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

Form 10-Q

x QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2017
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number 001-33462

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

Delaware	04-3523891
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)
600 Technology Park Drive, Suite 200 Billerica, Massachusetts	01821
(Address of Principal Executive Offices)	(Zip Code)

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

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x 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 x 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 x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨
	Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

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

INSULET CORPORATION
QUARTERLY REPORT ON FORM 10-Q FOR THE PERIOD ENDED
September 30, 2017
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PART I - FINANCIAL INFORMATION
Item 1. Consolidated Financial Statements (Unaudited)
INSULET CORPORATION
CONSOLIDATED BALANCE SHEETS

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

The accompanying condensed notes are an integral part of these consolidated financial statements.
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INSULET CORPORATION
CONSOLIDATED STATEMENTS OF OPERATIONS
(UNAUDITED)

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

The accompanying condensed notes are an integral part of these consolidated financial statements.
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INSULET CORPORATION
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS
(UNAUDITED)

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

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

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INSULET CORPORATION
CONSOLIDATED STATEMENTS OF CASH FLOWS
(UNAUDITED)

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

[1] 2016 includes activity related to discontinued operations. See Note 3 to the consolidated financial statements for discussion of discontinued operations.

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

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

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INSULET CORPORATION
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(UNAUDITED)
Note 1. Nature of the Business
Insulet Corporation, the "Company," is primarily engaged in the development, manufacturing and sale of its proprietary Omnipod Insulin Management System (“Omnipod System”), an innovative, discreet and easy-to-use continuous insulin delivery system for people with insulin-dependent diabetes. The Omnipod System features a small, lightweight, self-adhesive disposable tubeless Omnipod device which is worn on the body for approximately three days at a time and its wireless companion, the handheld Personal Diabetes Manager ("PDM"). Conventional insulin pumps require people with insulin-dependent diabetes to learn to use, manage and wear a number of cumbersome components, including up to 42 inches of tubing. In contrast, the Omnipod System features only two discreet, easy-to-use devices that eliminate the need for a bulky pump, tubing and separate blood glucose meter, provides for virtually pain-free automated cannula insertion, communicates wirelessly and integrates a blood glucose meter. The Company believes that the Omnipod System’s unique proprietary design and features allow people with insulin-dependent diabetes to manage their diabetes with unprecedented freedom, comfort, convenience, and ease.
Commercial sales of the Omnipod System began in the United States in 2005. The Company sells the Omnipod System in the United States through direct sales to customers or through its distribution partners. The Omnipod System is currently available in multiple countries in Europe, as well as in Canada and Israel.
The Company announced on July 20, 2017 its plans to assume, on July 1, 2018, the distribution, sales, marketing, training and support activities of its Omnipod System across Europe following the expiration of its global distribution agreement with Ypsomed Distribution AG ("Ypsomed') on June 30, 2018. Until the expiration of the agreement, Ypsomed will remain the distributor of the Company's Omnipod products in Europe. The Company will be required to pay to Ypsomed a per unit fee for direct sales over the 12 month period following the expiration of the global distribution agreement of its Omnipod device to former customers of Ypsomed, as defined in the distribution agreement. The Company will recognize a liability for this fee as it sells its Omnipod device to these customers during the twelve-month period beginning July 1, 2018.
In addition to using the Omnipod System for insulin delivery, the Company also partners with global pharmaceutical and biotechnology companies to tailor the Omnipod System technology platform for the delivery of subcutaneous drugs across multiple therapeutic areas.
The Company acquired Neighborhood Holdings, Inc. and its wholly-owned subsidiaries (collectively, “Neighborhood Diabetes”) in June 2011. Through Neighborhood Diabetes, the Company provided customers with blood glucose testing supplies, traditional insulin pumps, pump supplies and pharmaceuticals and had the ability to process claims as either durable medical equipment or through pharmacy benefits. In February 2016, the Company sold Neighborhood Diabetes to Liberty Medical LLC ("Liberty Medical"). Additional information regarding the disposition and treatment of the Neighborhood Diabetes business as discontinued operations is provided in Note 3 to these consolidated financial statements.

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

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

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

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Reclassification of Prior Period Balances

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

Use of Estimates in Preparation of Financial Statements

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

Principles of Consolidation

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

Foreign Currency Translation

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

Cash and Cash Equivalents

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

Short-term Investments

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

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

Property and Equipment

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

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Business Combinations

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

Segment Reporting

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

Goodwill

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

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

Revenue Recognition

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

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

- The evidence of an arrangement generally consists of a physician order form, a patient information form and, if applicable, third-party insurance approval for sales directly to patients or a purchase order for sales to a third-party distributor.
- Revenue is recognized when title and risk and rewards of ownership have transferred to the customer.

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

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

Collaborative Arrangements

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

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

Shipping and Handling Costs

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

Concentration of Credit Risk

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

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

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

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

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

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

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

Recently Adopted Accounting Standards:
In December 2016, the FASB issued ASU 2016-19, Technical Corrections and Improvements ("ASU 2016-19"). ASU 2016-19 includes numerous technical corrections and clarifications to GAAP that are designed to remove inconsistencies in the board's accounting guidance. Several provisions in this accounting guidance were effective immediately and did not have an impact on the Company's consolidated financial statements. Additional provisions in this accounting guidance are effective for the Company in the current fiscal year, including the clarification that the license of internal-use software shall be accounted for as the acquisition of an intangible asset. The standard allows for prospective or retrospective adoption and the Company has elected retrospective adoption. As a result of adoption, the Company reclassified $4.1 million of gross internal-use software costs, net of accumulated amortization of $2.6 million, from property and equipment to other intangible assets as of December 31, 2016.
In July 2015, the FASB issued ASU 2015-11, Simplifying the Measurement of Inventory ("ASU 2015-11"). ASU 2015-11 amends existing guidance and requires entities to measure most inventory at the lower of cost and net realizable value. The guidance is effective prospectively for annual reporting periods beginning after December 15, 2016. Early adoption is permitted. Upon adoption, entities must disclose the nature of and reason for the accounting change. The Company adopted ASU 2015-11 on January 1, 2017 and its adoption did not have a material impact on the consolidated financial statements.
The Company adopted ASU 2016-09, Improvements to Employee Share-Based Payment Accounting ("ASU 2016-09") on January 1, 2017 using the modified retrospective method. ASU 2016-09 simplifies several aspects of the accounting for employee share-based payment transactions, including the accounting for income taxes, forfeitures, and statutory tax withholding requirements, as well as classification in the statement of cash flows. The adoption of ASU 2016-09 resulted in the Company increasing its deferred tax assets (tax effected) by approximately $23.8 million, which is offset by a full valuation allowance. Overall, adoption of the standard did not have a material impact on the Company's consolidated financial statements.
The Company adopted ASU 2016-18, Restricted Cash (a consensus of the Emerging Issues Task Force) ("ASU 2016-18") as of January 1, 2017 using the retrospective transition method. ASU 2016-18 requires the statement of cash flows to show the changes in the total of cash, cash equivalents, and restricted cash. As the Company includes restricted cash within cash and cash equivalents on the consolidated balance sheet and discloses the carrying value of

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

Accounting Standards Issued and Not Yet Adopted:

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

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

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

While the Company continues to assess all potential impacts of the new standard on its consolidated financial statements, the Company currently expects that the adoption of ASC 606 will accelerate the timing of revenue recognition relative to a portion of its drug delivery product line whereby revenue will be recognized as the product is produced pursuant to the customer’s firm purchase commitments (as opposed to at a point in time when the product is shipped to the customer) as the Company has an enforceable right to payment for performance completed to date and the inventory has no alternative use. Upon the adoption of ASC 606 using the modified retrospective method on January 1, 2018, the Company expects to record an adjustment to accumulated deficit for the amount that would have been recognized in 2017 under the new guidance and would not have been recognized until shipment of the product in 2018 under the current guidance. In addition to the aforementioned impact on drug delivery revenue, the adoption of ASC 606 will impact the treatment of contract acquisition costs such as commissions, which will be capitalized and amortized over the expected period of benefit. Upon adoption, the Company expects to increase its current and other assets for the net value of commissions paid prior to adoption less amortization to date. The new standard will also require an enhanced level of disclosures in the Company’s quarterly and annual consolidated financial statements.

In January 2016, the FASB issued ASU 2016-01 ("ASU 2016-01"), Financial Instruments-Overall: Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 changes the current GAAP model for the accounting of equity investments, financial liabilities under the fair value option, and the presentation and disclosure requirements for financial instruments. All equity investments in unconsolidated entities (other than those accounted for using the equity method of accounting) will generally be measured at fair value through earnings. There will no longer be an available-for-sale classification (changes in fair value reported in other comprehensive income (loss)) for equity securities with readily determinable fair values. In addition, the FASB clarified guidance related to the valuation allowance assessment when recognizing deferred tax assets resulting from unrealized losses on available-for-sale debt securities. The classification and measurement guidance will be effective in fiscal years beginning after December 15, 2017, and interim periods within those years. While the Company is continuing to evaluate the potential impact of ASU 2016-01, the Company anticipates that the new guidance may create some volatility in earnings related to changes in fair value of its short term marketable securities. The Company does not expect the adoption of ASU 2016-01 to have a material impact on its consolidated financial statements.

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

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230), Classification of Certain Cash Receipts and Cash Payments (a consensus of the Emerging Issues Task Force) ("ASU 2016-15"). ASU 2016-15 clarifies how entities should classify certain cash receipts and cash payments on the statement of cash flows. The guidance also clarifies how the predominance principle should be applied when cash receipts and cash payments have aspects of more than one class of cash flows. The guidance is effective for annual reporting periods beginning after December 15, 2017, and interim periods within those years. Early adoption is permitted for all entities. The Company is currently evaluating the impact of ASU 2016-15 but does not expect it to be material to the consolidated financial statements.

In January 2017, the FASB issued ASU 2017-04, Simplifying the Test for Goodwill Impairment ("ASU 2017-04"). ASU 2017-04 simplifies the accounting for goodwill impairments by eliminating "Step 2" from the goodwill impairment test, which requires an entity to calculate the implied fair value of goodwill to measure a goodwill impairment charge, and alternatively, requires an entity to measure the impairment of goodwill assigned to a reporting unit as the amount by which the carrying value of the assets and liabilities of the reporting unit, including goodwill, exceeds the reporting unit's fair value. The guidance is effective for annual reporting periods beginning after December 15, 2019, and interim periods within those years. Early adoption is permitted for all entities. The Company is currently evaluating the impact of ASU 2017-04 but does not expect it to be material to the consolidated financial statements.

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

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

Note 3. Discontinued Operations

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

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

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

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

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

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

[1] Revenue includes revenue from the operations of Neighborhood Diabetes through date of sale in February 2016.
[2] Includes $1.3 million loss on sale of Neighborhood Diabetes for the nine months ended September 30, 2016.

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

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

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

Note 4. Fair Value Measurements

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

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

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

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

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

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

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

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

	Fair Value Measurements			
(in thousands)	Total	Level 1	Level 2	Level 3
September 30, 2017				
Recurring fair value measurements:				
Cash equivalents:				
Money market mutual funds	$45,343	$45,343	$—	$ —
Total cash equivalents	$45,343	$45,343	$—	$ —
Short-term investments:				
U.S. government and agency bonds	$113,294	$92,344	$20,950	$ —
Corporate bonds	47,625	—	47,625	—
Certificates of deposit	12,604	—	12,604	—
Total short-term investments	$173,523	$92,344	$81,179	$ —
December 31, 2016				
Recurring fair value measurements:				
Cash equivalents:				
Money market mutual funds	$93,467	$93,467	$—	$ —
Corporate bonds				