MASIMO CORP
Form 10-Q
May 07, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2018
OR
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from _________ to _________
Commission File Number 001-33642

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

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

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

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

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

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

Large accelerated filer ý	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	Smaller reporting company ¨
	Emerging growth company ¨

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards provided pursuant to Section 13(a) of the

Exchange Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
Indicate the number of shares outstanding of each of the issuer's classes of common stock, as of the latest practicable date:

Class	Number of Shares Outstanding as of March 31, 2018
Common stock, $0.001 par value	51,783,786

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

	March 31, 2018	December 30, 2017 As Adjusted
ASSETS		
Current assets		
Cash and cash equivalents	$369,498	$ 315,302
Accounts receivable, net of allowance for doubtful accounts of $1,717 and $2,116 at March 31, 2018 and December 30, 2017, respectively.	101,093	118,532
Inventories	91,062	92,259
Other current assets	34,663	33,601
Total current assets	596,316	559,694
Deferred costs and other contract assets	114,958	109,256
Property and equipment, net	164,236	164,096
Intangible assets, net	29,453	27,123
Goodwill	20,477	20,617
Deferred tax assets	20,026	19,981
Other non-current assets	4,093	4,668
Total assets	$949,559	$ 905,435
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities		
Accounts payable	$36,893	$ 33,780
Accrued compensation	28,704	39,515
Accrued and other current liabilities	30,824	24,254
Deferred revenue and other contract-related liabilities, current	34,509	32,105
Total current liabilities	130,930	129,654
Other non-current liabilities	52,118	51,757
Total liabilities	183,048	181,411
Commitments and contingencies		
Stockholders' equity		
Preferred stock, $0.001 par value; 5,000 shares authorized; 0 shares issued and outstanding at March 31, 2018 and December 30, 2017	—	—
Common stock, $0.001 par value; 100,000 shares authorized; 51,784 and 51,636 shares issued and outstanding at March 31, 2018 and December 30, 2017, respectively	52	52
Treasury stock, 15,255 and 15,059 shares at March 31, 2018 and December 30, 2017, respectively	(489,027)	(472,536)
Additional paid-in capital	475,538	461,494
Accumulated other comprehensive loss	(3,211)	(2,941)
Retained earnings	783,159	737,955
Total stockholders' equity	766,511	724,024
Total liabilities and stockholders' equity	$949,559	$ 905,435

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

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

	Three Months Ended	
	March 31, 2018	April 1, 2017 As Adjusted
Revenue:		
Product	$204,389	$182,466
Royalty and other revenue	8,564	14,177
Total revenue	212,953	196,643
Cost of goods sold	69,292	64,229
Gross profit	143,661	132,414
Operating expenses:		
Selling, general and administrative	71,175	66,087
Research and development	18,601	14,176
Total operating expenses	89,776	80,263
Operating income	53,885	52,151
Non-operating income	1,647	874
Income before provision for income taxes	55,532	53,025
Provision for income taxes	9,902	1,492
Net income	$45,630	$51,533
Net income per share:		
Basic	$0.88	$1.02
Diluted	$0.82	$0.93
Weighted-average shares used in per share calculations:		
Basic	51,709	50,652
Diluted	55,496	55,529

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

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

	Three Months Ended	
	March 31, 2018	April 1, 2017 As Adjusted
Net income	$45,630	$ 51,533
Other comprehensive income, net of tax:		
Unrealized gains (losses) from foreign currency translation adjustments	(270)	566
Comprehensive income	$45,360	$ 52,099

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

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

	Three Months Ended	
	March 31, 2018	April 1, 2017 As Adjusted
Cash flows from operating activities:		
Net income	$45,630	$51,533
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	5,241	4,736
Stock-based compensation	5,332	2,889
Loss on disposal of property, equipment and intangibles	429	144
Provision for doubtful accounts	(394)	60
Changes in operating assets and liabilities:		
Decrease (increase) in accounts receivable	17,776	(2,687)
Decrease (increase) in inventories	1,139	(7,381)
Increase in other current assets	(204)	(3,125)
Increase in deferred costs and other contract assets	(5,706)	(7,643)
Decrease in other non-current assets	644	878
Increase in accounts payable	2,363	1,470
Decrease in accrued compensation	(11,074)	(19,088)
Increase (decrease) in accrued liabilities	2,193	(94)
Increase (decrease) in income tax payable	6,318	(4,845)
Increase (decrease) in deferred revenue and other contract-related liabilities	2,381	(4,043)
(Decrease) increase in other non-current liabilities	(73)	1,094
Net cash provided by operating activities	71,995	13,898
Cash flows from investing activities:		
Purchases of property and equipment, net	(3,788)	(4,394)
Increase in intangible assets	(3,583)	(833)
Net cash used in investing activities	(7,371)	(5,227)
Cash flows from financing activities:		
Repayments of capital lease obligations	—	(69)
Proceeds from issuance of common stock	8,415	27,290
Payroll tax withholdings on behalf of employees for vested equity awards	(168)	—
Repurchases of common stock	(18,479)	—
Net cash provided by (used in) financing activities	(10,232)	27,221
Effect of foreign currency exchange rates on cash	(225)	414
Net increase in cash, cash equivalents, and restricted cash	54,167	36,306
Cash, cash equivalents and restricted cash at beginning of period	315,483	308,198
Cash, cash equivalents and restricted cash at end of period	$369,650	$344,504

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

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MASIMO CORPORATION
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

1. Description of the Company

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

The Company invented Masimo Signal Extraction Technology® (SET®), which provides the capabilities of Measure-through Motion and Low Perfusion™ pulse oximetry to address the primary limitations of conventional pulse oximetry. Over the years, the Company's product offerings have expanded significantly to also include rainbow® Pulse CO-Oximetry, with its ability to measure and monitor carboxyhemoglobin (SpCO®), methemoglobin (SpMet®), total hemoglobin concentration (SpHb®), fractional arterial oxygen saturation ($SpfO_2$™), Oxygen Content (SpOC™), Pleth Variability Index (PVi®), rainbow® Pleth Variability Index (RPVi™), respiration rate from the pleth (RRp®) and Oxygen Reserve Index (ORi™), acoustic respiration monitoring (RRa®), electrical brain function monitoring (SedLine®), and optical gas monitoring. The Company also developed the Root™ patient monitoring and connectivity platform, the Radical-7® and Rad-97™ bedside and portable patient monitors, the Radius-7® wearable wireless patient monitor and the Masimo Patient SafetyNet[1] remote patient surveillance monitoring system. These solutions and related products are based upon Masimo SET®, rainbow® and other proprietary algorithms. These software-based technologies are incorporated into a variety of product platforms depending on customers' specifications. This technology is supported by a substantial intellectual property portfolio that the Company has built through internal development and, to a lesser extent, acquisitions and license agreements.

2. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and note disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States of America (GAAP) have been condensed or omitted pursuant to such rules and regulations. The accompanying condensed consolidated financial statements have been prepared on the same basis as the annual financial statements and, in the opinion of management, reflect all adjustments, including normal recurring accruals, necessary to present fairly the Company's condensed consolidated financial statements. The accompanying condensed consolidated balance sheet as of December 30, 2017 was derived from the Company's audited consolidated financial statements at that date. The accompanying condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and related notes contained in the Company's Annual Report on Form 10-K for the fiscal year ended December 30, 2017 (fiscal year 2017), filed with the SEC on February 28, 2018. The results for the three months ended March 31, 2018 are not necessarily indicative of the results to be expected for the fiscal year ending December 29, 2018 (fiscal year 2018) or for any other interim period or for any future year.

As further discussed below in this Note 2 to these condensed consolidated financial statements, the Company adopted Financial Accounting Standards Board (FASB) Accounting Standards Update (ASU) No. 2014-09, Revenue (Topic 606): Revenue from Contracts with Customers (ASU 2014-09) effective December 31, 2017. All prior period amounts and disclosures set forth in this Quarterly Report on Form 10-Q have been updated to comply with the new standard, as indicated by the "as adjusted" notation.

Principles of Consolidation

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

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

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

Fiscal Periods
The Company follows a conventional 52/53 week fiscal year. Under a conventional 52/53 week fiscal year, a 52 week fiscal year includes four quarters of 13 fiscal weeks while a 53 week fiscal year includes three 13 fiscal week quarters and one 14 fiscal week quarter. The Company's last 53 week fiscal year was fiscal year 2014. Fiscal year 2018 is a 52 week fiscal year. All references to years in these notes to condensed consolidated financial statements are fiscal years unless otherwise noted.
Use of Estimates
The Company prepares its financial statements in conformity with GAAP, which requires the Company to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the dates of the financial statements and the reported amounts of revenues and expenses during the reporting periods. Significant estimates include the determination of accounts receivable allowances, inventory reserves, warranty reserves, rebate accruals, valuation of the Company's stock options, goodwill valuation, deferred taxes and any associated valuation allowances, royalty revenues, deferred revenue, deferred costs, uncertain income tax positions, litigation costs and related accruals. Actual results could differ from such estimates.
Reclassifications
Certain amounts in the accompanying condensed consolidated financial statements for prior periods have been reclassified to conform to the current period presentation.
Fair Value Measurements
Authoritative guidance describes a fair value hierarchy based on three levels of inputs, of which the first two are considered observable and the last unobservable, that may be used to measure fair value:
Level 1—Quoted prices in active markets for identical assets or liabilities.
Level 2—Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that can be corroborated by observable market data for substantially the full term of the assets or liabilities.
Level 3—Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.
Pursuant to current authoritative guidance, entities are allowed an irrevocable option to elect the fair value for the initial and subsequent measurement for specified financial assets and liabilities on a contract-by-contract basis. The Company did not elect to apply the fair value option under this guidance to specific assets or liabilities on a contract-by-contract basis. There were no transfers between Level 1, Level 2 and Level 3 inputs during the three months ended March 31, 2018. The Company carries cash and cash equivalents at cost, which approximates fair value. As of March 31, 2018 and December 30, 2017, the Company had an insignificant amount of other financial assets that were required to be measured under the fair value hierarchy, the measurement of which were based on level 1 and level 2 inputs.
Cash and Cash Equivalents
The Company considers all highly liquid investments with an original maturity from date of purchase of three months or less, or highly liquid investments that are readily convertible into known amounts of cash, to be cash equivalents.
Accounts Receivable and Allowance for Doubtful Accounts
Accounts receivable consist of trade receivables recorded upon recognition of revenue for product revenues, reduced by reserves for estimated bad debts and returns. Trade accounts receivable are recorded at the invoiced amount and do not bear interest. Credit is extended based on an evaluation of the customer's financial condition. Collateral is generally not required. The allowance for doubtful accounts is determined based on historical write-off experience, current customer information and other relevant factors, including specific identification of past due accounts, based on the age of the receivable in excess of the contemplated or contractual due date. Accounts are charged off against the allowance when the Company believes they are uncollectible.

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

Inventories

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

Property and Equipment

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

	Useful Lives
Aircraft and components	10 to 20 years
Buildings	39 years
Building improvements	7 to 15 years
Computer equipment	2 to 6 years
Demonstration units	3 years
Furniture and office equipment	2 to 6 years
Leasehold improvements	Lesser of useful life or term of lease
Machinery and equipment	5 to 10 years
Tooling	3 years
Vehicles	5 years

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

Intangible Assets

The Company’s policy is to renew its patents and trademarks. Total renewal costs for patents and trademarks for the three months ended March 31, 2018 and April 1, 2017 were $0.1 million and $0.2 million, respectively. As of March 31, 2018, the weighted-average number of years until the next renewal was one year for patents and six years for trademarks. Costs to renew patents and trademarks are capitalized and amortized over the remaining useful life of the intangible asset. The Company continually evaluates the amortization period and carrying basis of patents and trademarks to determine whether any events or circumstances warrant a revised estimated useful life or reduction in value. Capitalized application costs are charged to operations when it is determined that the patent or trademark will not be obtained or is abandoned.

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

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

the amount that the carrying amount of a reporting unit exceeds its fair value; or (b) the amount of the goodwill allocated to that reporting unit. The annual impairment test is performed during the fourth fiscal quarter.
The Company reviews long-lived assets and identifiable intangibles for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to the future undiscounted operating cash flow expected to be generated by the asset. If such asset is considered to be impaired, the impairment to be recognized is measured by the amount by which the carrying amount exceeds the fair value of the asset. Long-lived assets to be disposed of are reported at the lower of carrying amount or fair value less costs to sell.
No impairment of goodwill, intangible assets or other long-lived assets was recorded during each of the three months ended March 31, 2018 and April 1, 2017.
Revenue Recognition and Deferred Revenue
Effective December 31, 2017, the Company adopted ASU 2014-09, Revenue (Topic 606): Revenue from Contracts with Customers. Accounting Standards Codification (ASC) Topic 606 (ASC 606) provides a single, principles-based five-step model to be applied to all contracts with customers. ASC 606 generally provides for the recognition of revenue in an amount that reflects the consideration to which the Company expects to be entitled, net of allowances for estimated returns, discounts or sales incentives, as well as taxes collected from customers that are remitted to government authorities, when control over the promised goods or services are transferred to the customer.
The Company derives the majority of its product revenue from four primary sources: (i) direct sales under long-term sensor purchase agreements (LT Sensor Contracts) with end-user hospitals where the Company provides up-front monitoring equipment at no up-front charge in exchange for a multi-year sensor purchase commitment, (ii) other direct sales of noninvasive monitoring solutions to end-user hospitals, emergency medical response organizations and other direct customers; (iii) sales of noninvasive monitoring solutions to distributors who then typically resell to end-user hospitals, emergency medical response organizations and other customers; and (iv) sales of integrated circuit boards to OEM customers who incorporate the Company's embedded software technology into their multiparameter monitoring devices. Subject to customer credit considerations, the majority of such sales are made on open account using industry standard payment terms based on the geography within which the specific customer is located.
The Company enters into agreements to sell its monitoring solutions and services, sometimes as a part of arrangements with multiple performance obligations that include various combinations of product sales, equipment leases and services. In the case of contracts with multiple performance obligations, the authoritative guidance provides that the total consideration be allocated to each performance obligation on the basis of relative standalone selling prices. When a standalone selling price is not readily observable, the Company estimates the standalone selling price by considering multiple factors including, but not limited to, features and functionality of the product, geographies, type of customer, contractual prices pursuant to Group Purchasing Organization (GPO) contracts, the Company's pricing and discount practices, and other market conditions.
While the majority of the Company's revenue contracts and transactions contain standard business terms and conditions, there are some transactions that contain non-standard business terms and conditions. As a result, contract interpretation, judgment and analysis is required to determine the appropriate accounting, including: (i) the amount of the total consideration, including variable consideration, (ii) how the arrangement consideration should be allocated to each performance obligation when multiple performance obligations exist, including the determination of standalone selling price, (iii) when to recognize revenue on the performance obligations, and (iv) whether uncompleted performance obligations are essential to the functionality of the completed performance obligations. Changes in judgments on these assumptions and estimates could materially impact the timing of revenue recognition.
Sales under LT Sensor Contracts are generally structured such that the Company agrees to provide at no up-front charge certain monitoring-related equipment, software, installation, training and/or warranty support in exchange for the hospital's agreement to purchase sensors over the term of the agreement, which generally ranges from three to six years. The Company generally recognizes revenue for performance obligations related to software parameters under

LT Sensor Contracts with fixed annual commitments at the time such software is delivered to the customer. Revenue allocable to performance obligations related to sensor sales and monitoring-related equipment leased under LT Sensor Contracts is generally recognized as the sensors are delivered to the customer over the life of the contract.

Revenue from direct sales of products to the Company's end-user hospitals, emergency medical response organizations and other direct customers, as well as to its distributors, is generally recognized upon shipment or delivery to the customer based on the terms of the contract or underlying purchase order.

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

The Company provides certain customers with various sales incentives that may take the form of discounts or rebates. The Company estimates and provides allowances for these programs as a reduction to revenue at the time of sale. In general, customers do not have a right of return for credit or refund. However, the Company allows returns under certain circumstances. At the end of each period, the Company estimates and accrues for these returns as a reduction to revenue. The Company estimates the revenue constraints related to these forms of variable consideration based on various factors, including expected purchasing volumes, prior sales and returns history, and specific contractual terms and limitations.

The majority of the Company's royalty and other revenue arise from an agreement with Medtronic plc (Medtronic, formerly Covidien Ltd.) that provides for quarterly royalty payments to the Company based upon U.S. sales of certain Medtronic products. An estimate of these royalty revenues is recorded quarterly in the period earned based on historical results, adjusted for any new information or trends known to management at the time of estimation. This estimated revenue is adjusted prospectively when the Company receives the Medtronic royalty report, approximately sixty days after the end of the previous quarter. For the three months ended March 31, 2018 and April 1, 2017, the Company recognized royalty revenue pursuant to this agreement of approximately $8.1 million and $8.2 million, respectively.

From time-to-time, the Company also recognizes revenue related to non-recurring engineering (NRE) services provided to certain OEM customers. NRE revenue is generally recognized on a proportionate basis as the costs of performing such services are incurred by the Company.

Shipping and Handling Costs and Fees

All shipping and handling costs are expensed as incurred and are recorded as a component of cost of goods sold in the accompanying consolidated statements of operations. Charges for shipping and handling billed to customers are included as a component of product revenue in accordance with authoritative accounting guidance.

Taxes Collected From Customers and Remitted to Governmental Authorities

Pursuant to authoritative guidance, the Company's policy is to present revenue net of taxes collected from customers and remitted to governmental authorities.

Deferred Costs and Other Contract Assets

The costs of monitoring-related equipment leased to hospitals under LT Sensor Contracts are generally deferred and amortized to cost of goods sold over the life of the underlying contracts. Some of the Company's LT Sensor Contracts also contain provisions for certain payments to be made directly to the end-user hospital customer at the inception of the arrangement. These contractual incentive payments are generally deferred and amortized on a straight-line basis as contra-revenue over the life of the underlying LT Sensor Contract.

The Company records an unbilled contract receivable related to software delivered under LT Sensor Contracts with fixed annual commitments until such amounts are billed to the customer, which generally occurs at the time of delivery of the sensors over the term of the LT Sensor Contract.

The incremental costs of obtaining a contract with a customer are capitalized and deferred if the Company expects such costs to be recoverable over the life of the contract and the contract term is greater than one year. Such deferred costs generally relate to certain incentive sales commissions earned by the Company's internal sales team in connection with the execution of LT Sensor Contracts and are amortized to expense over the expected term of the underlying contract.

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

Product Warranty
The Company generally provides a warranty against defects in material and workmanship for a period ranging from six to forty-eight months, depending on the product type. In traditional sales activities, including direct and OEM sales, the Company establishes an accrued liability for the estimated warranty costs at the time of revenue recognition, with a corresponding provision to cost of sales. Customers may also purchase extended warranty coverage separately or as part of a long-term sensor purchase agreement. Revenue related to extended warranty coverage is recognized over the extended life of the contract, which is reasonably expected to be the period over which such services will be provided. The related extended warranty costs are expensed as incurred.
Changes in the product warranty accrual were as follows (in thousands):

	Three Months Ended	
	March 31, 2018	April 1, 2017
Warranty accrual, beginning of period	$1,149	$910
Accrual for warranties issued	430	334
Changes to pre-existing warranties (including changes in estimates)	(278)	61
Settlements made	(161)	(320)
Warranty accrual, end of period	$1,140	$985

Litigation Costs and Contingencies
The Company records a charge equal to at least the minimum estimated liability for a loss contingency or litigation settlement when both of the following conditions are met: (i) information available prior to issuance of the financial statements indicates that it is probable that a liability had been incurred at the date of the financial statements, and (ii) the range of loss can be reasonably estimated. The determination of whether a loss contingency or litigation settlement is probable or reasonably possible involves a significant amount of management judgment, as does the estimation of the range of loss given the nature of contingencies. Liabilities related to litigation settlements with multiple elements are recorded based on the fair value of each element. Legal and other litigation related expenses are recognized as the services are provided. The Company records insurance and other indemnity recoveries for litigation expenses when both of the following conditions are met: (a) the recovery is probable, and (b) collectability is reasonably assured. Insurance recoveries are only recorded to the extent the litigation costs to which they relate have been incurred and recognized in the financial statements.
Comprehensive Income
Authoritative accounting guidance establishes requirements for reporting and disclosure of comprehensive income and its components. Comprehensive income includes foreign currency translation adjustments and any related tax benefits that have been excluded from net income and reflected in stockholders' equity.
The change in accumulated other comprehensive loss was as follows (in thousands):

	Three Months Ended March 31, 2018
Accumulated other comprehensive loss, beginning of period	$(2,941)
Unrealized gains from foreign currency translation	(270)
Accumulated other comprehensive loss, end of period	$(3,211)

Net Income Per Share
Basic net income per share is computed by dividing net income by the weighted-average number of shares outstanding during the period. Net income per diluted share is computed by dividing the net income by the weighted-average

number of shares and potential shares outstanding during the period, if the effect of potential shares is dilutive. Potential shares include incremental shares of stock issuable upon the exercise of stock options and the vesting of both restricted share units (RSUs) and performance share units (PSUs). For the three months ended March 31, 2018 and April 1, 2017, weighted options to purchase 0.9 million and 0.1 million shares of common stock, respectively, were outstanding but not included in the computation of diluted net income per share because the effect of including such shares would have been antidilutive in the applicable period. For each of the three months ended March 31, 2018 and April 1, 2017, certain RSUs were considered contingently issuable shares as their vesting is contingent upon the occurrence of certain future events. Since such events had not occurred and were not considered probable of occurring as of March 31, 2018 and April 1, 2017, 2.7 million weighted average shares related to such RSUs have been excluded from the calculation of potential shares.

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

	Three Months Ended	
	March 31, 2018	April 1, 2017 As Adjusted
Net income	$45,630	$ 51,533
Basic net income per share:		
Weighted-average shares outstanding - basic	51,709	50,652
Net income per basic share	$0.88	$ 1.02
Diluted net income per share:		
Weighted-average shares outstanding - basic	51,709	50,652
Diluted share equivalent: stock options and RSUs	3,787	4,877
Weighted-average shares outstanding - diluted	55,496	55,529
Net income per diluted share	$0.82	$ 0.93

Supplemental Cash Flow Information

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

	Three Months Ended			
	March 31, 2018		April 1, 2017	
Cash paid during the year for:				
Interest	$	169	$	213
Income taxes	1,023		3,157	
Noncash investing and financing activities:				
Unpaid purchases of property, plant and equipment	$	1,492	$	1,203
Unsettled common stock proceeds from option exercises	794		2,560	
Reconciliation of cash, cash equivalents and restricted cash:				
Cash and cash equivalents	$	369,498	$	343,825
Restricted cash	152		679	
Total cash, cash equivalents and	$	369,650	$	344,504

restricted cash shown
in the statement of cash
flow

Seasonality

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

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Recently Adopted Accounting Pronouncements

In October 2016, the FASB issued ASU No. 2016-16, Income Taxes (Topic 740): Intra-Entity Transfers of Assets Other than Inventory (ASU 2016-16). The new standard eliminates the exception that allowed the income tax consequences of an intra-entity transfer of assets other than inventory to be deferred until the transferred asset was sold to a third party or otherwise recovered through use, and now requires recognition of such income tax consequences at the time the non-inventory asset is transferred. ASU 2016-16 is effective for annual and interim fiscal reporting periods beginning after December 15, 2017. The standard required companies to apply a modified retrospective approach with a cumulative catch-up adjustment to opening retained earnings in the period of adoption. Accordingly, we recorded a $0.4 million decrease to opening retained earnings and a corresponding increase to deferred tax assets of $0.1 million, and a decrease to prepaid taxes of $0.5 million during the three months ended March 31, 2018.

Effective December 31, 2017, the Company adopted ASU 2014-09, Revenue (Topic 606): Revenue from Contracts with Customers. ASC 606 provides a single, principles-based five-step model to be applied to all contracts with customers, and generally provides for the recognition of revenue in an amount that reflects the considerations to which the Company expects to be entitled when control over the promised goods or services are transferred to the customer. ASC 606 also enhances disclosures about revenue, provides additional guidance for transactions that were not previously addressed comprehensively and improves guidance for multiple-element arrangements. In addition, ASC 606 includes Subtopic 340-40, Other Assets and Deferred Costs - Contracts with Customers, which requires the deferral of incremental costs of obtaining a contract with a customer.

The Company adopted ASC 606 utilizing the full retrospective method of transition, which requires the Company to restate certain previously reported results, including the impact on the provision for income taxes. Adoption of the new standard resulted in changes to the Company's accounting policies for revenue recognition and related cost of goods sold, as well as the capitalization and deferral of certain commission expenses, and a cumulative increase to retained earnings of approximately $23.9 million and $17.1 million as of December 31, 2016 and December 30, 2017, respectively. The areas impacted by ASC 606 include: (i) the acceleration of certain revenue from product sales to distributors that was previously deferred under the "sell-through" method; (ii) the acceleration of revenue related to certain software/parameter sales; (iii) the aggregation of all contract modifications occurring prior to the beginning of the earliest period presented; (iv) the acceleration of costs related to equipment for which control transfers up-front under certain contracts, the future consideration for which will now be treated as an optional purchase; (v) the capitalization and amortization of certain contract-related costs that were previously expensed when incurred; and (vi) the corresponding income tax effects related to these adjustments.

The Company applied the new standard using certain practical expedients, including: (i) excluding disclosures of transaction prices allocated to remaining performance obligations when the Company expects to recognize such revenue for all periods prior to the date of initial application of ASC 606; (ii) not adjusting the promised amount of consideration for the effects of a significant financing component when the Company expects, at contract inception, that the period between the Company's transfer of a promised product or service to a customer and when the customer pays for that product or service will be one year or less; (iii) expensing costs as incurred for costs to obtain a contract when the amortization period would have been one year or less; (iv) not recasting revenue for contracts that begin and end in the same fiscal year; and (v) not assessing whether promised goods or services are performance obligations if they are immaterial in the context of the contract with the customer.

Pursuant to the full retrospective method of adoption under ASC 606, the Company has adjusted certain amounts previously reported in its unaudited condensed consolidated financial statements.

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The reconciliations below reflect the adoption of ASC 606, the adoption of ASU 2016-16 and certain other immaterial reclassifications (in thousands, except per share amounts):

Condensed Consolidated Balance Sheet:	December 30, 2017		
	As Previously Reported	Adjustments	As Adjusted
Accounts receivable	$121,309	$ (2,777)	$118,532
Inventories	95,944	(3,685)	92,259
Other current assets	31,563	2,038	33,601
Deferred costs and other contract assets	99,600	9,656	109,256
Deferred tax assets	23,898	(3,917)	19,981
Other non-current assets	10,782	(6,114)	4,668
Accrued and other liabilities	42,344	(18,090)	24,254
Deferred revenue and other contract liabilities, current	35,929	(3,824)	32,105
Retained earnings	720,842	17,113	737,955

Condensed Consolidated Statement of Operations:	April 1, 2017		
	As Previously Reported	Adjustments	As Adjusted
Product revenue	$178,097	$ 4,369	$182,466
Royalty and other revenue	8,205	5,972	14,177
Cost of goods sold	62,168	2,061	64,229
Selling, general and administrative	65,572	515	66,087
Provision (benefit) for income taxes	(1,265)	2,757	1,492
Net income	45,334	6,199	51,533
Net income per share:			
Basic	$0.90	$ 0.12	$1.02
Diluted	$0.82	$ 0.11	$0.93

Condensed Consolidated Statements of Cash Flows:	April 1, 2017		
	As Previously Reported	Adjustments	As Adjusted
Cash flows from operating activities:			
Net income	$45,334	$ 6,199	$51,533
Adjustments to reconcile net income to net cash provided by operating activities:			
Decrease in inventories	(7,655)	274	(7,381)
Decrease in other current assets	(3,106)	(19)	(3,125)
Decrease in deferred costs and other contract assets	(8,158)	515	(7,643)
Increase (decrease) in other non-current assets	(188)	1,066	878
Decrease in accrued liabilities	(1,960)	1,866	(94)
Decrease in income taxes payable	—	(4,845)	(4,845)
(Decrease) increase in deferred revenue and other contract liabilities	2,563	(6,606)	(4,043)
Increase in other non-current liabilities	1,094	—	1,094

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In January 2016, the FASB issued ASU No. 2016-01, Financial Instruments - Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities, (ASU 2016-01). The new standard requires that (i) all equity investments, other than equity-method investments, in unconsolidated entities generally be measured at fair value in net income, and (ii) changes in fair value due to instrument-specific credit risk be recognized separately in other comprehensive income when the fair value option has been elected for financial liabilities. ASU 2016-01 is effective for annual and interim fiscal reporting periods beginning after December 15, 2017. The Company adopted this standard during the three months ended March 31, 2018 and such adoption did not have a material impact on the Company's consolidated financial statements.

Recently Issued Accounting Pronouncements

In March 2018, the FASB issued ASU No. 2018-05, Income Taxes (Topic 740) Amendments to SEC Paragraphs Pursuant to SEC Staff Accounting Bulletin No. 118 (ASU 2018-05). ASU 2018-05 amends certain SEC material in ASC Topic 740 for the income tax accounting implications of the recently issued Tax Cuts and Jobs Act of 2017. The Company is currently evaluating the expected impact of this standard, but does not expect it to have a material impact on its consolidated financial statements upon adoption.

In February 2018, the FASB issued ASU No. 2018-02, Income Statement - Reporting Comprehensive Income (Topic 220): Reclassification of Certain Tax Effects from Accumulated Other Comprehensive Income (ASU 2018-02). The new standard, allows a reclassification from accumulated other comprehensive income to retained earnings for the tax effects resulting from "An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018" (the Reconciliation Act) that are stranded in accumulated other comprehensive income. The new standard also requires certain disclosures about stranded tax effects. The new standard, however, does not change the underlying guidance that requires that the effect of a change in tax laws or rates be included in income from continuing operations. ASU 2018-02 is effective for annual and interim periods beginning after December 15, 2018, with early adoption permitted. ASU 2018-02 must be applied either in the period of adoption or retrospectively to each period in which the effect of the change in the U.S. federal corporate income tax rate in the Reconciliation Act is recognized. The Company is currently evaluating the expected impact of this standard, but does not expect it to have a material impact on its consolidated financial statements upon adoption.

In June 2016, the FASB issued ASU No. 2016-13, Financial Instruments - Credit Losses (Topic 326): Measurement of Credit Losses on Financial Instruments (ASU 2016-13). The new standard requires entities to use a current expected credit loss model, which is a new impairment model based on expected losses rather than incurred losses. Under this model, an entity would recognize an impairment allowance equal to its current estimate of all contractual cash flows that the entity does not expect to collect. The entity's estimate would consider relevant information about past events, current conditions, and reasonable and supportable forecasts. ASU 2016-13 is effective for annual and interim fiscal reporting periods beginning after December 15, 2019, with early adoption permitted for annual reporting periods beginning after December 15, 2018. The Company is currently evaluating the expected impact of this standard but does not expect it to have a material impact on its consolidated financial statements upon adoption.

In February 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842) (ASU 2016-02). The new standard requires lessees to recognize most leases on their balance sheets but continue to recognize lease expenses in their income statement in a manner similar to current practice. The new standard states that a lessee will recognize a lease liability for the obligation to make lease payments and a right-of-use asset for the right to use the underlying asset for the lease term. Expense related to leases determined to be operating leases will be recognized on a straight-line basis, while those determined to be financing leases will be recognized following a front-loaded expense profile in which interest and amortization are presented separately in the income statement. ASU 2016-02 is effective for annual and interim fiscal reporting periods beginning after December 15, 2018, and early application is permitted. The Company is currently evaluating the expected impact of this standard on its consolidated financial statements, but anticipates that, among other things, the required recognition of a lease liability and related right-of-use asset will significantly increase both the assets and liabilities recognized and reported on its balance sheet. In addition, the Company anticipates that the classification of certain leases for which the Company is the lessor may change under the new guidance, resulting in the immediate expensing of certain costs that are currently deferred and expensed over the life of the lease. The Company currently expects to complete its assessment of the full financial impact of the new lease accounting guidance during the next twelve months.

3. Variable Interest Entity (VIE)

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

Cercacor is an independent entity that was spun off from the Company to its stockholders in 1998. Joe Kiani, the Company's Chairman and Chief Executive Officer (CEO), is also the Chairman and CEO of Cercacor. The Company is a party to a Cross-Licensing Agreement with Cercacor, which was most recently amended and restated effective January 1, 2007 (the Cross-Licensing Agreement), that governs each party's rights to certain intellectual property held by the two companies. The Company is also a party to certain other agreements with Cercacor. See Note 4 to these condensed consolidated financial statements for a description of the Company's various business relationships with Cercacor.

Based on authoritative consolidation guidance, the Company has determined that it is not the primary beneficiary of Cercacor as it does not have the power to direct the activities of Cercacor that most significantly impact Cercacor's economic performance and has no obligation to absorb Cercacor's losses.

4. Related Party Transactions

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

- Cross-Licensing Agreement - The Company and Cercacor are parties to the Cross-Licensing Agreement, which governs each party's rights to certain intellectual property held by the two companies. The Company is subject to certain annual minimum aggregate royalty obligations for use of the rainbow® licensed technology. The current annual minimum royalty obligation is $5.0 million. Aggregate liabilities to Cercacor arising under the Cross-Licensing Agreement were $2.5 million and $1.6 million for the three months ended March 31, 2018 and April 1, 2017, respectively.
- Administrative Services Agreement - The Company is a party to an administrative services agreement with Cercacor (G&A Services Agreement), which governs certain general and administrative services that the Company provides to Cercacor. Amounts charged by the Company pursuant to the G&A Services Agreement were less than $0.1 million and $0.1 million for the three months ended March 31, 2018 and April 1, 2017, respectively.
- Sublease Agreement - In March 2016, the Company entered into a sublease agreement with Cercacor for approximately 16,830 square feet of excess office and laboratory space located at 40 Parker, Irvine, California (Cercacor Sublease). The Cercacor Sublease began on May 1, 2016 and expires on November 30, 2019. The Company recognized less than $0.1 million and $0.1 million in sublease income for the three months ended March 31, 2018 and April 1, 2017, respectively.

Net amounts due to Cercacor at each of March 31, 2018 and December 30, 2017 were $2.6 million and $1.5 million, respectively.

The Company's CEO is also the Chairman of the Masimo Foundation for Ethics, Innovation and Competition in Healthcare (Masimo Foundation), a non-profit organization that was founded in 2010 to provide a platform for encouraging ethics, innovation and competition in healthcare. In addition, the Company's Executive Vice President (EVP) and General Counsel is a Director and also serves as the Secretary and Treasurer of the Masimo Foundation.

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

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

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In August 2017, the Company entered into an aircraft time share agreement, pursuant to which the Company has agreed from time to time to make its aircraft available to the CEO for lease on a time sharing basis. The Company charges the CEO for personal use based on agreed upon reimbursement rates. For the three months ended March 31, 2018, the Company charged the CEO less than $0.1 million related to such reimbursements.

5. Inventories

Inventories consist of the following (in thousands):

	March 31, 2018	December 30, 2017 As Adjusted
Raw materials	$ 32,315	$ 31,200
Work-in-process	7,435	8,619
Finished goods	51,312	52,440
Total inventories	$ 91,062	$ 92,259

6. Other Current Assets

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

	March 31, 2018	December 30, 2017 As Adjusted
Prepaid expenses	$ 18,363	$ 17,073
Royalties receivable	7,500	7,400
Customer note receivables	3,375	2,777
Prepaid income taxes	620	3,493
Employee loans and advances	361	364
Due from related party	21	39
Restricted cash	—	33
Other current assets	4,423	2,422
Total other current assets	$ 34,663	$ 33,601

7. Deferred Costs and Other Contract Assets

Deferred costs and other contract assets consist of the following (in thousands):

	March 31, 2018	December 30, 2017
Deferred cost of goods sold	$ 99,857	$ 93,261
Prepaid contract incentives	6,033	6,115
Deferred commissions	5,207	5,613
Unbilled contract receivables	3,861	4,267
Deferred costs and other contract assets	$ 114,958	$ 109,256

For the each of the three months ended March 31, 2018 and April 1, 2017, $0.4 million of prepaid contract incentives and $0.6 million of deferred commissions was amortized as a reduction to revenue and to selling, general and administrative expenses, respectively. For the three months ended March 31, 2018 and April 1, 2017, $7.3 million and $7.9 million, respectively, of deferred costs of goods sold was amortized to cost of goods sold.

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

	March 31, 2018	December 30, 2017
Building and building improvements	$88,215	$ 87,999
Machinery and equipment	49,842	47,556
Aircraft and vehicles	25,329	25,329
Land	23,762	23,762
Computer equipment	15,785	15,789
Leasehold improvements	15,649	15,326
Tooling	13,818	13,754
Furniture and office equipment	10,328	9,967
Demonstration units	491	486
Construction-in-progress (CIP)	6,994	6,365
Total property and equipment	250,213	246,333
Accumulated depreciation and amortization	(85,977)	(82,237)
Property and equipment, net	$164,236	$ 164,096

For the three months ended March 31, 2018 and April 1, 2017, depreciation expense of property and equipment was $4.0 million and $3.5 million, respectively.
The balances in CIP at March 31, 2018 and December 30, 2017 relate primarily to capitalized costs associated with the implementation of a new enterprise resource planning software system and manufacturing equipment, the underlying assets for which have not been completed or placed into service.
9. Intangible Assets
Intangible assets, net, consist of the following (in thousands):

	March 31, 2018	December 30, 2017
Patents	$21,558	$ 20,623
Licenses-related party	8,000	7,500
Customer relationships	7,669	7,669
Acquired technology	5,580	5,580
Trademarks	4,112	4,036
Capitalized software development costs	2,868	2,699
Other	5,466	3,691
Total intangible assets	55,253	51,798
Accumulated amortization	(25,800)	(24,675)
Intangible assets, net	$29,453	$ 27,123

Total amortization expense for the three months ended March 31, 2018 and April 1, 2017 was $1.1 million and $1.1 million, respectively. All of these intangible assets have a 10 year weighted average amortization period.

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

Fiscal year	Amount
2018 (balance of year)	$5,091
2019	3,748
2020	3,598
2021	3,345
2022	2,173
Thereafter	11,498
Total	$29,453

10. Other Non-Current Assets

Other assets, long-term consist of the following (in thousands):

	March 31, 2018	December 30, 2017
Prepaid deposits	$ 2,670	$ 3,286
Long term investments	1,271	1,234
Restricted cash[1]	152	148
Total other assets, long-term	$ 4,093	$ 4,668

[1] Restricted cash long term is generally related to collateral for certain lease deposits or other bank guarantees.

11. Accrued and Other Current Liabilities

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

	March 31, 2018	December 30, 2017 As Adjusted
Income taxes payable	$ 10,632	$ 4,292
Accrued indirect taxes payable	7,465	6,711
Accrued GPO fees	3,064	2,351
Related party payable	2,129	1,528
Accrued legal fees	1,546	975
Accrued warranty	1,140	1,149
Accrued donations	346	548
Accrued stock repurchases	—	1,988
Other	4,502	4,712
Total accrued and other current liabilities	$ 30,824	$ 24,254

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12. Deferred Revenue and Other Contract-Related Liabilities

Deferred revenue and other contract-related liabilities consist of the following (in thousands):

	March 31, 2018	December 30, 2017
Accrued customer reimbursements	$17,648	$ 16,896
Deferred revenue	12,385	11,589
Accrued rebates and incentives	4,407	3,598
Other contract-related liabilities	281	259
Total deferred revenue and other contract-related liabilities	34,721	32,342
Less: Non-current portion of deferred revenue	(212)	(237)
Deferred revenue and other contract-related liabilities - current	$34,509	$ 32,105

Deferred revenue relates to contracted amounts that have been invoiced to customers for which remaining performance obligations must be completed before the Company can recognize the revenue. These amounts primarily relate to undelivered equipment, sensors and services under long-term sensor purchase agreements, extended warranty agreements and NRE service agreements. Changes in deferred revenue for the three months ended March 31, 2018 were as follows:

	Three Months Ended March 31, 2018
Deferred revenue, beginning of the period	$11,589
Revenue deferred during the period	2,873
Recognition of revenue deferred in prior periods	(2,077)
Deferred revenue, end of the period	$12,385

Expected revenue from remaining contractual performance obligations (Unrecognized Contract Revenue) includes deferred revenue, as well as other amounts that will be invoiced and recognized as revenue in future periods, when the Company completes its performance obligations. While Unrecognized Contract Revenue is similar in concept to backlog, Unrecognized Contract Revenue excludes revenue allocable to monitoring-related equipment that is effectively leased to hospitals under LT Sensor Contracts and other contractual obligations for which neither party has performed. The following table summarizes the Company's estimated Unrecognized Contract Revenue as of March 31, 2018 and the future periods within which the Company expects to recognize such revenue. The estimated timing of this revenue is based, in part, on management's estimates and assumptions about when its performance obligations will be completed. As a result, the actual timing of this revenue in future periods may vary, possibly materially, from those reflected in this table.

	Expected Future Revenue By Period (in thousands)				
	Less than 1 year	Between 1-3 years	Between 3-5 years	More than 5 years	Total
Unrecognized Contract Revenue	$179,650	$241,482	$92,674	$ 15,412	$529,218

13. Other Non-Current Liabilities

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

	March 31, 2018	December 30, 2017
Income tax payable, long-term	$ 25,734	$ 25,734
Unrecognized tax benefits	14,715	14,348

Deferred tax liabilities, long-term	10,012	9,880
Deferred rent, long-term	1,267	1,266
Deferred revenue, long-term	212	237
Other	178	292
Total other non-current liabilities	$ 52,118	$ 51,757

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Unrecognized tax benefit relates to the Company's long-term portion of tax liability associated with uncertain tax positions. Authoritative guidance prescribes a recognition threshold and a measurement attribute for the financial statement recognition and measurement of tax positions taken or expected to be taken in a tax return. See Note 18 to these condensed consolidated financial statements for further details.

14. Stock Repurchase Program

In September 2015, the Company's Board of Directors (Board) authorized a stock repurchase program, whereby the Company can purchase up to 5.0 million shares of its common stock over a period of up to three years (2015 Repurchase Program). The 2015 Repurchase Program can be carried out at the discretion of a committee comprised of the Company's Chief Executive Officer and Chief Financial Officer through open market purchases, one or more Rule 10b5-1 trading plans, block trades and privately negotiated transactions. The total remaining shares authorized for repurchase under the 2015 Repurchase Program approximated 1.9 million shares as of March 31, 2018. The Company expects to fund the 2015 Repurchase Program through its available cash, cash expected to be generated from future operations and other potential sources of capital.

The following table provides a summary of the Company's stock repurchase activities during the three months ended March 31, 2018 and April 1, 2017 (in thousands, except per share amounts):

	Three Months Ended	
	March 31, 2018	April 1, 2017
Shares repurchased	198	—
Average cost per share	$84.14	$ —
Value of shares repurchased	$16,490	$ —

15. Stock-Based Compensation

Total stock-based compensation expense for the three months ended March 31, 2018 and April 1, 2017 was $5.3 million and $2.9 million, respectively. As of March 31, 2018, an aggregate of 13.4 million shares of common stock were reserved for future issuance under the Company's equity plans, of which 3.6 million shares were available for future grant under the Masimo Corporation 2017 Equity Incentive Plan (2017 Equity Plan). Additional information related to the Company's current equity incentive plans, stock-based award activity and valuation of stock-based awards is included below.

Equity Incentive Plans

2017 Equity Incentive Plan

On June 1, 2017, the Company's stockholders ratified and approved the 2017 Equity Plan. The 2017 Equity Plan permits the grant of stock options, restricted stock, RSUs, stock appreciation rights, PSUs, performance shares, performance bonus awards and other stock or cash awards to employees, directors and consultants of the Company and employees and consultants of any parent or subsidiary of the Company. The aggregate number of shares that may be awarded under the 2017 Equity Plan is 5.0 million shares.

The 2017 Equity Plan provides that at least 95% of the equity awards issued under the 2017 Equity Plan must vest over a period of not less than one year following the date of grant. The exercise price per share of each option granted under the 2017 Equity Plan may not be less than the fair market value of a share of the Company's common stock on the date of grant, which is generally equal to the closing price of the Company's common stock on the Nasdaq Global Select Market on the grant date.

2007 Stock Incentive Plan

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

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

	Three Months Ended March 31, 2018	
	Shares	Average Exercise Price
Options outstanding, beginning of period	6,953	$ 36.26
Granted	270	86.93
Canceled	(83)	47.36
Exercised	(314)	28.24
Options outstanding, end of period	6,826	$ 38.50
Options exercisable, end of period	4,003	$ 26.79

Total stock option expense for the three months ended March 31, 2018 and April 1, 2017 was $3.4 million and $2.8 million, respectively. As of March 31, 2018, the Company had $42.8 million of unrecognized compensation cost related to non-vested stock options that are expected to vest over a weighted average period of approximately 3.8 years. The weighted-average remaining contractual term of options outstanding with an exercise price less than the closing price of the Company's common stock as of March 31, 2018 was 5.9 years. The weighted-average remaining contractual term of options exercisable, with an exercise price less than the closing price of the Company's common stock as of March 31, 2018, was 4.4 years.
RSUs
The number of RSUs issued and outstanding under all of the Company's equity plans are as follows (in thousands, except for grant date fair value amounts):

	Three Months Ended March 31, 2018	
	Units	Weighted Average Grant Date Fair Value
RSUs outstanding, beginning of period	2,708	$ 95.51
Granted	—	—
Canceled	—	—
Expired	—	—
Vested	—	—
RSUs outstanding, end of period	2,708	$ 95.51

Total RSU expense for the three months ended March 31, 2018 and April 1, 2017 was $0.2 million and $0.1 million, respectively. As of March 31, 2018, the Company had $0.1 million of unrecognized compensation cost related to non-vested RSU awards expected to be recognized and vest over a weighted-average period of approximately 0.2 years.

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PSUs

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

	Three Months Ended March 31, 2018	
	Units	Weighted Average Grant Date Fair Value
PSUs outstanding, beginning of period	233	$ 90.70
Granted	197	86.95
Canceled	(86)	90.71
Expired	—	—
Vested	(31)	90.70
PSUs outstanding, end of period	313	$ 88.34

During the three months ended March 31, 2018, the Company awarded 197,000 PSUs that will vest three years from the award date, based on the achievement of certain 2020 performance criteria approved by the Board. If earned, the PSUs granted will vest upon achievement of the performance criteria after the year in which the performance achievement level has been determined. The number of shares that may be earned can range from 0% to 200% of the target amount; therefore, the maximum number of shares that can be issued under these awards is twice the original award of 197,000 PSUs or 394,000 shares. Based on management’s estimate of the number of units expected to vest, total PSU expense for the three months ended March 31, 2018 was $1.7 million. There were no PSUs outstanding as of April 1, 2017. As of March 31, 2018, the Company had $32.3 million of unrecognized compensation cost related to non-vested PSU awards expected to be recognized and vest over a weighted-average period of approximately 2.8 years.

Valuation of Stock-Based Award Activity

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

	Three Months Ended	
	March 31, 2018	April 1, 2017
Risk-free interest rate	2.3% to 2.7%	1.9% to 2.2%
Expected term (in years)	5.6	5.5
Estimated volatility	29.3% to 29.7%	29.7% to 30.1%
Expected dividends	0%	0%
Weighted-average fair value of options granted	$28.53	$25.25

The aggregate intrinsic value of options is calculated as the positive difference, if any, between the market value of the Company’s common stock on the date of exercise or the respective period end, as appropriate, and the exercise price of the options. The aggregate intrinsic value of options outstanding with an exercise price less than the closing price of the Company’s common stock as of March 31, 2018 was $338.5 million. The aggregate intrinsic value of options exercisable with an exercise price less than the closing price of the Company’s common stock as of March 31, 2018 was $244.9 million. The aggregate intrinsic value of options exercised during the three months ended March 31, 2018 was $19.1 million.

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

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16. Commitments and Contingencies
Leases
The Company leases certain facilities in North and South America, Europe, the Middle East and Asia-Pacific regions under operating lease agreements expiring at various dates through November 2026. Certain facility leases contain predetermined price escalations and in some cases renewal options. The Company recognizes the lease costs using a straight-line method based on total lease payments. The Company has received leasehold improvement incentives in connection with certain leased facilities in the U.S. These leasehold improvement incentives have been recorded as deferred rent and are being amortized as a reduction to rent expense on a straight-line basis over the life of the lease. As of each of March 31, 2018 and December 30, 2017, accrued rent expense in excess of the amount paid aggregated $1.5 million, which is classified within other current and non-current liabilities in the accompanying condensed consolidated balance sheets. In addition, the Company leases automobiles in the U.S. and Europe that are classified as operating leases and expire at various dates through November 2020. The majority of these leases are non-cancellable. The Company also has outstanding capital leases for office equipment and computer equipment, all of which are non-cancellable.
As of March 31, 2018, estimated future minimum lease payments, including interest, for each of the following fiscal years are as follows (in thousands):

	Total Operating Leases
2018 (balance of year)	$ 5,380
2019	5,926
2020	3,573
2021	2,216
2022	1,819
Thereafter	5,469
Total	$ 24,383

For the three months ended March 31, 2018 and April 1, 2017, rental expense related to operating leases was $1.8 million and $1.6 million, respectively.
Employee Retirement Savings Plan
The Company sponsors a qualified defined contribution plan or 401(k) plan, the Masimo Retirement Savings Plan (MRSP), covering the Company’s full-time U.S. employees who meet certain eligibility requirements. In general, the Company matches an employee’s contribution up to 3% of the employee’s compensation, subject to a maximum amount. The Company may also contribute to the MRSP on a discretionary basis. For the three months ended March 31, 2018 and April 1, 2017, the Company contributed $0.7 million and $0.6 million, respectively, to the MRSP.
In addition, the Company also sponsors various defined contribution plans in certain locations outside of the United States (Subsidiary Plans). For each of the three months ended March 31, 2018 and April 1, 2017, the Company contributed $0.1 million to the Subsidiary Plans.
Employment and Severance Agreements
In July 2017, the Company entered into the First Amendment to the certain Amended and Restated Employment Agreement entered into between the Company and Mr. Kiani on November 4, 2015 (as amended, the Amended Employment Agreement). Pursuant to the terms of the Amended Employment Agreement, upon a “Qualifying Termination” (as defined in the Amended Employment Agreement), Mr. Kiani will be entitled to receive a cash severance benefit equal to two times the sum of his then-current base salary and the average annual bonus paid to Mr. Kiani during the immediately preceding three years, the full amount of the Award Shares and the full amount of the Cash Payment. In addition, in the event of a “Change in Control” (as defined in the Amended Employment Agreement)

prior to a Qualifying Termination, on each of the first and second anniversaries of the Change in Control, 50% of the Cash Payment and 50% of the Award Shares will vest, subject in each case to Mr. Kiani's continuous employment through each such anniversary date; however, in the event of a Qualifying Termination or a termination of Mr. Kiani's employment due to death or disability prior to either of such anniversaries, any unvested amount of the Cash Payment and all of the unvested Award Shares shall vest and be paid in full. Additionally, in the event of a Change in Control prior to a Qualifying Termination, Mr. Kiani's stock options and any other equity awards will vest in accordance with

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their terms, but in no event later than in two equal installments on each of the one year and two year anniversaries of the Change in Control, subject in each case to Mr. Kiani's continuous employment through each such anniversary date. As of March 31, 2018, the expense related to the Award Shares and Cash Payment that would be recognized in the Company's consolidated financial statements upon the occurrence of a Qualifying Termination under the Restated Employment Agreement was approximately $292.9 million.

As of March 31, 2018, the Company had severance plan participation agreements with seven executive officers. The participation agreements (the Agreements) are governed by the terms and conditions of the Company's 2007 Severance Protection Plan (the Severance Plan), which became effective on July 19, 2007 and which was amended effective December 31, 2008. Under each of the Agreements, the applicable executive officer may be entitled to receive certain salary, equity, medical and life insurance benefits if he is terminated by the Company without cause or if he terminates his employment for good reason under certain circumstances. The executive officers are also required to give the Company six months advance notice of their resignation under certain circumstances.

Purchase Commitments

Pursuant to contractual obligations with vendors, the Company had $84.4 million of purchase commitments as of March 31, 2018, which are expected to be purchased within one year. These purchase commitments have been made for certain inventory items in order to secure sufficient levels of those items and to achieve better pricing.

Other Contractual Commitments

In the normal course of business, the Company may provide bank guarantees to support government hospital tenders in certain foreign jurisdictions. As of March 31, 2018, the Company had approximately $0.5 million in outstanding unsecured bank guarantees.

In certain circumstances, the Company also provides limited indemnification within its various customer contracts whereby the Company indemnifies the parties to whom it sells its products with respect to potential infringement of intellectual property, and against bodily injury caused by a defective Company product. It is not possible to predict the maximum potential amount of future payments under these or similar agreements, due to the conditional nature of the Company's obligations and the unique facts and circumstances involved. As of March 31, 2018, the Company had not incurred any significant costs related to contractual indemnification of its customers.

Concentrations of Risk

The Company is exposed to credit loss for the amount of its cash deposits with financial institutions in excess of federally insured limits. The Company invests its excess cash in time deposits with major financial institutions. As of March 31, 2018, the Company had $369.5 million of bank balances, of which $3.4 million was covered by either the U.S. Federal Deposit Insurance Corporation limit or foreign countries' deposit insurance organizations.

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

The Company's ability to sell its products to U.S. hospitals depends in part on its relationships with GPOs. Many existing and potential customers for the Company's products become members of GPOs. GPOs negotiate pricing arrangements and contracts, sometimes exclusively, with medical supply manufacturers and distributors, and these negotiated prices are made available to a GPO's affiliated hospitals and other members. During the three months ended March 31, 2018 and April 1, 2017, revenue from the sale of the Company's products to U.S. hospitals that are members of GPOs amounted to $119.1 million and $99.6 million, respectively.

For the three months ended March 31, 2018, the Company had sales to two just-in-time distributors that represented 13.6% and 10.7% of total revenue, respectively. For the three months ended April 1, 2017, the Company had sales to the same two just-in-time distributors that represented 13.8% and 12.1% of total revenue, respectively.

As of March 31, 2018, one just-in-time distributors represented 6.5% of the Company's accounts receivable balance, respectively. As of December 30, 2017, one different just-in-time distributors represented 6.5% of the Company's accounts receivable balance, respectively.