

**UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION**  
Washington, D.C. 20549

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**Form 10-Q**

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

For the quarterly period ended September 30, 2012

OR

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

Commission File Number 001-33462

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**INSULET CORPORATION**

(Exact name of Registrant as specified in its charter)

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**Delaware**  
(State or Other Jurisdiction of  
Incorporation or Organization)

**04-3523891**  
(I.R.S. Employer  
Identification No.)

**9 Oak Park Drive**  
**Bedford, Massachusetts**  
(Address of Principal Executive Offices)

**01730**  
(Zip Code)

**Registrant's Telephone Number, Including Area Code: (781) 457-5000**

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

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

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

Large accelerated filer	<input checked="" type="checkbox"/>	Accelerated filer	<input type="checkbox"/>
Non-accelerated filer	<input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company	<input type="checkbox"/>

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 November 2, 2012, the registrant had 48,164,869 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 September 30, 2012	As of December 31, 2011
	(Unaudited)	
	(In thousands, except share data)	
<b>ASSETS</b>		
<b>Current Assets</b>		
Cash and cash equivalents	\$ 63,443	\$ 93,955
Accounts receivable, net	30,145	23,190
Inventories	15,089	11,838
Prepaid expenses and other current assets	4,717	2,802
Total current assets	113,394	131,785
Property and equipment, net	24,910	19,422
Intangible assets, net	24,358	29,002
Goodwill	26,647	26,647
Other assets	2,333	2,727
Total assets	<u>\$ 191,642</u>	<u>\$ 209,583</u>
<b>LIABILITIES AND STOCKHOLDERS' EQUITY</b>		
<b>Current Liabilities</b>		
Accounts payable	\$ 16,216	\$ 11,418
Accrued expenses	17,816	13,064
Deferred revenue	1,138	2,582
Current portion of long-term debt	14,134	—
Other current liabilities	38	931
Total current liabilities	49,342	27,995
Long-term debt	101,517	108,540
Other long-term liabilities	1,670	1,652
Total liabilities	152,529	138,187
<b>Stockholders' Equity</b>		
Preferred stock, \$.001 par value:		
Authorized: 5,000,000 shares at September 30, 2012 and December 31, 2011. Issued and outstanding: zero shares at September 30, 2012 and December 31, 2011	—	—
Common stock, \$.001 par value:		
Authorized: 100,000,000 shares at September 30, 2012 and December 31, 2011. Issued and outstanding: 48,114,876 and 47,504,131 shares at September 30, 2012 and December 31, 2011, respectively	48	48
Additional paid-in capital	521,761	512,371
Accumulated deficit	(482,696)	(441,023)
Total stockholders' equity	39,113	71,396
Total liabilities and stockholders' equity	<u>\$ 191,642</u>	<u>\$ 209,583</u>

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

**INSULET CORPORATION**  
**CONSOLIDATED STATEMENTS OF OPERATIONS**

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2012	2011	2012	2011
	(Unaudited)			
	(In thousands, except share and per share data)			
Revenue	\$ 54,752	\$ 44,594	\$ 153,541	\$ 105,063
Cost of revenue	<u>30,362</u>	<u>26,033</u>	<u>86,524</u>	<u>58,431</u>
Gross profit	24,390	18,561	67,017	46,632
Operating expenses:				
Research and development	6,559	4,638	18,512	16,059
General and administrative	12,731	11,379	38,416	31,585
Sales and marketing	<u>13,571</u>	<u>12,312</u>	<u>39,974</u>	<u>30,943</u>
Total operating expenses	<u>32,861</u>	<u>28,329</u>	<u>96,902</u>	<u>78,587</u>
Operating loss	<u>(8,471)</u>	<u>(9,768)</u>	<u>(29,885)</u>	<u>(31,955)</u>
Interest income	31	31	83	107
Interest expense	<u>(3,949)</u>	<u>(3,825)</u>	<u>(11,728)</u>	<u>(10,983)</u>
Other expense, net	<u>(3,918)</u>	<u>(3,794)</u>	<u>(11,645)</u>	<u>(10,876)</u>
Loss before income taxes	(12,389)	(13,562)	(41,530)	(42,831)
Income tax expense	<u>(28)</u>	<u>—</u>	<u>(143)</u>	<u>—</u>
Net loss	<u>\$ (12,417)</u>	<u>\$ (13,562)</u>	<u>\$ (41,673)</u>	<u>\$ (42,831)</u>
Net loss per share basic and diluted	<u>\$ (0.26)</u>	<u>\$ (0.29)</u>	<u>\$ (0.87)</u>	<u>\$ (0.92)</u>
Weighted-average number of shares used in calculating net loss per share	<u>48,041,392</u>	<u>47,321,989</u>	<u>47,825,136</u>	<u>46,442,236</u>

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

**INSULET CORPORATION**  
**CONSOLIDATED STATEMENTS OF CASH FLOWS**

	Nine Months Ended September 30,	
	2012	2011
	(Unaudited)	
	(In thousands)	
<b>Cash flows from operating activities</b>		
Net loss	\$(41,673)	\$ (42,831)
Adjustments to reconcile net loss to net cash used in operating activities		
Depreciation and amortization	8,092	5,683
Non-cash interest expense	7,556	7,372
Stock-based compensation expense	7,500	5,606
Provision for bad debts	2,321	1,700
Changes in operating assets and liabilities:		
Accounts receivable	(9,276)	3,802
Inventories	(3,251)	594
Deferred revenue	(1,444)	(2,054)
Prepaid expenses and other assets	(1,966)	851
Accounts payable, accrued expenses, and other liabilities	8,657	1,852
Other long-term liabilities	18	(359)
Net cash used in operating activities	<u>(23,466)</u>	<u>(17,784)</u>
<b>Cash flows from investing activities</b>		
Purchases of property and equipment	(8,936)	(8,838)
Acquisition of Neighborhood Diabetes	—	(37,855)
Net cash used in investing activities	<u>(8,936)</u>	<u>(46,693)</u>
<b>Cash flows from financing activities</b>		
Proceeds from issuance of long-term debt	—	138,863
Payments to retire long-term debt	—	(88,195)
Proceeds from issuance of common stock	3,142	5,024
Payment of withholding taxes in connection with vesting of restricted stock units	(1,252)	(677)
Net cash provided by financing activities	<u>1,890</u>	<u>55,015</u>
Net decrease in cash and cash equivalents	(30,512)	(9,462)
Cash and cash equivalents, beginning of period	93,955	113,274
Cash and cash equivalents, end of period	<u>\$ 63,443</u>	<u>\$103,812</u>

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

**INSULET CORPORATION**  
**NOTES TO CONSOLIDATED FINANCIAL STATEMENTS**  
**(Unaudited)**

**1. Nature of the Business**

Insulet Corporation (the "Company") is primarily engaged in the sale of diabetes management supplies, including its proprietary OmniPod Insulin Management System (the "OmniPod System") as well as blood glucose testing supplies, traditional insulin pumps, pump supplies, and other pharmaceuticals. The Company was incorporated in Delaware in 2000, and its corporate headquarters is located in Bedford, Massachusetts. In June 2011, the Company acquired Neighborhood Holdings, Inc. and its wholly-owned subsidiaries (collectively "Neighborhood Diabetes") in order to expand its full suite diabetes management product offerings and obtain access to a larger number of insulin dependent patients. The Company has additional facilities in New York, Florida and Singapore.

Since inception, the Company has principally devoted its efforts to designing, developing, manufacturing and marketing the OmniPod System, which consists of the disposable OmniPod insulin infusion device and the handheld, wireless Personal Diabetes Manager ("PDM"). The Company commercially launched the OmniPod System in August 2005 after receiving FDA 510(k) approval in January 2005. The first commercial product was shipped in October 2005.

The Company sells its OmniPod System and other diabetes management supplies in the United States through direct sales to customers or through the Company's distribution partners. The OmniPod System is currently available in multiple countries in Europe through the Company's exclusive distribution partner there, Ypsomed Distribution AG ("Ypsomed"), and in Canada through the Company's exclusive Canadian distribution partner, GlaxoSmithKline Inc. ("GSK"). Through Ypsomed, the Company is now selling its next generation OmniPod System in certain countries in Europe.

**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 nine month periods ended September 30, 2012, are not necessarily indicative of the results that may be expected for the full year ending December 31, 2012, 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, 2011.

***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 accounts receivable, inventories, deferred revenue and equity instruments, the lives of property and equipment and intangible assets, as well as warranty and doubtful accounts 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.

***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 September 30, 2012 and December 31, 2011. 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.

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### ***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 capitalized 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 estimated life of the acquired customer relationship asset is 10 years. Intangible assets with determinable estimated lives are amortized over these lives. At September 30, 2012, intangible assets related to the acquisition of Neighborhood Diabetes consisted of \$21.8 million of customer relationships and \$2.6 million of tradenames.

### ***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 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.

Goodwill is evaluated at the reporting unit level. To test for impairment, the Company compares the carrying value of the reporting unit to its fair value. If the reporting unit's carrying value exceeds its fair value, the Company records an impairment loss to the extent that the carrying value of goodwill exceeds its implied fair value.

### ***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.

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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 March 2008, the Company received a cash payment from Abbott Diabetes Care, Inc. ("Abbott") for an agreement fee in connection with execution of the first amendment to the development and license agreement between the Company and Abbott. The Company is recognizing revenue on the agreement fee from Abbott over the initial five year term of the agreement. In addition, Abbott agreed to pay an amount to the Company for services performed in connection with each sale of a PDM that includes an Abbott Discrete Blood Glucose Monitor to customers in certain territories. The Company recognizes revenue related to this portion of the Abbott agreement at the time it meets the criteria for revenue recognition, typically at the time the revenue is recognized on the sale of the PDM to the patient.

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 is required to perform design, development, 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 estimated two-year term of the Development Agreement, the Company has and will continue to invoice amounts based upon meeting certain deliverable milestones. Revenue from the Development Agreement is recognized using a proportional performance methodology based on efforts incurred and total payments under the agreement.

The Company had deferred revenue of \$1.1 million and \$2.7 million as of September 30, 2012 and December 31, 2011, respectively. The deferred revenue recorded was comprised of product-related revenue, unrecognized amounts related to the Development Agreement, as well as the non-amortized portion of the Abbott agreement fee.

### ***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.

Although revenue is recognized from shipments directly to patients or third-party distributors, the majority of shipments are billed to third-party insurance payors and government agencies. There were no third-party payors or government agencies that accounted for more than 10% of gross accounts receivable as of September 30, 2012 or December 31, 2011.

### ***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***

Financial Accounting Standards Board ("FASB") Accounting Standard Codification ("ASC") 740-10, *Income Taxes* ("ASC 740-10") clarifies the accounting for uncertainty in income taxes recognized in an entity's 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 has accumulated significant losses since its inception in 2000. Since the net operating losses may potentially be utilized in future years to reduce taxable income (subject to any applicable limitations), all of the Company's tax years remain open to examination by the major taxing jurisdictions to which the Company is subject.

The Company recognizes estimated interest and penalties for uncertain tax positions in income tax expense. As of September 30, 2012, interest and penalties were immaterial to the consolidated financial statements.

For the three months ended September 30, 2012, income tax expense was comprised of \$15,000 for the current portion and \$13,000 for the deferred portion. For the nine months ended September 30, 2012, income tax expense was comprised of \$78,000 for the current portion and \$65,000 for the deferred portion. The current portion primarily relates to state, local, and foreign taxes. The deferred portion primarily relates to U. S. Federal and State tax amounts.

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### ***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 stock options, to be recognized in the income statement based on their fair values.

The Company uses the Black-Scholes option pricing model to determine the weighted average fair value of options granted. The Company determines the intrinsic value of restricted stock 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 over the vesting period of the award.

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.

See Footnote 12 for a summary of the stock activity under the Company’s stock-based employee compensation plan.

### ***Recent Accounting Pronouncements***

In May 2011, the FASB issued ASU No. 2011-04 *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* (“ASU No. 2011-04”). ASU No. 2011-04 clarifies existing concepts regarding existing fair value principles. The amendments are effective in fiscal years beginning after December 15, 2011. The Company adopted the guidance in the first quarter of 2012. The adoption of these amendments did not have a material impact on the Company’s financial statements.

In September 2011, the FASB issued ASU No. 2011-08 *Testing Goodwill for Impairment* (“ASU No. 2011-08”). ASU No. 2011-08 provides guidance on simplifying the impairment testing for goodwill. A company may first assess the qualitative factors to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test on the reporting unit. The guidance is effective in fiscal years beginning after December 15, 2011, and the Company adopted the guidance in the first quarter of 2012. The adoption of this guidance did not have a material impact on the Company’s financial statements.

In July 2012, the FASB issued ASU No. 2012-02 *Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment* (“ASU No. 2012-02”). ASU No. 2012-02 gives a company the option to first assess qualitative factors to determine whether it is more-likely-than-not that the indefinite-lived intangible is impaired. Qualitative factors include related events and circumstances that could affect the significant inputs used in determining the fair value of the indefinite-lived intangible asset. The guidance is effective in fiscal years beginning after September 15, 2012. The Company believes the adoption of ASU No. 2012-02 will have no material impact on its financial statements.

### **3. Acquisition of Neighborhood Diabetes**

In June 2011, the Company acquired all of the outstanding shares of privately-held Neighborhood Diabetes, a durable medical equipment distributor specializing in direct to consumer sales of diabetes supplies, including pharmaceuticals and support services. Neighborhood Diabetes provides more than 60,000 customers with Type 1 and Type 2 diabetes primarily in the northeast and southeast regions of the United States with blood glucose testing supplies, traditional insulin pumps, pump supplies and pharmaceuticals, as well as other products for the management and treatment of diabetes. Neighborhood Diabetes is based in Massachusetts, with additional offices in New York and Florida. At the time of the acquisition, Neighborhood Diabetes employed approximately 200 people across its three locations. The acquisition of Neighborhood Diabetes provides the Company with full suite diabetes management product offerings, accelerates the Company’s sales force expansion, strengthens the Company’s back office support capabilities, expands the Company’s access to insulin dependent patients, and provides pharmacy adjudication capabilities to drive incremental sales higher. The aggregate purchase price of approximately \$62.4 million consisted of approximately \$37.9 million in cash paid at closing, 1,197,631 shares of the Company’s common stock valued at approximately \$24.4 million, or \$20.40 per share based on the closing price of the Company’s common stock on the acquisition date, and contingent consideration with a fair value of approximately \$0.1 million. Of the \$37.9 million of cash paid at closing, \$6.6 million is being held in an escrow account to reimburse the Company and its affiliates, if necessary, for certain claims for which they are entitled to be indemnified pursuant to the terms of the agreement and plan of merger with Neighborhood Diabetes.

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The Company has accounted for the acquisition of Neighborhood Diabetes as a business combination. Under business combination accounting, the assets and liabilities of Neighborhood Diabetes were recorded as of the acquisition date at their respective fair values, and consolidated with the Company's results. The excess of the purchase price over the fair value of net assets acquired was recorded as goodwill. The operating results of Neighborhood Diabetes have been included in the consolidated financial statements since June 2011, the period in which the acquisition was completed. The purchase price allocation, including an independent appraisal for intangible assets, has been prepared based on the information that was available to management at the time the consolidated financial statements were prepared. The allocation of the purchase price was finalized during the year ended December 31, 2011.

The purchase price has been allocated as follows (in thousands):

Calculation of allocable purchase price:	
Cash	\$37,855
Common stock	24,432
Contingent consideration obligations	61
Total allocable purchase price	<u>\$62,348</u>
Allocation of purchase price:	
Accounts receivable	5,897
Inventories	2,336
Prepaid expenses and other current assets	242
Property and equipment	391
Customer relationships	30,100
Tradenames	2,800
Goodwill	26,647
Other assets	253
Accounts payable	4,109
Accrued expenses	1,700
Other long-term liabilities	509
	<u>\$62,348</u>

The Company incurred transaction costs of approximately \$3.2 million, which consisted primarily of banking, legal, accounting and other administrative fees. These costs were recorded as general and administrative expense in the nine months ended September 30, 2011.

#### 4. Debt

At September 30, 2012 and December 31, 2011, the Company had outstanding convertible debt and related deferred financing costs on its balance sheet as follows (in thousands):

	September 30, 2012	As of December 31, 2011
Principal amount of the 5.375% Convertible Senior Notes	\$ 15,000	\$ 15,000
Principal amount of the 3.75% Convertible Senior Notes	143,750	143,750
Unamortized discount	(43,099)	(50,210)
Total debt	115,651	108,540
Current portion of long-term debt	14,134	—
Long-term debt	<u>\$ 101,517</u>	<u>\$ 108,540</u>
Deferred financing costs	\$ 2,152	\$ 2,597

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

	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Contractual coupon interest	\$ 1,549	\$ 1,549	\$ 4,647	\$ 3,834
Accretion of debt discount	2,420	2,143	7,111	4,992
Other interest payments	—	—	—	1,992
Amortization of debt issuance costs	148	146	445	389
	<u>\$ 4,117</u>	<u>\$ 3,838</u>	<u>\$ 12,203</u>	<u>\$ 11,207</u>

### 5.375% Convertible Senior Notes

In June 2008, the Company sold \$85.0 million in principal amount of 5.375% Convertible Senior Notes due June 15, 2013 (the “5.375% Notes”) in a private placement to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. The interest rate on the notes is 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 are 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, which is equivalent to a conversion price of approximately \$21.35 per share, representing a conversion premium of 34% to the last reported sale price of the Company’s common stock on the NASDAQ Global Market on June 10, 2008, subject to adjustment under certain circumstances, at any time beginning on March 15, 2013 or under certain other circumstances and prior to the close of business on the business day immediately preceding the final maturity date of the notes. The 5.375% Notes will be 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.

If a fundamental change, as defined in the Indenture for the 5.375% Notes, occurs at any time prior to maturity, holders of the 5.375% Notes may require the Company to repurchase their notes in whole or in part for cash equal to 100% of the principal amount of the notes to be repurchased, plus accrued and unpaid interest, including any additional interest to, but excluding, the date of repurchase. If a holder elects to convert its 5.375% Notes upon the occurrence of a make-whole fundamental change, as defined in the Indenture for the 5.375% Notes, the holder may be entitled to receive an additional number of shares of common stock on the conversion date. These additional shares are intended to compensate the holders for the loss of the time value of the conversion option and are set forth in the Indenture to the 5.375% Notes. In no event will the number of shares issuable upon conversion of a note exceed 62.7746 per \$1,000 principal amount (subject to adjustment as described in the Indenture for the 5.375% Notes).

The Company recorded a debt discount of \$26.9 million to equity to reflect the value of its nonconvertible debt borrowing rate of 14.5% per annum. This debt discount is being amortized as non-cash interest expense over the five year term of the 5.375% Notes. The Company incurred deferred financing costs related to this offering of approximately \$3.5 million, of which \$1.1 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 5.375% Notes.

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.

Cash interest expense related to the 5.375% Notes was \$0.2 million and \$0.6 million for the three and nine months ended September 30, 2012, respectively. Cash interest expense related to the 5.375% Notes was \$0.2 million and \$2.5 million for the three and nine months ended September 30, 2011, respectively.

As of September 30, 2012, the Company included approximately \$14.1 million on its balance sheet in the current portion of long-term debt related to the 5.375% Notes. The 5.375% Notes have a remaining term of 9 months.

### 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, subject to adjustment under certain circumstances. The 3.75% Notes are convertible prior to March 15, 2016 only upon the occurrence of certain circumstances. On and after March 15, 2016 and prior to the close of business on the second scheduled trading day immediately preceding the final maturity date of the 3.75% Notes, the notes may be

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converted without regard to the occurrence of any such circumstances. The 3.75% Notes and any unpaid interest will be 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 for the principal amount. The Company intends to settle the principal in cash.

The Company may not redeem the 3.75% Notes prior to June 20, 2014. From June 20, 2014 to June 20, 2015 the Company may redeem the 3.75% Notes, at its option, in whole or in part, only if the last reported sale price per share of the Company's common stock has been at least 130% of the conversion price then in effect for at least 20 trading days during a period of 30 consecutive trading days. On and after June 20, 2015, the Company may redeem the 3.75% Notes, at its option (without regard to such sale price condition), in whole or in part. If a fundamental change, as defined in the Indenture for the 3.75% Notes, occurs at any time prior to maturity, holders of the 3.75% Notes may require the Company to repurchase their notes in whole or in part, for cash equal to 100% of the principal amount of the 3.75% Notes to be repurchased, plus accrued and unpaid interest. If a holder elects to convert its 3.75% Notes upon the occurrence of a make-whole fundamental change, as defined in the Indenture for the 3.75% Notes, the holder may be entitled to receive an additional number of shares of common stock on the conversion date. These additional shares are intended to compensate the holders for the loss of the time value of the conversion option and are set forth in the Indenture to the 3.75% Notes. In no event will the number of shares issuable upon conversion of a note exceed 50,5816 per \$1,000 principal amount (subject to adjustment as described in the Indenture for the 3.75% Notes). The 3.75% Notes are unsecured and are equal in right of payment to the 5.375% Notes.

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. At September 30, 2012, the Company separately accounted for and determined that these derivatives had de minimus value.

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, 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. 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 portion of the debt discount related to the value of the conversion feature was recorded as additional paid-in capital. The total debt discount of \$25.8 million related to the modified debt 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.

Cash interest expense related to the \$143.8 million in principal amount of 3.75% Notes was \$1.3 million and \$4.0 million in the three and nine months ended September 30, 2012, respectively. Cash interest expense related to \$143.8 million in principal amount of 3.75% Notes was \$1.3 million in the three and nine months ended September 30, 2011.

As of September 30, 2012 the Company included \$101.5 million on its balance sheet in long-term debt related to the 3.75% Notes. As of September 30, 2012, the 3.75% Notes have a remaining term of 3.75 years.

## **5. Net Loss Per Share**

Basic net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding for the period, excluding unvested restricted common shares. Diluted net loss per share is computed using the weighted average number of common shares outstanding and, when dilutive, potential common share equivalents from options, restricted stock units and warrants (using the treasury-stock method), and potential common shares from convertible securities (using the if-converted method). Because the Company reported a net loss for the three and nine months ended September 30, 2012 and 2011, 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:

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	Three and Nine Months Ended	
	September 30,	
	2012	2011
5.375% Convertible Senior Notes	702,701	702,701
3.75% Convertible Senior Notes	5,487,642	5,487,642
Unvested restricted stock units	863,651	648,215
Outstanding options	2,693,936	2,861,536
Outstanding warrants	62,752	62,752
Total dilutive common shares	<u>9,810,682</u>	<u>9,762,846</u>

## 6. Accounts Receivable

The components of accounts receivable are as follows:

	As of	
	September 30, 2012	December 31, 2011
	(In thousands)	
Trade receivables	\$ 36,998	\$ 30,211
Allowance for doubtful accounts	(6,853)	(7,021)
	<u>\$ 30,145</u>	<u>\$ 23,190</u>

## 7. Inventories

Inventories consist of the following:

	As of	
	September 30, 2012	December 31, 2011
	(In thousands)	
Raw materials	\$ 2,704	\$ 3,528
Work-in-process	1,527	359
Finished goods	10,858	7,951
	<u>\$ 15,089</u>	<u>\$ 11,838</u>

## 8. Other Intangible Assets

Other intangible assets consist of the following:

	As of	
	September 30, 2012	December 31, 2011
	(In thousands)	
Customer relationships	\$ 30,100	\$ 30,100
Tradename	2,800	2,800
Total intangible assets	\$ 32,900	\$ 32,900
Less: accumulated amortization	(8,542)	(3,898)
Total	<u>\$ 24,358</u>	<u>\$ 29,002</u>

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 (see Footnote 3 for further description). 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. The

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amortization of other intangible assets was approximately \$1.4 million and \$4.6 million for the three and nine months ended September 30, 2012, respectively. The amortization of other intangible assets was approximately \$1.7 million and \$2.2 million for the three and nine months ended September 30, 2011, respectively. Amortization expense for the year ending December 31, 2012 is expected to be approximately \$6.0 million. As of September 30, 2012, the weighted average amortization period of the Company's intangible assets is approximately ten years.

### 9. Goodwill

The Company follows the provisions of FASB ASC Topic 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. Goodwill and indefinite-lived assets are tested for impairment at least annually. In accordance with ASC 350-20, the Company tests goodwill for impairment on an annual basis or whenever events and circumstances indicate there might be an impairment. The Company's goodwill arose in connection with the acquisition of Neighborhood Diabetes in June 2011. No goodwill impairment loss was recorded in the nine months ended September 30, 2012.

### 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 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:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2012	2011	2012	2011
	(In thousands)		(In thousands)	
Balance at the beginning of the period	\$ 1,822	\$ 1,795	\$ 1,960	\$ 1,873
Warranty expense	645	792	1,867	2,171
Warranty claims settled	(661)	(725)	(2,021)	(2,182)
Balance at the end of the period	<u>\$ 1,806</u>	<u>\$ 1,862</u>	<u>\$ 1,806</u>	<u>\$ 1,862</u>

	As of	
	September 30, 2012	December 31, 2011
	(In thousands)	
Composition of balance:		
Short-term	\$ 769	\$ 940
Long-term	1,037	1,020
	<u>\$ 1,806</u>	<u>\$ 1,960</u>

### 11. Commitments and Contingencies

#### *Operating Leases*

The Company leases its facilities in Massachusetts, New York, 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 Company has extended the leases of its facilities in Bedford and Billerica, Massachusetts. Following the extensions, these leases expire in September 2014. The leases for Bedford contain a five year renewal option and escalating payments over the life of the lease. The leases in Woburn, Singapore and New York expire in June 2013, July 2013 and April 2015, respectively.

During the nine months ended September 30, 2012, the Company terminated a lease for one of its corporate office spaces in Bedford, Massachusetts. The lease termination resulted in no material impact to the financial statements for the nine months ended September 30, 2012. During the same period, the Company entered into a new lease agreement for an additional 26,500 square feet in Bedford, Massachusetts. The lease expires in September 2014 and includes escalating payments over its term.

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 of these leases as of September 30, 2012, are as follows (in thousands):

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<u>Year Ending December 31,</u>	<u>Minimum Lease Payments</u>
2012 (remaining)	398
2013	1,392
2014	914
2015	45
Total	<u>\$ 2,749</u>

### ***Legal Proceedings***

In August 2010, Becton, Dickinson and Company (“BD”), filed a lawsuit in the United States District Court in the State of New Jersey against the Company alleging that the OmniPod System infringes three of its patents. BD seeks a declaration that the Company has infringed its patents, equitable relief, including an injunction that would enjoin the Company from infringing these patents and an unspecified award for monetary damages. The Company believes that the OmniPod System does not infringe these patents. The Company expects that this litigation will not have a material adverse impact on its financial position or results of operations. The Company believes it has meritorious defenses to this lawsuit; however, litigation is inherently uncertain and there can be no assurance as to the ultimate outcome or effect of this action.

In a letter received in March 2007, Medtronic, Inc. invited the Company to discuss its “taking a license to certain Medtronic patents.” In October 2012, Medtronic MiniMed Inc., Medtronic Puerto Rico Operations Co. and MiniMed Distribution Corp. (collectively, “Medtronic”) filed a lawsuit alleging that the Company infringes the two patents referenced in their 2007 letter which are owned by Medtronic MiniMed Inc. and licensed to Medtronic Puerto Rico Operations Co. and MiniMed Distribution Corp., in United States District Court for the Central District of California. Medtronic seeks a declaration that the Company has infringed its patents, equitable relief, including an injunction that would enjoin the Company from infringing these patents and as unspecified award for monetary damages. The patents referenced by this lawsuit relate to technology that is material to the Company’s business. The Company believes that the OmniPod System does not infringe these patents. The Company believes it has meritorious defenses to this lawsuit; however, litigation is inherently uncertain and there can be no assurance as to the ultimate outcome or effect of this action.

### ***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 September 30, 2012, 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 June 2011, in connection with the acquisition of Neighborhood Diabetes, the Company issued 1,197,631 shares of its common stock at a price of \$20.40 per share, as partial consideration for the acquisition.

The Company grants share-based awards to employees under its Amended and Restated 2007 Stock Option and Incentive Plan (the “2007 Plan”) 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. In May 2012, shares available for grant under the 2007 Plan were increased by 3,775,000 shares. Stock-based compensation expense related to share-based awards recognized in the three and nine months ended September 30, 2012 was \$2.3 million and \$7.5 million, respectively, and was calculated based on awards ultimately expected to vest. Stock-based compensation expense related to share-based awards recognized in the three and nine months ended September 30, 2011 was \$1.8 million and \$5.6 million, respectively. At September 30, 2012, the Company had \$23.8 million of total unrecognized compensation expense related to stock options and restricted stock units.

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**Stock Options**

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

	<u>Number of Options (#)</u>	<u>Weighted Average Exercise Price (\$)</u>	<u>Aggregate Intrinsic Value (\$)</u> (In thousands)
Balance, December 31, 2011	2,814,591	\$ 11.02	
Granted	448,100	19.14	
Exercised	(465,470)	6.38	\$ 6,266(1)
Canceled	(103,285)	15.16	
Balance, September 30, 2012	<u>2,693,936</u>	\$ 13.01	\$ 23,192
Vested, September 30, 2012	1,625,317	\$ 10.64	\$ 17,875(2)
Vested and expected to vest, September 30, 2012 (3)	2,305,620		\$ 21,041(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 September 30, 2012 and the exercise price of the underlying options.
- (3) Represents the number of vested options as of September 30, 2012, plus the number of unvested options expected to vest as of September 30, 2012, based on the unvested options outstanding as of September 30, 2012, adjusted for the estimated forfeiture rate of 16%.

At September 30, 2012 there were 2,693,936 options outstanding with a weighted average exercise price of \$13.01 per share and a weighted average remaining contractual life of 6.9 years. At September 30, 2012 there were 1,625,317 options exercisable with a weighted average exercise price of \$10.64 per share and a weighted average remaining contractual life of 5.8 years.

Employee stock-based compensation expense related to stock options recognized in the three and nine months ended September 30, 2012 was \$1.2 million and \$3.7 million, respectively, and was based on awards ultimately expected to vest. Employee stock-based compensation related to stock options recognized in the three and nine months ended September 30, 2011 was \$1.2 million and \$3.2 million, respectively. At September 30, 2012, the Company had \$10.2 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 September 30, 2012 and 2011 the Company had zero shares contingently issued under the employee stock purchase plan ("ESPP"). In the three and nine months ended September 30, 2012 and 2011, the Company recorded no significant stock-based compensation charges related to the ESPP.

**Restricted Stock Units**

In the nine months ended September 30, 2012, the Company awarded 498,500 restricted stock units to certain employees. The restricted stock units were granted under the 2007 Plan and vest annually over three to four years from the grant date. The restricted stock units granted have a weighted average fair value of \$19.11 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 nine months ended September 30, 2012 were valued at approximately \$9.5 million on their grant date, and the Company is recognizing the compensation expense over the vesting period. Approximately \$1.1 million and \$3.8 million of stock-based compensation expense related to the vesting of restricted stock units was recognized in the three and nine months ended September 30, 2012, respectively. Approximately \$0.7 million and \$2.4 million of stock-based compensation expense related to the vesting of restricted stock units was recognized in the three and nine months ended September 30, 2011, respectively. Approximately \$13.6 million of the fair value of the restricted stock units remained unrecognized as of September 30, 2012. Under the terms of the award, 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:

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	Number of Shares (#)	Weighted Average Fair Value (\$)
Balance, December 31, 2011	603,882	\$ 17.12
Granted	498,500	19.11
Vested	(200,812)	16.85
Forfeited	(37,919)	17.80
Balance, September 30, 2012	<u>863,651</u>	<u>\$ 18.30</u>

### 13. Income Taxes

For the three months ended September 30, 2012, income tax expense was comprised of \$15,000 for the current portion and \$13,000 for the deferred portion. For the nine months ended September 30, 2012, income tax expense was comprised of \$78,000 for the current portion and \$65,000 for the deferred portion. The current portion primarily related to state, local, and foreign taxes. The deferred portion primarily related to U. S. 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. At September 30, 2012 and December 31, 2011, the Company had deferred tax liabilities of \$0.6 million including in other long-term liabilities on its consolidated balance sheet. There have been no significant changes in the Company's valuation allowance in the three and nine months ended September 30, 2012.

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. This amount gives rise to the need for additional valuation allowance.

## 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 legislation; 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 other third-party suppliers on which we are dependent; failure by us to retain supplier pricing discounts and achieve satisfactory gross margins; failure by us to retain key supplier and payor partners; international business risks; our inability to obtain adequate coverage or reimbursement from third-party payors for the OmniPod System and potential adverse changes in reimbursement rates or policies relating to the OmniPod; failure to retain key partner payors and their members; failure to retain and manage successfully our Medicare and Medicaid business; potential adverse effects resulting from competition with competitors; technological innovations adversely affecting our business; potential termination of our license to incorporate a blood glucose meter into the OmniPod System; 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 the proprietary rights of others; adverse regulatory or legal actions relating to the OmniPod System; failure to obtain timely regulatory approval for the sale of the next generation OmniPod System; failure of our contract manufacturers or component suppliers to comply with FDA's quality system regulations, the potential violation of federal or state laws prohibiting "kickbacks" or protecting patient health information, or any challenges to or investigations into our practices under these laws; product liability lawsuits that may be brought against us; reduced retention rates; 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 physician associations or other organizations that are unfavorable to our products; the concentration of substantially all of our manufacturing capacity at a single location in China and substantially all of our inventory at a single location in Massachusetts; our ability to attract and retain key personnel; our ability to manage our growth; fluctuations in quarterly results of operations; risks associated with potential future acquisitions; the costs associated with the acquisition of Neighborhood Diabetes; 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 controls; the volatility of our common stock; risks related to future sales of our common stock or the conversion of the 5.375% or 3.75% 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, 2012 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 sale of diabetes supplies, including our proprietary OmniPod Insulin Management System (the "OmniPod System") as well as blood glucose testing supplies, traditional insulin pumps, pump supplies, and other pharmaceuticals. Our proprietary OmniPod System consists of our disposable OmniPod insulin infusion device and our handheld, wireless Personal Diabetes Manager ("PDM"). The U.S. Food and Drug Administration ("FDA"), approved the OmniPod System in January 2005. In October 2005, we shipped our first commercial OmniPod System. In June 2011, we acquired Neighborhood Holdings, Inc. and their wholly-owned subsidiaries (collectively, "Neighborhood Diabetes") in order to expand our full suite diabetes management product offerings and obtain access to a larger number of insulin dependent patients.

We sell the OmniPod System and other diabetes management supplies in the United States through direct sales to customers or through our distribution partners. The OmniPod System is currently available in multiple countries in Europe through our exclusive distribution partner, Ypsomed Distribution AG ("Ypsomed") and in Canada through our exclusive distribution partner, GlaxoSmithKline Inc. ("GSK").

Our total revenue was \$54.8 million and \$153.5 million for the three and nine months ended September 30, 2012, respectively. Our total revenue was \$44.6 million and \$105.1 million for the three and nine months ended September 30, 2011, respectively.

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. We are aligning third-party payor contracts to be

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able to better leverage our cross-selling initiatives. As we expand our sales and marketing focus, increase our manufacturing capacity, expand to additional international markets and broaden our high-touch patient model, 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 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 as well as our high-touch patient model 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.

We currently produce the OmniPod System on a partially automated manufacturing line 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 12 month forecast that we provide. The agreement may be terminated at any time by either party 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. By purchasing OmniPods manufactured by Flextronics in China, we have been able to substantially increase production volumes for the OmniPod and reduce our per unit production cost.

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. This, as well as the introduction of our next generation OmniPod, is important as we strive to achieve profitability. We believe our current manufacturing capacity is sufficient to meet our expected 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 nine months ended September 30, 2012, we incurred net losses of \$12.4 million and \$41.7 million, respectively. As of September 30, 2012, we had an accumulated deficit of \$482.7 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 September 30, 2012, we had \$158.8 million of convertible debt outstanding. Of the \$158.8 million of convertible debt outstanding, \$15.0 million matures in June 2013 and approximately \$143.8 million matures in June 2016.

Our long-term financial objective is to achieve and sustain profitable growth. Our efforts in the remainder of 2012 will be focused primarily on the FDA approval of our next generation OmniPod System in the United States, production capacity and launch of our next generation OmniPod System in certain European countries. Our next generation OmniPod System is now available in certain countries in Europe through our distribution partner, Ypsomed. Achieving these objectives is expected to require additional investments in certain personnel and initiatives to allow for us to increase our penetration in the United States and international markets. We believe that we will continue to incur net losses in the near term in order to achieve these objectives. However, we believe that the accomplishment of our near-term objectives will have a positive impact on our financial condition in the future.

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 12 months.

### **Acquisition of Neighborhood Diabetes**

In June 2011, we acquired all of the outstanding shares of Neighborhood Diabetes, a durable medical equipment distributor specializing in direct to consumer sales of diabetes supplies, including pharmaceuticals, and support services. Neighborhood Diabetes provides more than 60,000 customers with Type 1 and Type 2 diabetes, primarily in the northeast and southeast regions of the United States with blood glucose testing supplies, traditional insulin pumps, pump supplies and pharmaceuticals, as well as other products for the management and treatment of diabetes. Neighborhood Diabetes is based in Massachusetts, with additional offices in New York and Florida. At the time of the acquisition, Neighborhood Diabetes employed approximately 200 people across the three locations. The acquisition of Neighborhood Diabetes provides us with full suite diabetes management product offerings, accelerates our sales force expansion, strengthens our back office support capabilities, expands our access to insulin dependent patients, and provides pharmacy adjudication capabilities to drive incremental sales higher. The aggregate purchase price of approximately \$62.4 million consisted of approximately \$37.9 million in cash paid at closing, 1,197,631 shares of our common stock valued at approximately \$24.4 million, or \$20.40 per share based on the closing price of our common stock on the acquisition date, and contingent consideration with a fair value of approximately \$0.1 million. Of the \$37.9 million of cash paid at closing, \$6.6 million is being held in an escrow account to reimburse us and our affiliates, if necessary, for certain claims for which we and our affiliates are entitled to be indemnified pursuant to the terms of the agreement and plan of merger with Neighborhood Diabetes.

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We have accounted for the acquisition of Neighborhood Diabetes as a business combination. Under business combination accounting, the assets and liabilities of Neighborhood Diabetes were recorded as of the acquisition date, at their respective fair values, and consolidated with our results. The excess of the purchase price over the fair value of net assets acquired was recorded as goodwill. The operating results of Neighborhood Diabetes have been included in the consolidated financial statements since June 2011, the period in which the acquisition was completed. The purchase price allocation, including an independent appraisal for intangible assets, has been prepared based on the information that was available to management at the time the consolidated financial statements were prepared. The allocation of the purchase price was finalized during the year ended December 31, 2011. The purchase price has been allocated as follows (in thousands):

Calculation of allocable purchase price:	
Cash	\$37,855
Common stock	24,432
Contingent consideration obligations	61
Total allocable purchase price	<u>\$62,348</u>
Allocation of purchase price:	
Accounts receivable	\$ 5,897
Inventories	2,336
Prepaid expenses and other current assets	242
Property and equipment	391
Customer relationships	30,100
Tradenames	2,800
Goodwill	26,647
Other assets	253
Accounts payable	4,109
Accrued expenses	1,700
Other long-term liabilities	509
	<u>\$62,348</u>

In connection with acquisition of Neighborhood Diabetes, we incurred transaction costs of approximately \$3.2 million, which consisted primarily of banking, legal, accounting and other administrative fees. These costs were recorded as general and administrative expense in the nine months ended September 30, 2011.

### Financial Operations Overview

*Revenue.* We derived 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 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. We received FDA approval of the OmniPod System in January 2005 and began commercial sale in the U.S. in October 2005. We are currently selling our OmniPod System through our distribution agreement with Ypsomed in multiple countries, including Germany, the United Kingdom, the Netherlands and Switzerland. We entered into an amendment to the distribution agreement with Ypsomed in April 2012 which increased the number of countries and extended the expiration of the agreement for an additional year. We are currently selling our OmniPod System through our distribution agreement with GSK in Canada.

In March 2008, we received a cash payment from Abbott Diabetes Care, Inc., (“Abbott”), for an agreement fee in connection with execution of the first amendment to the development and license agreement with Abbott. We are recognizing the payment as revenue over the five year term of the agreement. In addition, Abbott agreed to pay us certain amounts for services performed in connection with each sale of a PDM that includes an Abbott Discrete Blood Glucose Monitor to customers in certain territories. We recognize the revenue related to this portion of the Abbott agreement at the time we meet the criteria for revenue recognition, typically at the time of the sale of the PDM to the patient.

In June 2011, we entered into a development agreement with a U.S. based pharmaceutical company (the “Development Agreement”). Under the Development Agreement, we are 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 estimated two year term of the Development Agreement, we have and expect to continue to invoice amounts as we meet certain defined deliverable milestones. Revenue on the Development Agreement is recognized using a proportional performance methodology based on costs incurred and total payments under the agreement.

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As of September 30, 2012 and December 31, 2011, we had deferred revenue of \$1.1 million and \$2.7 million, respectively. These amounts include product-related revenue, unrecognized amounts related to the Development Agreement, as well as the non-amortized portion of the Abbott agreement fee.

For the year ending December 31, 2012, we expect our revenue to continue increase as we leverage our high-touch patient model to gain new customers in the United States and are expanding 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 and awareness grows, the successful introduction of our next generation OmniPod System, 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 packaging costs related to the OmniPod System, the cost of products we acquire from third party suppliers, and costs incurred related to the Development Agreement. Cost of revenue will continue to increase in line with an increase in revenues.

*Research and development.* Research and development expenses consist primarily of personnel costs within our product development, regulatory and clinical functions, and the costs of clinical studies and product development projects. We expense all research and development costs as incurred. For the remainder of the year ending December 31, 2012, we expect overall research and development spending to remain consistent with current levels as we finalize the validation of our next generation OmniPod System manufacturing lines with Flextronics and continue research and development work on potential new product introductions.

*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. We expect general and administrative expenses for the remainder of 2012 to decrease from current levels.

*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 for the remainder of 2012 to increase from current levels as we continue expansion of our sales force to support the growth of our existing business and introduce our next generation OmniPod System.

## Results of Operations

The following table presents certain statement of operations information for the three and nine months ended September 30, 2012 and 2011:

	Three Months Ended September 30,			Nine Months Ended September 30,		
	2012 (In thousands)	2011 (In thousands)	% Change	2012 (In thousands)	2011 (In thousands)	% Change
Revenue	\$ 54,752	\$ 44,594	23%	\$ 153,541	\$ 105,063	46%
Cost of revenue	30,362	26,033	17%	86,524	58,431	48%
Gross profit	24,390	18,561	31%	67,017	46,632	44%
Operating expenses:						
Research and development	6,559	4,638	41%	18,512	16,059	15%
General and administrative	12,731	11,379	12%	38,416	31,585	22%
Sales and marketing	13,571	12,312	10%	39,974	30,943	29%
Total operating expenses	32,861	28,329	16%	96,902	78,587	23%
Operating loss	(8,471)	(9,768)	13%	(29,885)	(31,955)	6%
Other expense, net	(3,918)	(3,794)	3%	(11,645)	(10,876)	7%
Income tax expense	(28)	—	100%	(143)	—	100%
Net loss	<u>\$(12,417)</u>	<u>\$(13,562)</u>	8%	<u>\$(41,673)</u>	<u>\$(42,831)</u>	3%

## Comparison of the Three and Nine Months Ended September 30, 2012 and 2011

### Revenue

Our total revenue was \$54.8 million and \$153.5 million for the three and nine months ended September 30, 2012, respectively, as compared to \$44.6 million and \$105.1 million, respectively, for the same periods in 2011. The increase in the three month period is due to continued adoption of the OmniPod System by patients in the United States and internationally, as well as expansion of sales of other diabetes supplies to our existing patient base. The increase in the nine month period was primarily related to the expansion of sales of other diabetes supplies to our existing patient base as a result of the June 2011 acquisition of Neighborhood Diabetes.

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### *Cost of Revenue*

Cost of revenue was \$30.4 million and \$86.5 million for the three and nine months ended September 30, 2012, respectively, as compared to \$26.0 million and \$58.4 million, respectively, for the same periods in 2011. The increase in cost of revenue is due to higher sales volumes as our patient base continues to increase.

### *Research and Development*

Research and development expenses increased \$2.0 million, or 41%, to \$6.6 million for the three months ended September 30, 2012, compared to \$4.6 million for the same period in 2011. The increase was primarily a result of a \$0.8 million increase in products used for research and development, an increase of \$0.8 million in outside services including additional requirements for regulatory approval of the next generation OmniPod System, and an increase of \$0.4 million in employee related expenses including stock-based compensation.

Research and development expenses increased \$2.4 million, or 15%, to \$18.5 million for the nine months ended September 30, 2012, compared to \$16.1 million for the same period in 2011. The increase was primarily a result of an increase of \$2.2 million in outside services mainly related to the development and regulatory approval of the next generation OmniPod System and an increase of \$1.8 million in employee related expenses including stock-based compensation. These increases were offset in part by a \$1.6 million reduction in products used for research and development purposes.

### *General and Administrative*

General and administrative expenses increased \$1.3 million, or 12%, to \$12.7 million for the three months ended September 30, 2012, compared to \$11.4 million for the same period in 2011. This increase was primarily the result of an increase of \$1.1 million related to sales and use tax compliance and a \$0.6 million increase in product shipping expenses due to higher shipment volumes. These increases were offset by a decrease of \$0.3 million in employee related expenses, including stock-based compensation.

General and administrative expenses increased \$6.8 million, or 22%, to \$38.4 million for the nine months ended September 30, 2012, compared to \$31.6 million for the same period in 2011. This increase was a result of an increase in employee related expenses, including stock-based compensation, of \$1.4 million, a \$2.4 million increase in amortization expense on the customer relationship and tradename assets related to the June 2011 acquisition of Neighborhood Diabetes, a \$1.7 million increase in product shipping expenses due to higher shipment volumes, a \$1.2 million increase related to sales and use tax compliance, a \$1.5 million increase in administrative and consulting services, and a \$0.7 million increase in bad debt expense. These increases were offset in part by \$3.2 million related to the transactions costs for the acquisition of Neighborhood Diabetes recorded in June 2011.

### *Sales and Marketing*

Sales and marketing expenses increased \$1.3 million, or 10%, to \$13.6 million for the three months ended September 30, 2012, compared to \$12.3 million for the same period in 2011. This increase was primarily a result of employee related expenses, including increased stock-based compensation expense of \$1.4 million due to the on-going expansion of our sales force.

Sales and marketing expenses increased \$9.1 million, or 29%, to \$40.0 million for the nine months ended September 30, 2012, compared to \$30.9 million for the same period in 2011. This increase was primarily a result of employee related expenses, including increased stock-based compensation expense of \$8.2 million and additional outside services costs primarily related to customer support functions. Of the \$8.2 million increase, \$6.4 million relates to the operations of Neighborhood Diabetes which was acquired in June 2011.

### *Other Expense, Net*

Other expense, net mainly consists of interest income and expense. Net interest expense was \$3.9 million for the three months ended September 30, 2012 compared to \$3.8 million for the same period in 2011. Net interest expense was \$11.6 million for the nine months ended September 30, 2012 compared to \$10.9 million for the same period in 2011. The increase in net interest expense for the three and nine months ended September 30, 2012 is primarily the result of additional interest expense due to the issuance of the 3.75% Notes (as defined below) and modification of the 5.375% Notes (as defined below) in June 2011.

### *Income Taxes*

Income tax expense was \$28,000 and \$143,000 for the three and nine months ended September 30, 2012. 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 U.S. Federal and State tax amounts.

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### 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. In June 2011, we acquired all of the outstanding shares of Neighborhood Diabetes. The aggregate purchase price of approximately \$62.4 million included approximately \$37.9 million in cash paid at closing. Of the \$37.9 million, \$6.6 million is being held in an escrow account to reimburse us and our affiliates, if necessary, with respect to claims for which we and our affiliates are entitled to be indemnified pursuant to the applicable agreements. As of September 30, 2012, we had \$63.4 million in cash and cash equivalents. We believe that our current 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 at least the next twelve months.

### Equity

In June 2011, in connection with the acquisition of Neighborhood Diabetes, we issued 1,197,631 shares of our common stock with a value of \$20.40 per share on the issuance date, as partial consideration for the acquisition.

In May 2012 the Company increased the number of shares available for grant under the Amended and Restated 2007 Stock Option and Incentive Plan (the "2007 Plan") by 3,775,000 shares.

### Debt

At September 30, 2012 and December 31, 2011, we had outstanding convertible debt and related financing costs on our balance sheet as follows (in thousands):

	As of	
	September 30, 2012	December 31, 2011
Principal amount of the 5.375% Convertible Senior Notes	\$ 15,000	\$ 15,000
Principal amount of the 3.75% Convertible Senior Notes	143,750	143,750
Unamortized discount	(43,099)	(50,210)
Total debt	115,651	108,540
Current portion of long-term debt	14,134	—
Long-term debt	\$ 101,517	\$ 108,540
Deferred financing costs	\$ 2,152	\$ 2,597

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

	Three Months Ended		Nine Months Ended	
	September 30, 2012	September 30, 2011	September 30, 2012	September 30, 2011
Contractual coupon interest	\$ 1,549	\$ 1,549	\$ 4,647	\$ 3,834
Accretion of debt discount	2,420	2,143	7,111	4,992
Other interest payments	—	—	—	1,992
Amortization of debt issuance costs	148	146	445	389
	\$ 4,117	\$ 3,838	\$ 12,203	\$ 11,207

### 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") in a private placement to qualified institutional buyers pursuant to Rule 144A under the Securities Act of 1933, as amended. The interest rate on the notes is 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 are convertible into our common stock at an initial conversion rate of 46.8467 shares of common

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stock per \$1,000 principal amount of the 5.375% Notes, which is equivalent to a conversion price of approximately \$21.35 per share, representing a conversion premium of 34% to the last reported sale price of our common stock on the NASDAQ Global Market on June 10, 2008, subject to adjustment under certain circumstances, at any time beginning on March 15, 2013 or under certain other circumstances and prior to the close of business on the business day immediately preceding the final maturity date of the notes. The 5.375% Notes will be 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.

If a fundamental change, as defined in the Indenture for the 5.375% Notes, occurs at any time prior to maturity, holders of the 5.375% Notes may require us to repurchase their notes in whole or in part for cash equal to 100% of the principal amount of the notes to be repurchased, plus accrued and unpaid interest, including any additional interest to, but excluding, the date of repurchase. If a holder elects to convert its 5.375% Notes upon the occurrence of a make-whole fundamental change, as defined in the Indenture for the 5.375% Notes, the holder may be entitled to receive an additional number of shares of common stock on the conversion date. These additional shares are intended to compensate the holders for the loss of the time value of the conversion option and are set forth in the Indenture to the 5.375% Notes. In no event will the number of shares issuable upon conversion of a note exceed 62.7746 per \$1,000 principal amount (subject to adjustment as described in the Indenture for the 5.375% Notes).

We recorded a debt discount of \$26.9 million to equity to reflect the value of our nonconvertible debt borrowing rate of 14.5% per annum. This debt discount is being amortized as non-cash interest expense over the five year term of the 5.375% Notes. We incurred deferred financing costs related to this offering of approximately \$3.5 million, of which \$1.1 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 5.375% Notes.

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.

Cash interest expense related to the 5.375% Notes was \$0.2 million and \$0.6 million for the three and nine months ended September 30, 2012, respectively. Cash interest expense related to the 5.375% Notes was \$0.2 million and \$2.5 million for the three and nine months ended September 30, 2011, respectively.

As of September 30, 2012, we included approximately \$14.1 million on our balance sheet in the current portion of long-term debt related to the 5.375% Notes. The 5.375% Notes have a remaining term of 9 months.

### **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, subject to adjustment under certain circumstances. The 3.75% Notes are convertible prior to March 15, 2016 only upon the occurrence of certain circumstances. On and after March 15, 2016 and prior to the close of business on the second scheduled trading day immediately preceding the final maturity date of the 3.75% Notes, the notes may be converted without regard to the occurrence of any such circumstances. 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 for the principal amount. We intend to settle the principal in cash.

We may not redeem the 3.75% Notes prior to June 20, 2014. From June 20, 2014 to June 20, 2015, we may redeem the 3.75% Notes, at our option, in whole or in part, only if the last reported sale price per share of our common stock has been at least 130% of the conversion price then in effect for at least 20 trading days during a period of 30 consecutive trading days. On and after June 20, 2015, we may redeem the 3.75% Notes, at our option (without regard to such sale price condition), in whole or in part. If a fundamental change, as defined in the Indenture for the 3.75% Notes, occurs at any time prior to maturity, holders of the 3.75% Notes may require us to repurchase their notes in whole or in part for cash equal to 100% of the principal amount of the notes to be repurchased, plus accrued and unpaid interest. If a holder elects to convert their 3.75% Notes upon the occurrence of a make-whole fundamental change, as defined in the Indenture for the 3.75% Notes, the holder may be entitled to receive an additional number of shares of common stock on the conversion date. These additional shares are intended to compensate the holders for the loss of the time value of the conversion option and are set forth in the Indenture to the 3.75% Notes. In no event will the number of shares issuable upon conversion of a 3.75% Note exceed 50.5816 per \$1,000 principal amount (subject to adjustment as described in the Indenture for the 3.75% Notes). The 3.75% Notes are unsecured and are equal in right of payment to the 5.375% Notes.

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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 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. At September 30, 2012, we determined that these derivatives had de minimus value.

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, 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. This transaction was treated as a modification of the existing 5.375% Notes. We accounted for this modification of a portion of the 5.375% Notes 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 portion of the debt discount related to the value of the conversion feature was recorded as additional paid-in capital. The total debt discount of \$25.8 million related to the modified debt 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.

Cash interest expense related to the \$143.8 million in principal amount of 3.75% Notes was \$1.3 million and \$4.0 million in the three and nine months ended September 30, 2012, respectively. Cash interest expense related to the \$143.8 million in principal amount of 3.75% Notes was \$1.3 million in the three and nine months ended September 30, 2011.

We included \$101.5 million on our balance sheet in long-term debt related to the 3.75% Notes at September 30, 2012. As of September 30, 2012, the 3.75% Notes have a remaining term of 3.75 years.

### *Operating Activities*

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

	Nine Months Ended	
	September 30,	
	2012	2011
	(In thousands)	
Cash used in operating activities	\$(23,466)	\$(17,784)
Net loss	\$(41,673)	\$(42,831)

For each of the periods above, the net cash used in operating activities was attributable primarily to the growth of our operations after adjustment for non-cash expenses. Adjustments for non-cash items were approximately \$25.5 million and \$20.4 million in the nine months ended September 30, 2012 and 2011, respectively. Non-cash items mainly consist of depreciation and amortization, stock-based compensation and non-cash interest expense.

Uses of cash from operations in the nine months ended September 30, 2012 include an increase in accounts receivable of \$9.3 million and an increase in inventories of \$3.3 million, offset in part by a increase in accounts payable and accruals of \$8.7 million. Uses of cash from operations in the nine months ended September 30, 2011 include a decrease in deferred revenue of \$2.1 million offset by a reduction in accounts receivable of \$3.8 million and an increase in accounts payable and accruals of \$1.9 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:

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	Nine Months Ended	
	September 30,	
	2012	2011
	(In thousands)	
Cash used in investing activities	\$(8,936)	\$(46,693)
Cash provided by financing activities	\$ 1,890	\$ 55,015

Cash used in investing activities in the nine months ended September 30, 2012 was primarily for the purchase of manufacturing equipment for use in the production of our next generation OmniPod System. Cash used in investing activities in the nine months ended September 30, 2011 primarily related to the acquisition of Neighborhood Diabetes. We paid approximately \$37.9 million in cash as partial consideration for that acquisition.

Cash provided by financing activities in the nine months ended September 30, 2012 is mainly related to the net proceeds from the issuance of common stock in connection with the exercise of employee stock options. Cash provided by financing activities in the nine months ended September 30, 2011 mainly related to the net proceeds from the issuance of the 3.75% Notes, offset by the repurchase of \$70 million principal of the 5.375% Notes for \$85.1 million.

*Commitments and Contingencies*

We lease facilities in Massachusetts, New York, 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. We have extended the leases of our facilities in Bedford and Billerica, Massachusetts. Following these extensions, these leases expire in September 2014. The leases for Bedford contain a five year renewal option and escalating payments over the life of the leases. The leases in Woburn, Massachusetts, Singapore and New York, expire in June 2013, July 2013 and April 2015, respectively. As of September 30, 2012, we had an outstanding letter of credit which totaled \$0.1 million to cover our security deposits for lease obligations.

During the nine months ended September 30, 2012, we terminated a lease for one of our corporate office spaces in Bedford, Massachusetts. The lease termination resulted in no material impact to the financial statements for the nine months ended September 30, 2012. During the same period, we entered into a new lease agreement for an additional 26,500 square feet in Bedford, Massachusetts. That lease expires in September 2014 and includes escalating payments over its term.

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 September 30, 2012 (in thousands):

Contractual Obligations	Payments Due in					
	Total	2012 Remaining	2013	2014	2015	2016
Operating lease obligations	\$ 2,749	\$ 398	\$ 1,392	\$ 914	\$ 45	\$ —
Debt obligations (1)	180,891	3,098	20,790	5,391	5,391	146,221
<b>Total contractual obligations</b>	<b>\$183,640</b>	<b>\$ 3,496</b>	<b>\$22,182</b>	<b>\$6,305</b>	<b>\$5,436</b>	<b>\$146,221</b>

- (1) The interest rate on the convertible debt is 5.375% and 3.75% per annum. We have included future payments of interest on the long-term debt in our obligations.

At September 30, 2012, 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 September 30, 2012, 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 believe that the policies set forth below may involve a higher degree of judgment and complexity in their application than our other accounting policies and represent the critical accounting policies and estimates used in the preparation of our financial statements. If different assumptions or conditions were to prevail, the results could be materially different from our reported results.

### ***Revenue Recognition***

We generate nearly all of our revenue from sales of our 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 typically 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.

We offer a 45 day right of return for our OmniPod System sales to new patients, and we defer revenue to reflect estimated sales returns in the same period that the related product sales are recorded. Returns are estimated through a comparison of historical return data to our related sales. Historical rates of return are adjusted for known or expected changes in the marketplace when appropriate. Historically, sales returns have amounted to approximately 3% of gross product sales. When doubt exists about reasonable assuredness of collectability from specific customers, we defer revenue from sales of products to those customers until payment is received.

In March 2008, we received a cash payment from Abbott for an agreement fee in connection with execution of the first amendment to the development and license agreement between us and Abbott. We are recognizing the agreement fee received from Abbott over the initial five year term of the agreement. In addition, Abbott agreed to pay us certain amounts for services performed in connection with each sale of a PDM that includes an Abbott Discrete Blood Glucose Monitor to customers in certain territories. We recognize revenue related to this portion of the Abbott agreement at the time we meet the criteria for revenue recognition, typically at the time the revenue is recognized on the sale of the PDM to the patient.

In June 2011, we entered into a development agreement with a U.S. based pharmaceutical company ("the Development Agreement"). Under the Development Agreement, we are 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 estimated two year term of the Development Agreement, we have invoiced and expect to continue to invoice amounts as we meet certain defined deliverable milestones. Revenue from the Development Agreement is recognized using a proportional performance methodology based on efforts incurred and total payments under the agreement.

We had deferred revenue of \$1.1 million as of September 30, 2012. The deferred revenue recorded as of September 30, 2012 was comprised of product-related revenue, unrecognized amounts related to the Development Agreement, as well as the non-amortized portion of the Abbott agreement fee.

### ***Asset Valuation***

Asset valuation includes assessing the recorded value of certain assets, including accounts receivable, inventory and fixed assets. We use a variety of factors to assess valuation, depending upon the asset. Actual results may differ materially from our estimates. Inventories are held at the lower of their cost or market value. We periodically review inventories for potential impairment based on quantities on hand and expectations of future use. Property and equipment is stated at cost and depreciated using the straight-line method over the estimated useful lives of the respective assets. Leasehold improvements are amortized over their useful life or the life of the lease, whichever is shorter. We review long-lived assets, including property and equipment and intangibles, for impairment whenever events or changes in business circumstances indicate that the carrying amount of the assets may not be fully recoverable. We also review assets under construction to ensure certainty of their future installation and integration into the manufacturing process. An impairment loss would be recognized when

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estimated undiscounted future cash flows expected to result from the use of the asset and its eventual disposition are less than its carrying amount. Impairment, if any, is measured as the amount by which the carrying amount of a long-lived asset exceeds its fair value. We consider various valuation factors, principally planned use of the assets and discounted cash flows, to assess the fair values of long-lived assets.

### ***Income Taxes***

The Financial Accounting Standards Board (“FASB”) Accounting Standards Codification (“ASC”) 740-10, *Income Taxes* (“ASC 740-10”) clarifies the accounting for uncertainty in income taxes recognized in an entity’s financial statements. ASC 740-10 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. In addition, ASC 740-10 provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. As of September 30, 2012, we had \$0.2 million of unrecognized tax benefits recorded.

We have accumulated significant losses since its inception in 2000. Since the net operating losses may potentially be utilized in future years to reduce taxable income (subject to any applicable limitations), all of our tax years remain open to examination by the major taxing jurisdictions to which we are subject.

For the three months ended September 30, 2012, income tax expense was comprised of \$15,000 for the current portion and \$13,000 for the deferred portion. For the nine months ended September 30, 2012, income tax expense was comprised of \$78,000 for the current portion and \$65,000 for the deferred portion. The current portion primarily relates to state, local, and foreign taxes. The deferred portion primarily relates to U. S. Federal and State tax amounts.

### ***Stock-Based Compensation***

We account for stock-based compensation under the provisions of FASB ASC 718-10, *Compensation — Stock Compensation*. (“ASC 718-10”), which requires all share-based payments to employees, including grants of employee stock options, to be recognized in the income statement based on their fair values.

We use the Black-Scholes option pricing model to determine the weighted average fair value of options granted. We determine the intrinsic value of restricted stock units based on the closing price of our common stock on the date of grant. We recognize the compensation expense of share-based awards on a straight-line basis over the vesting period of the award.

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 our 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. We evaluate 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, we may be required to accelerate, increase or cancel any remaining unearned stock-based compensation expense.

In the three and nine months ended September 30, 2012, we recorded \$2.3 million and \$7.5 million of stock-based compensation expense, respectively.

### ***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 potential collection risk is identified. We estimate our allowance based on historical experience, assessment of specific risk, discussions with individual customers and various assumptions and estimates that we believe to be reasonable under the circumstances.

### ***Intangibles and Other Long-Lived Assets***

Our finite-lived intangible assets are stated at cost less accumulated amortization. We assess our 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. We assess the need for an impairment of 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 us to make significant judgments regarding future periods that are subject to some factors outside our 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 estimated life of the acquired customer relationships asset is 10 years. Intangible assets with determinable estimated lives are amortized over these lives. At September 30, 2012, intangibles assets related to the acquisition of Neighborhood Diabetes consisted of \$21.8 million of customer relationships and \$2.6 million of tradenames.

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### **Goodwill**

Goodwill represents the excess of the cost of the acquired Neighborhood Diabetes business over the fair value of identifiable net assets acquired. We perform an assessment of our goodwill for impairment on at least an annual basis or whenever events or changes in circumstances indicate there might be impairment.

Goodwill is evaluated at the reporting unit level. To test for impairment, we compare the carrying value of the reporting unit to its fair value. If the reporting unit's carrying value exceeds its fair value, we would record an impairment loss to the extent that the carrying value of goodwill exceeds its implied fair value.

### **Warranty**

We provide a four year warranty on our PDMs and may replace any OmniPods that do not function in accordance with product specifications. We estimate our 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 we continue to introduce new versions of existing products, we also consider the anticipated performance of the product over its warranty period in estimating warranty reserves. At September 30, 2012 the warranty reserve was \$1.8 million.

### **Recent Accounting Pronouncements**

In May 2011, the FASB issued ASU No. 2011-04 *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and IFRSs* ("ASU No. 2011-04"). ASU No. 2011-04 clarifies existing concepts regarding existing fair value principles. The amendments are effective in fiscal years beginning after December 15, 2011. We adopted the guidance in the first quarter of 2012. The adoption of these amendments did not have a material impact on our financial statements.

In September 2011, the FASB issued ASU No. 2011-08 *Testing Goodwill for Impairment* ("ASU No. 2011-08"). ASU No. 2011-08 provides guidance on simplifying the impairment testing for goodwill. A company may first assess the qualitative factors to determine whether it is more-likely-than-not that the fair value of a reporting unit is less than its carrying amount as a basis for determining whether it is necessary to perform the two-step goodwill impairment test on the reporting unit. The guidance is effective in fiscal years beginning after December 15, 2011, and we adopted the guidance in the first quarter of 2012. The adoption of this guidance did not have a material impact on our financial statements.

In July 2012, the FASB issued ASU No. 2012-02 *Intangibles – Goodwill and Other (Topic 350): Testing Indefinite-Lived Intangible Assets for Impairment* ("ASU No. 2012-02"). ASU No. 2012-02 gives a company the option to first assess qualitative factors to determine whether it is more-likely-than-not that the indefinite-lived intangible is impaired. Qualitative factors include related events and circumstances that could affect the significant inputs used in determining the fair value of the indefinite-lived intangible asset. The guidance is effective in fiscal years beginning after September 15, 2012. We believe the adoption of ASU No. 2012-02 will have no material impact on our financial statements.

### **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 September 30, 2012, we had outstanding debt recorded on our consolidated balance sheet of \$15.0 million related to our 5.375% Notes and \$143.8 million related to our 3.75% Notes. These amounts were offset by related debt discounts of \$43.1 million. As the interest rates on the 5.375% Notes and 3.75% Notes are fixed, changes in interest rates do not affect the value of our debt.

### **Item 4. Controls and Procedures**

#### **Disclosure Controls and Procedures**

As of September 30, 2012, 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

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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 September 30, 2012, 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 September 30, 2012 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

## **PART II — OTHER INFORMATION**

### **Item 1. Legal Proceedings**

In August 2010, Becton, Dickinson and Company, ("BD"), filed a lawsuit in the United States District Court in the State of New Jersey against us alleging that the OmniPod Insulin Management System (the "OmniPod System") infringes three of its patents. BD seeks a declaration that we have infringed its patents, equitable relief, including an injunction that would enjoin us from infringing these patents and an unspecified award for monetary damages. We believe that the OmniPod System does not infringe these patents. We do not expect this litigation to have a material adverse impact on our financial position or results of operations. We believe we have meritorious defenses to this lawsuit; however, litigation is inherently uncertain and there can be no assurance as to the ultimate outcome or effect of this action.

In a letter received in March 2007, Medtronic, Inc. invited us to discuss our "taking a license to certain Medtronic patents." In October 2012, Medtronic MiniMed Inc., Medtronic Puerto Rico Operations Co. and MiniMed Distribution Corp. (collectively, "Medtronic") filed a lawsuit alleging that we have infringed the two patents referenced in their 2007 letter which are owned by Medtronic MiniMed Inc. and licensed to Medtronic Puerto Rico Operations Co. and MiniMed Distribution Corp., in United States District Court for the Central District of California. Medtronic seeks a declaration that we infringe its patents, equitable relief, including an injunction that would enjoin us from infringing these patents and an unspecified award for monetary damages. The patents referenced by this lawsuit relate to technology that is material to our business. We believe that the OmniPod System does not infringe these patents. We believe we have meritorious defenses to this lawsuit; however, litigation is inherently uncertain and there can be no assurance as to the ultimate outcome or effect of this action.

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, 2011, 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. Except as set forth below, there have been no material changes in our risk factors from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2011.

We have updated or added the following risk factor to reflect our recent Medtronic litigation.

***Claims that our current or future products infringe or misappropriate the proprietary rights of others could adversely affect our ability to sell those products and cause us to incur additional costs.***

Substantial litigation over intellectual property rights exists in the medical device industry. We expect that we could be increasingly subject to third-party infringement claims as our revenue increases, the number of competitors grows and the functionality of products and technology in different industry segments overlaps. Third parties may currently have, or may eventually be issued, patents on which our current or future products or technologies may infringe. For example, we are aware of certain patents and patent applications owned by our competitors that cover different aspects of insulin infusion and the related devices. Any of these third parties might make a claim of infringement against us.

For example, in August 2010, BD filed a lawsuit in the United States District Court in the State of New Jersey against us alleging that the OmniPod System infringes three of its patents. BD seeks a declaration that we have infringed its patents, equitable relief, including an injunction that would enjoin us from infringing these patents, and an unspecified award for monetary damages.

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We believe we have meritorious defenses to these lawsuits; however, litigation is inherently uncertain and there can be no assurance as to the ultimate outcome or effect of this action. Both of these suits and any future patent claims to which we may be subject, regardless of outcome, will likely result in the expenditure of significant financial resources and the diversion of management’s time and resources. In addition, litigation may cause negative publicity, adversely impact prospective customers, cause product shipment delays, prohibit us from manufacturing, marketing or selling our current or future products, require us to develop non-infringing technology, make substantial payments to third parties or enter into royalty or license agreements, which may not be available on acceptable terms or at all. If a successful claim of infringement were made against us and we could not develop non-infringing technology or license the infringed or similar technology on a timely and cost-effective basis, our revenue may decrease substantially and we could be exposed to significant liability. A court could enter orders that temporarily, preliminarily or permanently enjoin us or our customers from making, using, selling, offering to sell or importing our current or future products, or could enter an order mandating that we undertake certain remedial activities.

### **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**

<u>Exhibit Number</u>	<u>Description of Document</u>
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 September 30, 2012, formatted in XBRL (eXtensible Business Reporting Language), as follows: (i) Consolidated Balance Sheets as of September 30, 2012 and December 31, 2011 (Unaudited) (ii) Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2012 and September 30, 2011 (Unaudited) (iii) Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2012 and September 30, 2011 (Unaudited) (iv) Notes to Condensed Consolidated Financial Statements (Unaudited)
§	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.

**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: November 8, 2012

/s/ Duane DeSisto

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

Date: November 8, 2012

/s/ Brian Roberts

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

**EXHIBIT INDEX**

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§	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.

## CERTIFICATION

I, Duane DeSisto, certify that:

- (1) I have reviewed this Quarterly Report on Form 10-Q of Insulet Corporation;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- (4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- (5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Duane DeSisto

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Duane DeSisto  
President and Chief Executive Officer

November 8, 2012

## CERTIFICATION

I, Brian Roberts, certify that:

- (1) I have reviewed this Quarterly Report on Form 10-Q of Insulet Corporation;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- (4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- (5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ Brian Roberts  
\_\_\_\_\_  
Brian Roberts  
Chief Financial Officer

November 8, 2012

**CERTIFICATION PURSUANT TO  
18 U.S.C. SECTION 1350,  
AS ADOPTED PURSUANT TO  
SECTION 906 OF THE SARBANES-OXLEY ACT OF 2002**

Pursuant to 18 U.S.C. § 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, each of the undersigned officers of Insulet Corporation, a Delaware corporation (the "Company"), does hereby certify with respect to the Quarterly Report of the Company on Form 10-Q for the period ended September 30, 2012, as filed with the Securities and Exchange Commission (the "Report") that, to his knowledge:

- (1) the Report fully complies with the requirements of section 13(a) or 15(d) of the Securities Exchange Act of 1934; and
- (2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

/s/ Duane DeSisto

Name: Duane DeSisto

Title: President and Chief Executive Officer

Date: November 8, 2012

/s/ Brian Roberts

Name: Brian Roberts

Title: Chief Financial Officer

Date: November 8, 2012