to \$33.3 million and \$65.5 million for the same periods in 2013. The \$3.0 million and \$7.1 million respective increases are due to higher sales volumes in the United States and internationally. The increase was partially offset by lower per-unit costs of the OmniPod System resulting from cost savings on raw materials, volume discounts from our suppliers and increased absorption of manufacturing overhead driven by increased production volumes.

## Research and Development

Research and development expenses increased \$1.5 million, or 29%, to \$6.7 million for the three months ended June 30, 2014, compared to \$5.2 million for the same period in 2013. The increase was primarily a result of a \$0.5 million increase in employee related expenses, mainly comprised of costs related to the addition of employees and increased stock-based compensation as our stock price rises. Additionally, we incurred higher costs including a \$0.5 million increase in supplies and consumables and a \$0.3 million increase in consultant and temporary labor as we continued to advance a number of research and development projects during this period.

Research and development expenses increased \$3.9 million, or 41%, to \$13.5 million for the six months ended June 30, 2014, compared to \$9.6 million for the same period in 2013. The increase was primarily a result of a \$2.4 million increase in employee related expenses, mainly comprised of the addition of employees and increased stock-based compensation. Additionally, we incurred higher costs related to our development projects including a \$0.6 million increase in supplies and consumables and a \$0.5 million increase in consulting and temporary labor in the six months ended June 30, 2014 compared to the same period in 2013.



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### General and Administrative

General and administrative expenses increased \$5.6 million, or 40%, to \$19.5 million for the three months ended June 30, 2014, compared to \$13.9 million for the same period in 2013. This increase was primarily the result of an increase of \$5.6 million in legal expense mainly related to the Becton Dickinson patent litigation settlement and related legal fees, and an increase of \$0.4 million in employee related expenses including stock-based compensation. These increases were partially offset by a decrease of \$0.2 million in amortization expense related to the customer relationship asset acquired in the June 2011 acquisition of Neighborhood Diabetes.

General and administrative expenses increased \$6.8 million, or 25%, to \$33.8 million for the six months ended June 30, 2014, compared to \$27.0 million for the same period in 2013. This increase was primarily the result of an increase of \$6.6 million in legal expense mainly related to the Becton Dickinson patent litigation settlement and related legal fees, and an increase of \$1.0 million in employee related expenses including stock-based compensation. These increases were partially offset by a decrease of \$0.5 million in amortization expense related to the customer relationship asset acquired in the June 2011 acquisition of Neighborhood Diabetes.

### Sales and Marketing

Sales and marketing expenses increased \$1.3 million, or 9%, to \$14.9 million for the three months ended June 30, 2014, compared to \$13.6 million for the same period in 2013. This increase was primarily a result of a \$0.5 million increase in marketing campaigns and a \$0.4 million increase in other advertising expenses and marketing research as we continue to expand our patient base.

Sales and marketing expenses increased \$1.1 million, or 4%, to \$28.5 million for the six months ended June 30, 2014, compared to \$27.5 million for the same period in 2013. This increase was primarily a result of an increase in costs associated with marketing campaigns and other advertising costs as we continue to expand our patient base.

### Interest and Other Expense, Net

Interest and other expense, net increased \$19.2 million to \$23.8 million for the three months ended June 30, 2014, compared to \$4.6 million for the same period in 2013. This increase was primarily related to an increase in the loss from extinguishment of long-term debt of \$18.6 million and \$0.9 million of additional expense related to the reduction of the fair value of the call option on the 3.75% Notes. The remaining amounts primarily related to the cash and non-cash interest expense recorded on our long-term debt.

Interest and other expense, net increased \$19.1 million to \$28.0 million for the six months ended June 30, 2014, compared to \$8.9 million for the same period in 2013. This increase was primarily related to the loss from extinguishment of long-term debt of \$18.6 million and \$0.6 million of additional expense related to the reduction of the fair value of the call option on the 3.75% Notes. The remaining amounts primarily related to the cash and non-cash interest expense recorded on our long-term debt.

### Income Tax Expense

Income tax expense was \$0.1 million and for each of the three months ended June 30, 2014 and 2013. Income tax expense was \$0.1 million and \$0.2 million for the six months ended June 30, 2014 and 2013, respectively. Income tax expense is comprised of a current and deferred portion. The current portion primarily related to state, local and foreign taxes and the deferred portion primarily related to federal and state tax amounts.

### Liquidity and Capital Resources

We commenced operations in 2000 and to date we have financed our operations primarily through private placements of common and preferred stock, secured indebtedness, public offerings of our common stock and issuances of convertible debt.

Beginning on June 20, 2014, we had the right to redeem the outstanding 3.75% Notes in whole or in part since the last reported sales price per share of our common stock was equal to or greater than 130% of the conversion price for at least 20 of 30 consecutive trading days. If a holder elects to convert its 3.75% Notes we have the right to effect such conversion using cash, shares of our common stock or a combination of cash and shares of our common stock for the principal amount. In June 2014, we notified holders of our 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 notified us that they exercised their right to convert their outstanding 3.75% Notes. In July 2014, we settled this conversion of the 3.75% Notes by providing cash for the principal amount of the 3.75% Notes converted and 348,535 shares of common stock representing the conversion

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premium. We 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.

As of June 30, 2014, we had \$175.5 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.

Equity

In January 2013, in a public offering, we issued and sold 4,715,000 shares of our common stock at a price of \$20.75 per share. In connection with the offering, we received total gross proceeds of \$97.8 million, or approximately \$92.8 million in net proceeds after deducting underwriting discounts and offering expenses.

In May 2013, we entered into an Exchange Agreement with a holder of our 5.375% Notes. Under the Exchange Agreement, we issued 620,122 shares of our common stock to the holder in exchange for the extinguishment of \$13 million in principal amount of the 5.375% Notes. In June 2013, in connection with the repayment of the remaining \$2 million in principal amount of the 5.375% Notes, we issued 26,523 shares of our common stock to the holders representing the conversion value in excess of the principal amount as per the conversion terms of the 5.375% Notes. In November 2013, we issued 47,392 shares of our common stock as a result of the exercise of warrants.

Debt

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

	As of June 30, 2014	December 31, 2013
Principal amount of the 3.75% Convertible Senior Notes	\$28,836	\$143,750
Principal amount of the 2% Convertible Senior Notes	201,250	—
Unamortized debt discount	(40,342	) (30,099
Total long-term debt	\$189,744	\$113,651
Current portion of debt	23,874	—
Long-term debt	\$165,870	\$113,651
Deferred financing costs	\$5,638	\$1,414

Interest expense related to the 5.375% Notes, the 3.75% Notes and the 2% Notes was included in interest and other expense on the consolidated statements of operations as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2014	2013	2014	2013
Contractual coupon interest	\$1,273	\$1,460	\$2,621	\$3,009
Accretion of debt discount	2,258	2,751	4,883	5,511
Amortization of debt issuance costs	192	149	338	297
Loss on extinguishment of long-term debt	18,943	325	18,943	325
Total interest and other expense	\$22,666	\$4,685	\$26,785	\$9,142

5.375% Convertible Senior Notes

In June 2008, we sold \$85.0 million in principal amount of 5.375% Convertible Senior Notes due June 15, 2013 (the "5.375% Notes"). The interest rate on the notes was 5.375% per annum on the principal amount from June 16, 2008, payable semi-annually in arrears in cash on December 15 and June 15 of each year. The 5.375% Notes were convertible into our common stock at an initial conversion rate of 46.8467 shares of common stock per \$1,000 principal amount of the 5.375%



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Notes. The 5.375% Notes were convertible for cash up to their principal amount and shares of our common stock for the remainder of the conversion value in excess of the principal amount.

In June 2011, in connection with the issuance of \$143.8 million in principal amount of 3.75% Convertible Notes due June 2016 (the “3.75% Notes”), we repurchased \$70 million in principal amount of 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. See the section entitled “3.75% Convertible Senior Notes” below.

In May 2013, we entered into an Exchange Agreement with a holder of our 5.375% Notes. Under the Exchange Agreement, we purchased \$13 million in principal amount of the 5.375% Notes in exchange for 620,122 shares of our common stock and a cash payment of \$0.3 million, representing accrued and unpaid interest. In June 2013, we repaid the remaining outstanding principal and accrued interest on the 5.375% Notes in accordance with their terms. In addition to a cash payment of \$2.1 million, representing principal and accrued and unpaid interest, we issued 26,523 shares of our common stock to the holders representing the conversion value in excess of the principal amount as per the terms of the 5.375% Notes.

No cash interest expense was recorded related to the 5.375% Notes in the three and six month periods ended June 30, 2014. Cash interest expense related to the 5.375% Notes was \$0.1 million and \$0.3 million in the three and six month periods ended June 30, 2013, respectively.

As of June 30, 2014, no amounts remain outstanding related to the 5.375% Notes.

**3.75% Convertible Senior Notes**

In June 2011, we sold \$143.8 million in principal amount of the 3.75% Notes. The interest rate on the notes is 3.75% per annum, payable semi-annually in arrears in cash on December 15 and June 15 of each year. The 3.75% Notes are convertible into our 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 is equivalent to a conversion price of approximately \$26.20 per share.

In connection with the issuance of the 3.75% Notes, we repurchased \$70 million in principal amount of the 5.375% Notes for \$85.1 million. 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. This transaction was treated as a modification of a portion of the 5.375% Notes. We accounted for this modification of existing debt separately from the issuance of the remainder of the 3.75% Notes.

Prior to the transaction, the \$70 million in principal amount of repurchased 5.375% Notes had a debt discount of \$10.5 million. This amount remained in debt discount related to the \$73 million in principal amount of modified debt. We recorded an additional debt discount of \$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 of \$25.8 million related to the modified portion of the 3.75% Notes is being amortized as non-cash interest expense at the effective rate of 16.5% over the five year term of the modified debt. We paid transaction fees of approximately \$2.0 million related to the modification which were recorded as interest 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. We 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 our nonconvertible debt borrowing rate of 12.4% per annum. This debt discount is being amortized as non-cash interest expense over the five year term of the 3.75% Notes. We 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 is recorded as other assets in the consolidated balance sheet and is 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"), we 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 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.

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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. We allocated \$112.4 million of the payment to the debt and \$48.3 million to equity. A loss on extinguishment of debt of \$18.9 million was recorded in the three and six months ended June 30, 2014, representing the excess of the remaining \$112.4 million payment allocated to the debt over its carrying value, net of deferred financing costs.

At June 30, 2014, approximately \$28.8 million in principal amount of 3.75% Notes remain outstanding.

The 3.75% Notes are convertible prior to March 15, 2016 only upon the occurrence of certain circumstances. 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 our 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 will be convertible at our option for cash, shares of our common stock or a combination of cash and shares of our common stock.

We were not entitled to redeem the outstanding 3.75% Notes prior to June 20, 2014. Beginning on June 20, 2014, we had the right to redeem the 3.75% Notes, at our option, in whole or in part, if the last reported sale price per share of our 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, we met the redemption requirements and notified holders of our 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 notified us that they exercised their right to convert their outstanding 3.75% Notes. In July 2014, we settled this conversion of the 3.75% Notes by providing cash for the principal amount of the 3.75% Notes converted and 348,535 shares of common stock representing the conversion premium. We 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.

We identified certain features related to a portion of the 3.75% Notes, including the holders' ability to require us to repurchase their notes and the higher interest and tax payments required in an event of default, which are considered embedded derivatives and should be bifurcated and accounted for at fair value. We assess the value of each of these embedded derivatives at each balance sheet date. We separately accounted for the call feature related to the possibility that we can redeem the outstanding 3.75% Notes, at our option, beginning June 20, 2014. We determined that the fair value of this feature was approximately \$0.7 million and \$1.4 million at June 30, 2014 and December 31, 2013, respectively, and included these amounts in current other assets on our balance sheet. We determined that the remaining derivatives had de minimis value at the balance sheet dates.

Cash interest expense related to the outstanding 3.75% Notes was \$1.1 million and \$1.4 million in the three month periods ended June 30, 2014 and 2013, respectively, and \$2.4 million and \$2.7 million in the six month periods ended June 30, 2014 and 2013, respectively. Non-cash interest expense related to the outstanding 3.75% Notes was \$2.1 million and \$2.9 million in the three month periods ended June 30, 2014 and 2013, respectively, and \$4.9 million and \$5.5 million in the six month periods ended June 30, 2014 and 2013, respectively.

As of June 30, 2014, we included \$23.9 million on our balance sheet in current portion of long-term debt and \$5.0 million in temporary equity related to the outstanding 3.75% Notes. The total balance represents the principal to be repaid in cash upon conversion.

#### 2% Convertible Senior Notes

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

In June 2014, in connection with the issuance of the 2% Notes, we 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 held approximately \$80.0 million in repurchased 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. See 3.75% Senior Convertible Notes above for additional detail on the extinguishment accounting.

We 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 our 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. We incurred deferred financing costs related to

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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 other assets in the consolidated balance sheet and is being amortized as non-cash interest expense over the five year term of the 2% Notes.

We determined that the higher interest and tax payments in certain circumstances are considered an embedded derivatives and should be bifurcated and accounted for at fair value. We assess the value of the embedded derivatives at each balance sheet date. We determined that the derivatives had de minimis value at June 30, 2014.

Cash interest expense related to the 2% Notes was \$0.2 million in the three and six month periods ended June 30, 2014. Non-cash interest expense related to the 2% Notes was \$0.3 million in the three and six month periods ended June 30, 2014. No cash or non-cash interest was recorded in the three and six month periods ended June 30, 2013. As of June 30, 2014, we included \$165.9 million on our balance sheet in long-term debt related to the 2% Notes.

Capital Leases

In the year ended December 31, 2013, we acquired \$9.0 million of manufacturing equipment under capital leases. The \$9.0 million obligation under the capital leases is being repaid in equal monthly installments over the 36 month terms of the leases and includes principal and interest payments with an effective interest rate of 17%. In the year ended December 31, 2013, we recorded a \$2.5 million charge to expense the value of certain equipment as it was no longer expected to be used in our manufacturing process. The remaining underlying assets have been recorded at their fair value of \$6.5 million and are included in property and equipment on our balance sheet as of June 30, 2014.

At June 30, 2014, \$2.9 million was included in current liabilities and \$3.9 million was included in long-term liabilities on our balance sheet related to these capital leases. The aggregate future minimum lease payments related to these capital leases as of June 30, 2014, are as follows (in thousands):

Year Ending	Minimum Lease Payments
December 31, 2014 (remaining)	\$1,907
2015	3,815
2016	2,409
Total future minimum lease payments	\$8,131
Interest expense	(1,366 )
Total capital lease obligations	\$6,765

We recorded \$0.3 million and \$0.6 million of interest expense on the capital leases in the three and six months ended June 30, 2014, respectively. No interest expense was recorded on capital leases in the three and six months ended June 30, 2013.

Operating Activities

The following table sets forth the amounts of cash provided by (used in) operating activities and net loss for each of the periods indicated (in thousands):

	Six Months Ended June 30,	
	2014	2013
Cash provided by (used in) operating activities	\$(509 )	\$3,172
Net loss	\$(35,255 )	\$(21,184 )

In the six months ended June 30, 2014 net cash used in operating activities was attributable primarily to the growth of our operations after adjustments for non-cash expenses. Adjustments for non-cash and other items were approximately \$41.3 million and \$21.3 million in the six months ended June 30, 2014 and 2013, respectively. In the six months ended June 30, 2014 non-cash and other items include of a loss from the extinguishment of debt of \$18.9 million, depreciation and amortization of \$6.1 million, stock-based compensation of \$8.6 million, and non-cash interest and other expense of \$5.9 million.

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Uses of cash from operations in the six months ended June 30, 2014 included an increase in accounts receivable of \$10.5 million and an increase in prepaid expenses and other assets of \$1.0 million. These changes were offset in part by an increase of \$4.4 million in accounts payable, accrued expenses, and other liabilities and a decrease in inventories of \$0.7 million. The increase in accounts receivable largely relates to the timing of shipments to customers and overall expansion of our customer base. The decrease in inventories is largely attributed to the increase in product sales. The increase in accounts payable, accrued expenses, and other liabilities is primarily related to timing on vendor payments. Cash provided by operations in the six months ended June 30, 2013 included a decrease in inventories of \$8.9 million and an increase in accounts payable and accruals of \$3.3 million, offset in part by a decrease of \$4.5 million in deferred revenue, an increase of accounts receivable of \$2.9 million and an increase in prepaid expense and other current assets of \$2.1 million.

**Investing and Financing Activities**

The following table sets forth the amounts of cash used in investing activities and cash provided by financing activities for each of the periods indicated (in thousands):

	Six Months Ended June 30,	
	2014	2013
Cash used in investing activities	\$(5,745	) \$(2,695
Cash provided by financing activities	\$32,072	\$93,174

Cash used in investing activities in the six months ended June 30, 2014 and 2013 was primarily for the purchase of manufacturing equipment for use in the production of our new OmniPod System.

Cash provided by financing activities in the six months ended June 30, 2014 was mainly related to the net proceeds from the issuance of long-term debt and common stock related to exercises of employee stock options offset by our repayment of debt and payment of taxes in connection with the vesting of the restricted stock units in the period. Cash provided by financing activities in the six months ended June 30, 2013 mainly related to net proceeds from the issuance of common stock in connection with the public offering.

**Commitments and Contingencies**

We lease facilities in Massachusetts, New York, Florida, and Singapore. We account for these leases as operating leases. The leases generally provide for a base rent plus real estate taxes and certain operating expenses related to the leases. The leases in Bedford Massachusetts expire in September 2014. The leases for Bedford contain a five-year renewal option and escalating payments over the life of the leases. During the year ended December 31, 2013, we extended the term of our lease related to Woburn, Massachusetts, Florida, and Singapore locations. Following the extension, both the Woburn, Massachusetts and Florida lease expire in December 2014 and the Singapore lease expires in July 2015. The lease in New York expires in April 2015. During the year ended December 31, 2013, we entered into a new lease agreement for approximately 90,000 square feet of laboratory and office space in Billerica, Massachusetts. The lease term begins in August 2014 and expires in October 2022. During the six months ended June 30, 2014, we amended our existing lease for warehouse space in Billerica, Massachusetts. In addition to extending the term, the lease increased the approximate square footage to 18,000. Following the amendment, the lease now expires in September 2019. The execution of these leases did not result in any material impact to the financial statements for the three and six month periods ended June 30, 2014.

Certain of our operating lease agreements contain scheduled rent increases, which are being amortized over the terms of the agreements using the straight-line method and are included in other liabilities on our balance sheet.

The following table summarizes our principal obligations as of June 30, 2014 (in thousands):

	Payments Due in						
	Total	2014 Remaining	2015	2016	2017	2018	Later
Contractual Obligations							
Operating lease obligations	\$17,461	\$776	\$2,096	\$2,057	\$2,139	\$2,144	\$8,249
Debt obligations (1)	250,044	30,849	4,025	4,025	4,025	4,025	203,095
Capital lease obligations (2)	8,131	1,907	3,815	2,409	—	—	—
Total contractual obligations	\$275,636	\$33,532	\$9,936	\$8,491	\$6,164	\$6,169	\$211,344

(1) The interest rate on the convertible debt is 3.75% and 2% per annum. We have included future payments of interest on the long-term debt in our obligations.

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

At June 30, 2014, we are subject to an on-going sales and use tax audit by the Massachusetts Department of Revenue related to Neighborhood Diabetes for a period prior to the acquisition. Under the Merger Agreement, we have been indemnified by the former Stockholders of Neighborhood Diabetes for any liability resulting from or related to any tax attributable to pre-acquisition periods. We have recorded a contingent liability in current liabilities and a corresponding indemnification asset in current assets related to the estimated sales tax payable to the state of Massachusetts for the period under audit.

Off-Balance Sheet Arrangements

As of June 30, 2014, 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 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 six months ended June 30, 2014. 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, 2013.

Recent Accounting Pronouncements Not Yet Adopted

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 may make additional estimates regarding performance conditions and the allocation of variable consideration. The guidance is effective in fiscal years beginning after January 1, 2017, with early adoption permitted. We are evaluating the impact of ASU 2014-09, however the adoption of the guidance is not expected to have a material impact on our financial statements.

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. We are evaluating the impact of ASU 2014-12, however the adoption of the guidance is not expected to have a material impact on our financial statements.

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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 June 30, 2014, we had outstanding debt recorded on our consolidated balance sheet of \$230.1 million related to our 3.75% Notes and 2% Notes and \$6.8 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.



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Item 4. Controls and Procedures

Disclosure Controls and Procedures

As of June 30, 2014, 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 June 30, 2014, 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 June 30, 2014 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

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PART II — OTHER INFORMATION

Item 1. Legal Proceedings

In June 2014, we entered into a Settlement and License Agreement (the "Settlement Agreement") with Becton, Dickinson and Company ("BD") resolving the lawsuit filed by BD against the Company in the United States District Court for the District of New Jersey alleging that the OmniPod System infringes two of its patents. The Settlement Agreement provides for a one-time cash payment by us to BD and a cross-license of certain patent claims. We have recorded approximately \$7 million of expense related to the on-time cash payment and associated legal fees in connection with the lawsuit. The lawsuit was dismissed with prejudice on July 15, 2014.

In October 2013, we received a letter from the Office of the Massachusetts Attorney General contending that prior to September 2012 Neighborhood Diabetes engaged in improper sales practices by automatically refilling certain prescriptions for MassHealth patients. We responded to this letter, stating that Neighborhood Diabetes' refill practices during the period in question were appropriate and consistent with applicable laws. In light of the preliminary nature of this matter, we are unable to reasonably assess its ultimate outcome. However, we do not believe we have any material financial exposure at June 30, 2014.

We are, 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 we are unable to quantify the exact financial impact of any of these matters, we believe that none of these currently pending matters will have an outcome material to our financial condition or business.

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, 2013, 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, 2013.

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.

Item 6. Exhibits

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Exhibit Number	Description of Document
10.1+	Third Addendum to Manufacturing Services Agreement between Insulet Corporation and Flextronics Marketing (L) Ltd., dated May 29, 2014
10.2+	Four Addendum to Manufacturing Services Agreement between Insulet Corporation and Flextronics Marketing (L) Ltd., dated July 15, 2014
10.3+	Fifth Addendum to Manufacturing Services Agreement between Insulet Corporation and Flextronics Marketing (L) Ltd., dated July 15, 2014
31.1	Certification of Duane DeSisto, 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 Brian Roberts, 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 Duane DeSisto, President and Chief Executive Officer, and Brian Roberts, 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 June 30, 2014, formatted in XBRL (eXtensible Business Reporting Language), as follows: <ul style="list-style-type: none"> <li>(i) Consolidated Balance Sheets as of June 30, 2014 and December 31, 2013 (Unaudited)</li> <li>(ii) Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2014 and June 30, 2013 (Unaudited)</li> <li>(iii) Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2014 and June 30, 2013 (Unaudited)</li> <li>(iv) Notes to Condensed Consolidated Financial Statements (Unaudited)</li> </ul>
+	Application has been made to the Securities and Exchange Commission for confidential treatment of certain provisions. Omitted material for which confidential treatment has been requested has been filed separately with the Securities and Exchange Commission.
§	As provided in Rule 406T of Regulation S-T, this information is furnished and not filed for purposes of Sections 11 and 12 of the Securities Act of 1933, as amended, and Section 18 of the Securities Exchange Act of 1934, as amended.

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SIGNATURES

Pursuant to the requirements 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: August 7, 2014

/s/ Duane DeSisto  
Duane DeSisto  
President and Chief Executive Officer  
(Principal Executive Officer)

Date: August 7, 2014

/s/ Brian Roberts  
Brian Roberts  
Chief Financial Officer  
(Principal Financial and Accounting Officer)