OMNICELL, Inc
Form 10-Q
November 03, 2017
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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 September 30, 2017

OR

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

For the transition period from to

Commission File No. 000-33043

OMNICELL, INC.
(Exact name of registrant as specified in its charter)

Delaware	94-3166458
(State or other jurisdiction of incorporation or organization)	(IRS Employer Identification No.)

590 East Middlefield Road
Mountain View, CA 94043
(Address of registrant's principal executive offices, including zip code)

(650) 251-6100
(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 o

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, 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 o

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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 o	Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o	Emerging growth company o

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

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

As of October 26, 2017, there were 37,932,401 shares of the registrant's common stock, $0.001 par value, outstanding.

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PART I. FINANCIAL INFORMATION
ITEM 1. CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)
OMNICELL, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS (UNAUDITED)

	September 30, 2017	December 31, 2016
	(In thousands, except par value)	
ASSETS		
Current assets:		
Cash and cash equivalents	$7,466	$ 54,488
Accounts receivable, net of allowances of $5,279 and $4,796, respectively	171,869	150,303
Inventories	92,239	69,297
Prepaid expenses	28,044	28,646
Other current assets	15,763	12,674
Total current assets	315,381	315,408
Property and equipment, net	40,219	42,011
Long-term investment in sales-type leases, net	15,986	20,585
Goodwill	334,780	327,724
Intangible assets, net	174,227	190,283
Long-term deferred tax assets	5,629	4,041
Other long-term assets	37,596	35,051
Total assets	$923,818	$ 935,103
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$51,182	$ 27,069
Accrued compensation	27,380	26,722
Accrued liabilities	33,061	31,195
Long-term debt, current portion, net	13,410	8,410
Deferred revenue, net	80,837	87,516
Total current liabilities	205,870	180,912
Long-term deferred revenue	16,376	17,051
Long-term deferred tax liabilities	40,527	51,592
Other long-term liabilities	9,625	8,210
Long-term debt, net	178,923	245,731
Total liabilities	451,321	503,496
Commitments and contingencies (Note 10)		
Stockholders' equity:		
Preferred stock, $0.001 par value, 5,000 shares authorized; no shares issued	—	—
Common stock, $0.001 par value, 100,000 shares authorized; 47,064 and 45,778 shares issued; 37,919 and 36,633 shares outstanding, respectively	47	46
Treasury stock at cost, 9,145 shares outstanding	(185,074)	(185,074)
Additional paid-in capital	565,406	525,758
Retained earnings	98,294	100,396
Accumulated other comprehensive loss	(6,176)	(9,519)
Total stockholders' equity	472,497	431,607
Total liabilities and stockholders' equity	$923,818	$ 935,103

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

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OMNICELL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS (UNAUDITED)

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
	(In thousands, except per share data)			
Revenues:				
Product	$135,103	$133,621	$362,089	$392,190
Services and other revenues	51,679	43,116	156,132	128,458
Total revenues	186,782	176,737	518,221	520,648
Cost of revenues:				
Cost of product revenues	79,725	76,188	225,051	224,412
Cost of services and other revenues	22,204	19,041	66,150	56,766
Total cost of revenues	101,929	95,229	291,201	281,178
Gross profit	84,853	81,508	227,020	239,470
Operating expenses:				
Research and development	16,414	15,264	50,128	42,896
Selling, general and administrative	58,725	61,316	186,818	189,912
Total operating expenses	75,139	76,580	236,946	232,808
Income (loss) from operations	9,714	4,928	(9,926)	6,662
Interest and other income (expense), net	(2,732)	(2,721)	(4,992)	(6,773)
Income (loss) before provision for income taxes	6,982	2,207	(14,918)	(111)
Provision for (benefit from) income taxes	751	224	(11,232)	(557)
Net income (loss)	$6,231	$1,983	$(3,686)	$446
Net income (loss) per share:				
Basic	$0.17	$0.05	$(0.10)	$0.01
Diluted	$0.16	$0.05	$(0.10)	$0.01
Weighted-average shares outstanding:				
Basic	37,698	36,332	37,266	36,020
Diluted	38,973	37,079	37,266	36,695

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

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OMNICELL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS) (UNAUDITED)

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
	(In thousands)			
Net income (loss)	$6,231	$1,983	$(3,686)	$446
Other comprehensive income (loss), net of reclassification adjustments:				
Unrealized gains (losses) on interest rate swap contracts	(74)	108	(45)	108
Foreign currency translation adjustments	1,389	(502)	3,388	(5,296)
Other comprehensive income (loss)	1,315	(394)	3,343	(5,188)
Comprehensive income (loss)	$7,546	$1,589	$(343)	$(4,742)

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

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OMNICELL, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS (UNAUDITED)

	Nine months ended September 30,	
	2017	2016
	(In thousands)	
Operating Activities		
Net income (loss)	$(3,686)	$446
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation and amortization	38,542	43,905
Loss on disposal of fixed assets	128	(9)
Share-based compensation expense	16,315	14,063
Income tax benefits from employee stock plans	11	1,256
Deferred income taxes	(11,071)	(4,767)
Amortization of debt financing fees	1,192	1,192
Changes in operating assets and liabilities, net of business acquisitions:		
Accounts receivable	(21,710)	(25,802)
Inventories	(22,942)	(7,745)
Prepaid expenses	602	(5,782)
Other current assets	(5,133)	(89)
Investment in sales-type leases	6,643	(5,296)
Other long-term assets	(150)	1,153
Accounts payable	23,717	5,573
Accrued compensation	658	(687)
Accrued liabilities	4,021	(1,901)
Deferred revenue	(7,354)	12,819
Other long-term liabilities	865	(2,299)
Net cash provided by operating activities	20,648	26,030
Investing Activities		
Purchases of intangible assets, intellectual property and patents	(160)	(1,311)
Software development for external use	(10,121)	(10,569)
Purchases of property and equipment	(9,374)	(10,005)
Business acquisitions, net of cash acquired	(4,446)	(271,458)
Net cash used in investing activities	(24,101)	(293,343)
Financing Activities		
Proceeds from debt	37,000	247,051
Repayment of debt and revolving credit facility	(100,000)	(25,000)
Payment for contingent consideration	(2,400)	(3,000)
Proceeds from issuances under stock-based compensation plans	26,468	16,516
Employees' taxes paid related to restricted stock units	(3,133)	(1,917)
Net cash provided by (used in) financing activities	(42,065)	233,650
Effect of exchange rate changes on cash and cash equivalents	(1,504)	(1,267)
Net decrease in cash and cash equivalents	(47,022)	(34,930)
Cash and cash equivalents at beginning of period	54,488	82,217
Cash and cash equivalents at end of period	$7,466	$47,287
Supplemental disclosure of non-cash activities		
Unpaid purchases of property and equipment	$886	$948
Effect of adoption of new accounting standard	$1,582	$—

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

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OMNICELL, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (UNAUDITED)

Note 1. Organization and Summary of Significant Accounting Policies

Business

Omnicell, Inc. was incorporated in California in 1992 under the name Omnicell Technologies, Inc. and reincorporated in Delaware in 2001 as Omnicell, Inc. Our major products are automated medication, supply control systems and medication adherence solutions which are sold in our principal market, which is the healthcare industry. Our market is primarily located in the United States and Europe. "Omnicell", "our", "us", "we" or the "Company" collectively refer to Omnicell, Inc. and its subsidiaries.

Basis of presentation

The accompanying unaudited Condensed Consolidated Financial Statements reflect, in the opinion of management, all adjustments, consisting of normal recurring adjustments and accruals, necessary to present fairly the financial position of the Company as of September 30, 2017 and December 31, 2016, the results of its operations, comprehensive income (loss) and cash flows for the three and nine months ended September 30, 2017 and September 30, 2016. Certain information and footnote disclosures normally included in financial statements prepared in accordance with U.S. generally accepted accounting principles (“GAAP”) have been condensed or omitted in accordance with the rules and regulations of the Securities and Exchange Commission (“SEC”). These unaudited Condensed Consolidated Financial Statements should be read in conjunction with the audited Consolidated Financial Statements and accompanying Notes included in the Company's annual report on Form 10-K for the year ended December 31, 2016 filed with the SEC on February 28, 2017. The Company's results of operations, comprehensive income (loss) and cash flows for the three and nine months ended September 30, 2017 are not necessarily indicative of results that may be expected for the year ending December 31, 2017, or for any future period.

Principles of consolidation

The Condensed Consolidated Financial Statements include the accounts of the Company and its subsidiaries. All intercompany accounts and transactions have been eliminated in consolidation.

Certain prior year amounts have been reclassified to conform to the 2017 presentation with the adoption of ASU 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. Additionally, see "Recently adopted authoritative guidance" for the effects of first quarter adoption of ASU 2016-09.

Use of estimates

The preparation of financial statements in accordance with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the Company's Condensed Consolidated Financial Statements and accompanying Notes. Management bases its estimates on historical experience and various other assumptions believed to be reasonable. Although these estimates are based on management's best knowledge of current events and actions that may impact the Company in the future, actual results may be different from the estimates. The Company's critical accounting policies are those that affect its financial statements materially and involve difficult, subjective or complex judgments by management. Those policies are revenue recognition, accounts receivable and notes receivable from investment in sales-type leases, inventory valuation, capitalized software development costs, valuation and impairment of goodwill, purchased intangibles and long-lived assets, fair value of assets acquired and liabilities assumed in business combination, share-based compensation, and accounting for income taxes.

Segment reporting

The Company's Chief Operating Decision Maker ("CODM") is its Chief Executive Officer. The CODM allocates resources and evaluates the performance of the Company's segments using information about its revenues, gross profit, and income from operations. Such evaluation excludes general corporate-level costs that are not specific to either of the reportable segments and are managed separately at the corporate level. Corporate-level costs include expenses related to executive management, finance and accounting, human resources, legal, training and development, and certain other administrative expenses. See Note 13, Segment and Geographical Information, for additional information on segment reporting.

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Recently adopted authoritative guidance

In March 2016, the FASB issued ASU No. 2016-09. This ASU simplifies several aspects of the accounting for share-based payment transactions, including the income tax consequences, classification of awards as either equity or liabilities, and classification on the statement of cash flows. The provision of ASU No. 2016-09 is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. The Company adopted the standard effective January 1, 2017. The impact of adoption was the recording of excess tax benefits within income tax expense, rather than in Additional Paid in Capital of $2.1 million and $4.7 million for the three and nine months ended September 30, 2017, respectively. Additionally, in the first quarter of 2017, the Company recognized the previously unrecognized excess tax benefits using the modified retrospective transition method, which resulted in a cumulative-effect adjustment of $1.6 million to retained earnings.

In January 2017, the FASB issued ASU 2017-04, Intangibles-Goodwill and Other (Topic 350): Simplifying the Test for Goodwill Impairment, which simplifies the accounting for goodwill impairment for all entities by requiring impairment charges to be based on the first step in today's two-step impairment test under ASC 350, "Intangibles-Goodwill and Other." Under the new guidance, if a reporting unit's carrying amount exceeds its fair value, an entity will record an impairment charge based on that difference. The impairment charge will be limited to the amount of goodwill allocated to that reporting unit. The standard eliminates the current ASC 350 requirement to calculate a goodwill impairment charge using Step 2. ASU 2017-04 is effective for annual and interim impairment tests performed in periods beginning after December 15, 2019. Early adoption is permitted for annual and interim goodwill impairment testing dates after January 1, 2017. The Company adopted ASU 2017-04 effective January 1, 2017. The adoption of this authoritative guidance did not have impact on the Company's Condensed Consolidated Financial Statements or related disclosures for the periods presented.

In January 2017, the FASB issued ASU 2017-01, Business Combinations, which clarifies the definition of a business and provides a screen to determine when a set of assets and activities is not a business. The screen requires that when substantially all of the fair value of the gross assets acquired (or disposed of) is concentrated in a single identifiable asset or a group of similar identifiable assets, the set is not a business. This screen reduces the number of transactions that need to be further evaluated. ASU 2017-01 is effective for fiscal years beginning after December 15, 2017, with early adoption permitted. The Company adopted ASU 2017-01 effective January 1, 2017. The adoption of this authoritative guidance did not have impact on the Company's Condensed Consolidated Financial Statements or related disclosures for the periods presented.

In August 2017, the FASB issued ASU 2017-12, Derivatives and Hedging (Topic 815), which simplifies the application of the hedge accounting guidance and improves the financial reporting, specifically simplifies designation and measurement for qualifying hedging relationships and the presentation of hedge results. ASU 2017-12 is effective for annual periods beginning after December 15, 2018 and interim periods within those annual periods with early adoption permitted. The Company adopted ASU 2017-12 effective August 1, 2017. The adoption of this authoritative guidance did not have impact on the Company's Condensed Consolidated Financial Statements or related disclosures for the periods presented.

Recently issued authoritative guidance

In May 2014, the FASB issued ASU 2014-09-Revenue from Contracts with Customers, which outlines a single, comprehensive model for entities to use in accounting for revenue arising from contracts with customers. The core principle of ASU 2014-09 is to recognize revenue when promised goods or services are transferred to customers in an amount that reflects the consideration that is expected to be received for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, accordingly, it is possible more judgment and estimates may be required within the revenue recognition process than is required under existing U.S. GAAP, including identifying performance obligations in the contract, estimating the amount of variable consideration to include in the transaction price and allocating the transaction price to each separate performance obligation. The FASB has recently issued several amendments to ASU 2014-09, including clarification on accounting for licenses of intellectual property and identifying performance obligations. ASU 2014-09 will be effective for the Company beginning January 1, 2018. The two permitted transition methods under ASU 2014-09 are the full retrospective method, in which case ASU 2014-09 would be applied to each prior reporting period presented and the cumulative effect of applying ASU

2014-09 would be recognized at the earliest period shown, or the modified retrospective method, in which case the cumulative effect of applying ASU 2014-09 would be recognized at the date of initial application. While the Company currently expects to apply the full retrospective method, the Company is continuing to evaluate the availability of information and resources necessary and may decide the benefit of applying the full retrospective method is not significant enough to support the cost.

Currently, the Company is in the process of reviewing its historical contracts to quantify the impact on its consolidated financial statements. The most significant impact of the standard relates to accounting for term software license revenue, contingent income, and commission expense. Specifically, under the standard the Company expects to recognize revenue on term software licenses upon installation of the license rather than ratably over the life of the term license. Additionally, the

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standard no longer requires deferral of contingent revenue in transactions where the amount charged to the customer for a particular performance obligation is less than the allocation of standalone selling price which will result in earlier recognition of revenue. Finally, the standard requires expense to be recognized for incremental costs incurred to obtain a contract, primarily commission expense, on a systematic basis that is consistent with the transfer to the customer of the product and services to which the cost relates, including an estimate of the period of service renewals for the transaction. Currently, the Company recognizes commission expense at the time of recognizing the related product revenue. The Company is also in the process of assessing the appropriate changes to its business processes and upgrading its systems and controls to support recognition and disclosure under ASU 2014-09. The Company expects to complete its assessment process within the last quarter of 2017.

There was no other recently issued and effective authoritative guidance that is expected to have a material impact on the Company's Condensed Consolidated Financial Statements through the reporting date.

Note 2. Business Acquisitions

2017 Acquisitions

On April 12, 2017, the Company completed the acquisition of all of the membership interest of Dixie Drawl, LLC d/b/a InPharmics ("InPharmics") pursuant to InPharmics' Member Interest Purchase Agreement. InPharmics is a technology and services company that provides advanced pharmacy informatics solutions to hospital pharmacies. The total consideration for the transaction was $5.0 million, net of cash on hand at signing of $0.3 million. Approximately $0.5 million of the total consideration was classified as a long-term liability for potential settlement of performance obligations. The Company accounted for the acquisition of InPharmics in accordance with the authoritative guidance on business combinations; therefore, the tangible and intangible assets acquired and liabilities assumed were recorded at fair value on the acquisition date. The purchase price was preliminary allocated to intangible assets in the amount of $1.9 million, which included developed technology and customer contracts, with the remainder allocated to goodwill. The results of the InPharmics' operations have been included in our consolidated results of operations, and presented as part of the Automation and Analytics segment.

2016 Acquisitions

On January 5, 2016, the Company completed the acquisition of all of the membership interests of Aesynt pursuant to the Aesynt Securities Purchase Agreement. Aesynt is a provider of automated medication management systems, including dispensing robots with storage solutions, medication storage and dispensing carts and cabinets, I.V. sterile preparation robotics, and software, including software related to medication management. The total consideration was $271.5 million, net of cash on hand at signing of $8.2 million. The results of Aesynt's operations have been included in the Company's consolidated results of operations as of the time of the acquisition, and presented as part of the Automation & Analytics segment.

On December 8, 2016, the Company completed its acquisition of ateb, Inc., and Ateb Canada Ltd. (together, “Ateb”) pursuant to Ateb's Securities Purchase Agreement for $40.7 million of cash consideration, net of $0.9 million cash on hand. The cash consideration, included the repayment of Ateb indebtedness and other adjustments provided for in the Ateb's Securities Purchase Agreement. Ateb is a provider of pharmacy-based patient care solutions and the medication synchronization solutions leader to independent and chain pharmacies. The results of Ateb's operations have been included in the Company's consolidated results of operations as of the time of the acquisition, and presented as part of the Medication Adherence segment.

The Company accounted for the acquisitions of Aesynt and Ateb in accordance with the authoritative guidance on business combinations; therefore, the tangible and intangible assets acquired and liabilities assumed were recorded at fair value on the acquisition dates, respectively.

The following table represents the allocation of the purchase price to the assets acquired and the liabilities assumed by the Company during each acquisition, respectively, reconciled to the purchase price transferred included in the Company's Consolidated Balance Sheet:

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	Aesynt	Ateb (preliminary)	Total
	(in thousands)		
Cash	$8,164	$ 902	$9,066
Accounts receivable	43,312	7,761	51,073
Inventory	19,021	225	19,246
Other current assets	3,787	1,239	5,026
Total current assets	74,284	10,127	84,411
Property and equipment	10,389	2,447	12,836
Intangibles	123,700	12,500	136,200
Goodwill	163,599	21,651	185,250
Other non-current assets	968	334	1,302
Total assets	372,940	47,059	419,999
Current liabilities	26,753	2,314	29,067
Deferred revenue	25,512	2,776	28,288
Non-current deferred tax liabilities	38,622	—	38,622
Other non-current liabilities	2,431	367	2,798
Total liabilities	93,318	5,457	98,775
Total purchase price	$279,622	$ 41,602	$321,224
Total purchase price, net of cash received	$271,458	$ 40,700	$312,158

The $163.6 million of goodwill arising from the Aesynt acquisition is primarily attributed to sales of future products and services and Aesynt's assembled workforce. The goodwill has been assigned to the Automation & Analytics segment and is not deductible for tax purposes.

The $21.7 million of goodwill arising from the Ateb acquisition is primarily attributed to sales of future products and services and Ateb's assembled workforce.

Intangibles eligible for recognition separate from goodwill were those that satisfied either the contractual/legal criterion or the separability criterion in the accounting guidance. The identifiable intangible assets acquired and their estimated useful lives for amortization are as follows:

	Aesynt		Ateb (Preliminary)	
	Fair value	Weighted average useful life	Fair value	Weighted average useful life
	(In thousands)	(In years)	(In thousands)	(In years)
Customer relationships	$58,200	14-16	$8,900	12
Developed technology	38,800	8	3,400	5
Backlog	20,200	1-3	—	—
In-process research and development [(1)]	3,900	—	—	—
Non-compete	1,800	3	100	1
Trade names	800	1	100	1
Total purchased intangible assets	$123,700		$12,500	

[(1)] The amortization of the in-process R&D assets begins when the in-process R&D projects are complete.

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Aesynt Acquisition

Customer relationships represent the fair value of the underlying relationships and agreements with Aesynt’s customers, acquired developed technology represents the fair value of Aesynt products that have reached technological feasibility and were part of Aesynt’s product offerings at the date of acquisition, backlog represents the fair value of sales order backlog at the date of acquisition, non-compete intangible asset represents the fair value of non-compete agreements with former key members of Aesynt's management, and trade name represents the fair value of brand and name recognition associated with the marketing of Aesynt’s products and services. In-process research and development ("IPR&D") represents the fair value of incomplete Aesynt research and development projects that had not reached technological feasibility as of the date of acquisition. Incremental costs incurred for those projects are expensed as incurred in research and development.

The fair value of trade names, acquired developed technology, and acquired IPR&D was determined based on an income approach using the relief-from-royalty method at the royalty rates of 0.5%, 4% to 8% and 12.5%, respectively. The fair value of customer relationships, backlog, and non-compete intangible assets were determined based on an income approach using the discounted cash flow method, at the discounted rates of 13%, 10% and13%, respectively. The intangible assets, except customer relationship and IPR&D, are being amortized over their estimated useful lives using the straight line method of amortization. The customer relationship intangible asset is being amortized using a double-declining method of amortization as such method better represents the economic benefits to be obtained. In accordance with authoritative guidance, the IPR&D is accounted for as an indefinite-lived intangible asset until completion or abandonment of the associated research and development efforts. IPR&D is tested for impairment during the period it is considered an indefinite lived asset. IPR&D related projects are expected to be completed in two to three years. As of September 30, 2017, none of the IPR&D projects have been completed, and they have progressed as previously estimated and are expected to be completed in fiscal 2018.

Ateb Acquisition

Customer relationships represent the fair value of the underlying relationships and agreements with Ateb’s customers expected to result in future sales, acquired developed technology represents the fair value of Ateb intellectual property incorporated in their products, non-compete intangible asset represents the fair value of non-compete agreements with former key members of Ateb's management, and trade name represents the fair value of brand and name recognition associated with the marketing of Ateb’s products and services.

The fair value of Ateb trade names and acquired developed technology was determined based on an income approach using the relief-from-royalty method at the royalty rates of 0.5% and 5% to 6%, respectively. The fair value of customer relationships, and non-compete intangible assets were determined based on an income approach using the discounted cash flow method, both using a 15% discount rate. The intangible assets for non-compete agreements and trade name are being amortized over their estimated useful lives using the straight line method of amortization. The intangible assets for customer relationship and developed technology are being amortized using a double-declining method of amortization as such method better represents the economic benefits to be obtained.

Note 3. Net Income (Loss) Per Share

Basic net income (loss) per share is computed by dividing net income (loss) for the period by the weighted-average number of shares outstanding during the period, less shares repurchased. In periods of net loss, all potential common shares are anti-dilutive, so diluted net loss per share equals the basic net loss per share. In periods of net income, diluted net income per share is computed by dividing net income for the period by the basic weighted-average number of shares plus any dilutive potential common stock outstanding during the period. Potential common stock includes the effect of outstanding dilutive stock options, restricted stock awards and restricted stock units computed using the treasury stock method. Any anti-dilutive weighted-average dilutive shares related to stock award plans are excluded from the computation of the diluted net income per share.

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The basic and diluted net income (loss) per share calculation for the three and nine months ended September 30, 2017 and 2016 is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2017	2016	2017	2016
	(In thousands, except per share data)			
Net income (loss)	$6,231	$1,983	$(3,686)	$446
Weighted-average shares outstanding — basic	37,698	36,332	37,266	36,020
Effect of dilutive securities from stock award plans	1,275	747	—	675
Weighted-average shares outstanding — diluted	$38,973	$37,079	37,266	36,695
Net income (loss) per share - basic	$0.17	$0.05	$(0.10)	$0.01
Net income (loss) per share - diluted	$0.16	$0.05	$(0.10)	$0.01
Anti-dilutive weighted-average shares related to stock award plans	1,383	326	3,757	1,255

Note 4. Cash and Cash Equivalents and Fair Value of Financial Instruments

Cash and cash equivalents of $7.5 million and $54.5 million as of September 30, 2017 and December 31, 2016, respectively, consisted of demand deposits only.

Fair value hierarchy

The Company measures its financial instruments at fair value. The Company’s cash equivalents are classified within Level 1 of the fair value hierarchy as they are valued primarily using quoted market prices utilizing market observable inputs. The Company's foreign currency contracts are classified within Level 2 as the valuation inputs are based on quoted prices and market observable data of similar instruments. In accordance with the 2015 Avantec share purchase agreement, the Company agreed to make potential earn-out payments of $3.0 million based on the achievement of bookings targets. The Company has concluded that only $2.4 million of the total potential earn out payment has been earned, which was paid out during the three month period ended September 30, 2017.

The following table represents the fair value hierarchy of the Company’s financial assets and financial liabilities measured at fair value as of September 30, 2017:

	Level 1	Level 2	Level 3	Total
	(In thousands)			
Interest rate swap contracts	$—	$1,200	$—	$1,200
Total financial assets	$—	$1,200	$—	$1,200

There have been no transfers between fair value measurement levels during the nine months ended September 30, 2017 and September 30, 2016.

The following table represents the fair value hierarchy of the Company’s financial assets and financial liabilities measured at fair value as of December 31, 2016:

	Level 1	Level 2	Level 3	Total
	(In thousands)			
Interest rate swap contracts	$—	$1,245	$—	$1,245
Total financial assets	$—	$1,245	$—	$1,245
Contingent consideration liability	$—	$—	$2,400	$2,400
Total financial liabilities	$—	$—	$2,400	$2,400

Net investment in sales-type leases. The carrying amount of the Company's sales-type lease receivables is a reasonable estimate of fair value, as the unearned interest income is immaterial.

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Interest Rate Swap Contracts

The Company uses interest rate swap agreements to protect the Company against adverse fluctuations in interest rates by reducing its exposure to variability in cash flows relating to interest payments on a portion of its outstanding debt. The Company's interest rate swaps, which are designated as cash flow hedges, involve the receipt of variable amounts from counterparties in exchange for the Company making fixed-rate payments over the life of the agreements. The Company does not hold or issue any derivative financial instruments for speculative trading purposes.

During 2016, the Company entered into an interest rate swap agreement with a combined notional amount of $100.0 million with one counter-party that became effective on June 30, 2016 and is maturing on April 30, 2019. The swap agreement requires the Company to pay a fixed rate of 0.8% and provides that the Company will receive a variable rate based on the one month LIBOR rate subject to a LIBOR floor of 0.0%. Amounts payable by or due to the Company will be net settled with the respective counter-party on the last business day of each month, commencing July 31, 2016.

The fair value of the interest rate swap agreements at September 30, 2017 and December 31, 2016 was $1.2 million and $1.2 million, respectively. There were no amounts reclassified into current earnings due to ineffectiveness during the periods presented.

Note 5. Balance Sheet Components

Balance sheet details as of September 30, 2017 and December 31, 2016 are presented in the tables below:

	September 30, 2017	December 31, 2016
	(In thousands)	
Inventories:		
Raw materials	$20,736	$ 14,322
Work in process	10,769	7,800
Finished goods	60,734	47,175
Total inventories	$92,239	$ 69,297
Prepaid expense		
Prepaid commissions	$11,622	$ 13,176
Other prepaid expenses	16,422	15,470
Total prepaid expense	$28,044	$ 28,646
Property and equipment:		
Equipment	$70,343	$ 64,384
Furniture and fixtures	6,881	6,517
Leasehold improvements	10,143	9,778
Software	37,574	35,607
Construction in progress	8,083	7,211
Property and equipment, gross	133,024	123,497
Accumulated depreciation and amortization	(92,805)	(81,486)
Total property and equipment, net	$40,219	$ 42,011
Other long term assets:		
Capitalized software, net	$36,713	$ 33,233
Other assets	883	1,818
Total other long term assets, net	$37,596	$ 35,051

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	September 30, 2017	December 31, 2016
Accrued liabilities:		
Advance payments from customers	$ 7,780	$ 7,030
Rebates and lease buyouts	5,943	4,025
Group purchasing organization fees	3,380	3,737
Taxes payable	5,575	4,003
Other accrued liabilities	10,383	12,400
Total accrued liabilities	$ 33,061	$ 31,195

The following tables summarize the changes in accumulated balances of other comprehensive income (loss) for the three and nine months ended September 30, 2017 and 2016:

	Three months ended September 30,					
	2017			2016		
	Foreign currency translation adjustments	Unrealized gain (loss) on interest rate swap hedges	Total	Foreign currency translation adjustments	Unrealized gain (loss) on interest rate swap hedges	Total
	(In thousands)					
Beginning balance	$(8,765)	$ 1,274	$(7,491)	$(7,524)	$ —	$(7,524)
Other comprehensive income (loss) before reclassifications	1,389	35	1,424	(502)	108	(394)
Amounts reclassified from other comprehensive income (loss), net of tax	—	(109)	(109)	—	—	—
Net current-period other comprehensive income (loss), net of tax	1,389	(74)	1,315	(502)	108	(394)
Ending balance	$(7,376)	$ 1,200	$(6,176)	$(8,026)	$ 108	$(7,918)

	Nine months ended September 30,					
	2017			2016		
	Foreign currency translation adjustments	Unrealized gain (loss) on interest rate swap hedges	Total	Foreign currency translation adjustments	Unrealized gain (loss) on interest rate swap hedges	Total
	(In thousands)					
Beginning balance	$(10,764)	$ 1,245	$(9,519)	$(2,730)	$ —	$(2,730)
Other comprehensive income (loss) before reclassifications	3,388	111	3,499	(5,296)	108	(5,188)
Amounts reclassified from other comprehensive income (loss), net of tax	—	(156)	(156)	—	—	—
Net current-period other comprehensive income (loss), net of tax	3,388	(45)	3,343	(5,296)	108	(5,188)
Ending balance	$(7,376)	$ 1,200	$(6,176)	$(8,026)	$ 108	$(7,918)

Note 6. Net Investment in Sales-Type Leases

On a recurring basis, we enter into sales-type lease transactions with the majority varying in length from one to five years. The receivables as a result of these types of transactions are collateralized by the underlying equipment leased and consist of the following components at September 30, 2017 and December 31, 2016:

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	September 30, 2017	December 31, 2016
	(In thousands)	
Net minimum lease payments to be received	$26,173	$ 33,591
Less: Unearned interest income portion	(1,986)	(2,763)
Net investment in sales-type leases	24,187	30,828
Less: Short-term portion[1]	(8,201)	(10,243)
Long-term net investment in sales-type leases	$15,986	$ 20,585

[1] The short-term portion of the net investments in sales-type leases is included in other current assets in the Condensed Consolidated Balance Sheets.

The Company evaluates its sales-type leases individually and collectively for impairment. The allowance for credit losses were $0.2 million and $0.3 million as of September 30, 2017 and of December 31, 2016, respectively.

At September 30, 2017, the future minimum lease payments under sales-type leases are as follows:

	September 30, 2017
	(In thousands)
Remaining three months of 2017	$ 2,470
2018	8,038
2019	6,474
2020	4,548
2021	2,749
Thereafter	1,894
Total	$ 26,173

Note 7. Goodwill and Intangible Assets

Goodwill

The following table represents changes in the carrying amount of goodwill:

	Automation and Analytics	Medication Adherence	Total
	(In thousands)		
Net balance as of December 31, 2016	$215,082	$ 112,642	$327,724
Goodwill acquired	3,113	819	3,932
Foreign currency exchange rate fluctuations	2,351	773	3,124
Net balance as of September 30, 2017	$220,546	$ 114,234	$334,780

Goodwill acquired in the Automation and Analytics segment represents the value assigned to goodwill as part of the InPharmics acquisition. Goodwill acquired in the Medication Adherence segment represents adjustments to the preliminary value assigned to goodwill in connection with Ateb acquisition to reflect measurement period adjustments related to accounts receivable and other non-current assets of $0.1 million and $0.7 million, respectively.

Intangible assets, net

The carrying amounts of intangibles assets as of September 30, 2017 and December 31, 2016 are as follows:

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	September 30, 2017				
	Gross carrying amount	Accumulated amortization	Foreign currency exchange rate fluctuations	Net carrying amount	Useful life (years)
	(In thousands, except for years)				
Customer relationships	$133,456	$ (30,421)	$ 297	$103,332	1 - 30
Acquired technology	74,457	(19,493)	75	55,039	3 - 20
Backlog	21,702	(16,654)	—	5,048	1 - 5
Trade names	8,683	(4,508)	13	4,188	1 - 12
Patents	3,290	(1,331)	(6)	1,953	2 - 20
Non-compete agreements	1,900	(1,133)	—	767	3
In-process technology	3,900	—	—	3,900	—
Total intangibles assets, net	$247,388	$ (73,540)	$ 379	$174,227	

	December 31, 2016				
	Gross carrying amount	Accumulated amortization	Foreign currency exchange rate fluctuations	Net carrying amount	Useful life (years)
	(In thousands, except for years)				
Customer relationships	$133,358	$ (20,930)	$ (596)	$111,832	1 - 30
Acquired technology	73,599	(13,287)	(159)	60,153	3 - 20
Backlog	20,550	(14,083)	—	6,467	1 - 3
Trade names	8,667	(3,887)	(31)	4,749	1 - 12
Patents	3,154	(1,264)	—	1,890	2 - 20
Non-compete agreements	1,900	(608)	—	1,292	3
In-process technology	3,900	—	—	3,900	—
Total intangibles assets, net	$245,128	$ (54,059)	$ (786)	$190,283	

Amortization expense of intangible assets was $6.4 million and $8.9 million for the three months ended September 30, 2017 and 2016, respectively. Amortization expense of intangible assets was $19.4 million and $27.2 million for the nine months ended September 30, 2017 and 2016, respectively.

The estimated future amortization expenses for amortizable intangible assets are as follows:

	September 30, 2017
	(In thousands)
Remaining three months of 2017	$ 6,166
2018	23,302
2019	17,837
2020	16,631
2021	15,065
Thereafter (excluding in-process technology)	91,326
Total	$ 170,327

Note 8. Debt

On January 5, 2016, the Company entered into a $400 million senior secured credit facility pursuant to a credit agreement, by and among the Company, the lenders from time to time party thereto, Wells Fargo Securities, LLC, as Sole Lead Arranger and Wells Fargo Bank, National Association, as administrative agent (the "Credit Agreement"). The Credit Agreement provides for (a) a five-year revolving credit facility of $200 million (the "Revolving Credit Facility") and (b) a five-year $200 million term loan facility (the "Term Loan Facility" and together with the Revolving Credit Facility, the "Facilities"). In addition, the Credit

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Agreement includes a letter of credit sub-limit of up to $10 million and a swing line loan sub-limit of up to $10 million. The Credit Agreement expires on January 5, 2021, upon which date all remaining outstanding borrowings are due and payable.

Loans under the Facilities bear interest, at the Company's option, at a rate equal to either (a) the LIBOR Rate, plus an applicable margin ranging from 1.50% to 2.25% per annum based on the Company's Consolidated Total Net Leverage Ratio (as defined in the Credit Agreement), or (b) an alternate base rate equal to the highest of (i) the prime rate, (ii) the federal funds rate plus 0.50%, and (iii) LIBOR for an interest period of one month, plus an applicable margin ranging from 0.50% to 1.25% per annum based on the Company's Consolidated Total Net Leverage Ratio (as defined in the 2016 Credit Agreement). Undrawn commitments under the Revolving Credit Facility will be subject to a commitment fee ranging from 0.20% to 0.35% per annum based on the Company's Consolidated Total Net Leverage Ratio on the average daily unused portion of the Revolving Credit Facility. A letter of credit participation fee ranging from 1.50% to 2.25% per annum based on the Company's Consolidated Total Net Leverage Ratio will accrue on the average daily amount of letter of credit exposure.

The Company is permitted to make voluntary prepayments at any time without payment of a premium or penalty, except for any amounts relating to the LIBOR breakage indemnity described in the Credit Agreement. The Company is required to make mandatory prepayments under the Term Loan Facility with (a) net cash proceeds from any issuances of debt (other than certain permitted debt) and (b) net cash proceeds from certain asset dispositions (other than certain asset dispositions) and insurance and condemnation events (subject to reinvestment rights and certain other exceptions). Loans under the Term Loan Facility will amortize in quarterly installments, equal to 5% per annum of the original principal amount thereof during the first two years, which shall increase to 10% per annum during the third and fourth years, and 15% per annum during the fifth year, with the remaining balance payable on January 5, 2021. The Company is required to make mandatory prepayments under the Revolving Credit Facility if at any time the aggregate outstanding principal amount of loans together with the total amount of outstanding letters of credit exceeds the aggregate commitments, with such mandatory prepayment to be equal to the amount of such excess.

The Credit Agreement contains customary representations and warranties and customary affirmative and negative covenants applicable to the Company and its subsidiaries, including, among other things, restrictions on indebtedness, liens, investments, mergers, dispositions, dividends and other distributions. The Credit Agreement contains financial covenants that require the Company and its subsidiaries to not exceed a maximum consolidated total leverage ratio and maintain a minimum fixed charge coverage ratio. The Company's obligations under the Credit Agreement and any swap obligations and banking services obligations owing to a lender (or an affiliate of a lender) are guaranteed by certain of its domestic subsidiaries and secured by substantially all of its and the subsidiary guarantors' assets. In connection with entering into the Credit Agreement, and as a condition precedent to borrowing loans thereunder, the Company and certain of the Company's other direct and indirect subsidiaries have entered into certain ancillary agreements, including, but not limited to, a collateral agreement and subsidiary guaranty agreement.

On January 5, 2016, the Company borrowed the full $200.0 million under the Term Loan Facility and $55.0 million under the Revolving Credit Facility to complete the Aesynt acquisition and pay related fees and expenses. On December 2, 2016, the Company borrowed $40.0 million under the Revolving Credit Facility to complete the Ateb acquisition and pay related fees and expenses. On April 3, 2017, the Company borrowed an additional $10.0 million under the Revolving Credit Facility to pay for the InPharmics acquisition and fund its operations. On July 7, 2017 and July 31, 2017, the Company borrowed an additional $15.0 million and $12.0 million, respectively, under the Revolving Credit Facility to fund its operations. As of September 30, 2017 the Company has repaid $134.5 million borrowed under these Facilities, which includes $100.0 million repaid during the nine months ended September 30, 2017.

On April 11, 2017, the parties entered into the First Amendment to Credit Agreement and Collateral Agreement. Under this amendment, (i) the maximum capital expenditures limit in any fiscal year for property, plant and equipment and software development increased from $35.0 million to $45.0 million, and (ii) the maximum limit for non-permitted investments increased from $10.0 million to $20.0 million.

In connection with these Facilities, the Company incurred $7.9 million of debt issuance costs. The debt issuance costs were capitalized and presented as a direct deduction from the carrying amount of that debt liability in accordance with

the accounting guidance. The debt issuance costs are being amortized to interest expense using the straight line method from issuance date through 2021. Interest expense (exclusive of fees and issuance cost amortization) was approximately $1.6 million and $1.2 million for the three months ended September 30, 2017 and 2016, respectively. Interest expense (exclusive of fees and issuance cost amortization) was approximately $4.6 million and $4.0 million for the nine months ended September 30, 2017 and 2016, respectively. The Company was in full compliance with all covenants as of September 30, 2017 and December 31, 2016.

The components of the Company’s debt obligations for the nine months ended September 30, 2017 are as follows:

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	December 31, 2016	Borrowings	Repayment / Amortization	September 30, 2017
	(In thousands)			
Term loan facility	$192,500	$ —	$ (7,500)	$ 185,000
Revolving credit facility	68,000	37,000	(92,500)	12,500
Total debt under the facilities	260,500	37,000	(100,000)	197,500
Less: Deferred issuance cost	(6,359)	—	1,192	(5,167)
Total Debt, net of deferred issuance cost	$254,141	$ 37,000	$ (98,808)	$ 192,333
Long term debt, current portion, net of deferred issuance cost	8,410			13,410
Long term debt, net of deferred issuance cost	$245,731			$ 178,923

As of September 30, 2017, the carrying amount of debt of $197.5 million approximates the comparable fair value of $199.2 million. The Company's debt facilities are classified as a Level 3 in the fair value hierarchy. The calculation of the fair value is based on a discounted cash flow model using observable market inputs and taking into consideration variables such as interest rate changes, comparable instruments, and long-term credit ratings.

Note 9. Deferred revenue

Short-term deferred revenue includes deferred revenue from product sales and service contracts, net of deferred cost of sales of $14.5 million and $14.2 million as of September 30, 2017 and December 31, 2016, respectively. The short-term deferred revenues from product sales relate to the delivered and invoiced products, pending installation and acceptance, expected to occur within the next twelve months.

Long-term deferred revenue includes deferred revenue from service contracts of $16.4 million and $17.1 million, as of September 30, 2017 and December 31, 2016, respectively.

Note 10. Commitments and Contingencies

Lease commitments

The Company leases office space and office equipment under operating leases. Commitments under operating leases primarily relate to leasehold property and office equipment. At September 30, 2017, the minimum future payments on non-cancelable operating leases were as follows:

	(In thousands)
Remaining three months of 2017	$ 3,203
2018	12,447
2019	12,270
2020	10,972
2021	10,316
Thereafter	31,168
Total minimum future lease payments	$ 80,376

Purchase obligations

In the ordinary course of business, the Company issues purchase orders based on its current manufacturing needs. At September 30, 2017, the Company had non-cancelable purchase commitments of $59.9 million, which are expected to be paid within the next twelve months.

Legal Proceedings

The Company is currently involved in various legal proceedings. As required under ASC 450, Contingencies, the Company accrues for contingencies when it believes that a loss is probable and that it can reasonably estimate the amount of any such loss. The Company has not recorded any accrual for contingent liabilities associated with any current legal proceedings based on its belief that any potential loss, while reasonably possible, is not probable. Further, any possible range of loss in these matters cannot be reasonably estimated at this time. The Company believes that it has valid defenses with respect to legal proceedings pending against it. However, litigation is inherently unpredictable, and it is possible that cash flows or

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results of operations could be materially affected in any particular period by the unfavorable resolution of this contingency or because of the diversion of management's attention and the creation of significant expenses.

The Company is not a party to any legal proceedings that management believes may have a material impact on the Company's financial position or results of operations.

Note 11. Income Taxes

The Company generally provides for income taxes in interim periods based on the estimated annual effective tax rate for the year, adjusting for discrete items in the quarter in which they arise. For the three month ended September 30, 2017, the provision for income taxes was computed based on the actual effective tax rate for the year-to-date by applying the discrete method. The Company determined that as small changes in estimated “ordinary” income result in significant changes in the estimated annual effective tax rate, the actual effective tax rate provided a more accurate income tax provision for the reporting period ended September 30, 2017. The estimated effective tax rate before discrete items was 34.4% and 38.3% for the nine months ended September 30, 2017 and 2016, respectively.

The estimated effective tax rate for the nine months ended September 30, 2017 differed from the statutory rate of 35% primarily due to the unfavorable impact of state income taxes, foreign rate differential, and non-deductible equity charges, which were partially offset by the favorable impact of the Research & Development credits. The effective tax rate for the nine months ended September 30, 2016 differed from the statutory rate of 35% primarily due to the favorable impact of the IRS settlement and release of tax reserves, the domestic production activities deduction, Research & Development credits and a calculated benefit in state income taxes, offset by unfavorable items such as non-deductible transaction costs related to the Aesynt transaction, and non-deductible equity charges under ASC 740-718.

As of September 30, 2017 and December 31, 2016, the Company had gross unrecognized tax benefits of $6.8 million and $6.5 million, respectively. It is the Company’s policy to classify accrued interest and penalties as part of the unrecognized tax benefits, but to record interest and penalties in operating expense. As of September 30, 2017 and December 31, 2016, the amount of accrued interest and penalties was $1.2 million and $0.7 million, respectively.

As of September 30, 2017, calendar years 2011 and thereafter are open and subject to potential examination in one or more jurisdictions. However, our research credit carryforwards that may be used in future years are subject to adjustment, if and when utilized. As such our federal and California tax years remain open from 2015 and 1992, respectively. During fiscal 2016, the Internal Revenue Service and the Company settled all outstanding items related to the audit of the Company's federal income tax returns for the fiscal year ended December 31, 2014.

Although the Company believes it has adequately provided for uncertain tax positions, the provisions on these positions may change as revised estimates are made or the underlying matters are settled or otherwise resolved. It is not possible at this time to reasonably estimate changes in the unrecognized tax benefits within the next twelve months.

Note 12. Employee Benefits and Share-Based Compensation

Stock based plans

For a detailed explanation of the Company's stock plans and subsequent changes, please refer to Note 11, Employee Benefits and Stock-Based Compensation, of the Company's Annual Report on Form 10-K for the year ended December 31, 2016 filed with the SEC on February 28, 2017.

Share-based compensation expense

The following table sets forth the total share-based compensation expense recognized in the Company's Condensed Consolidated Statements of Operations:

	Three months ended		Nine months ended	
	September 30,	September 30,	September 30,	September 30,
	2017	2016	2017	2016
	(In thousands)			
Cost of product and service revenues	$882	$ 628	$2,727	$ 1,821
Research and development	915	825	2,651	2,267
Selling, general and administrative	3,462	3,224	10,937	9,975
Total share-based compensation expense	$5,259	$ 4,677	$16,315	$ 14,063

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The following weighted average assumptions are used to value stock options and Employee Stock Purchase Plan ("ESPP") shares issued pursuant to the Company's equity incentive plans for the three and nine months ended September 30, 2017 and 2016:

	Three months ended		Nine months ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Stock Option Plans				
Expected life, years	4.67	4.92	4.67	4.92
Expected volatility, %	28.1%	30.0%	29.2%	31.4%
Risk free interest rate, %	1.81%	1.21%	1.83%	1.34%
Estimated forfeiture rate %	7.7%	8.6%	7.7%	8.6%
Dividend yield, %	—%	—%	—%	—%

	Three months ended		Nine months ended	
	September 30, 2017	September 30, 2016	September 30, 2017	September 30, 2016
Employee Stock Purchase Plan				
Expected life, years	0.5-2.0	0.5-2.0	0.5-2.0	0.5-2.0
Expected volatility, %	26.7-32.1%	25.8-34.8%	25.8-32.8%	25.8-34.8%
Risk free interest rate, %	0.61-1.39%	0.41-0.79%	0.52-1.39%	0.34-0.79%
Dividend yield, %	—%	—%	—%	—%

Stock options activity

The following table summarizes the share option activity under the Company’s equity incentive plans during the nine months ended September 30, 2017:

	Number of Shares	Weighted-Average Exercise Price	Weighted-Average Remaining Years	Aggregate Intrinsic Value
	(In thousands, except per share data)			
Stock Options				
Outstanding at December 31, 2016	3,214	$ 26.06	7.3	$ 26,331
Granted	504	38.87		
Exercised	(668)	21.66		
Expired	(6)	27.53		
Forfeited	(79)	32.54		
Outstanding at September 30, 2017	2,965	$ 29.06	7.4	$ 65,247
Exercisable at September 30, 2017	1,252	$ 22.36	5.5	$ 35,915
Vested and expected to vest at September 30, 2017 and thereafter	2,965	$ 29.06	7.4	$ 65,247

The weighted-average fair value per share of options granted during the three months ended September 30, 2017 and 2016 was $12.49 and $10.32, respectively, and the weighted-average fair value per share of options granted during the nine months ended September 30, 2017 and 2016 was $11.22 and $8.82, respectively. The intrinsic value of options exercised during the three months ended September 30, 2017 and 2016 was $6.8 million and $2.1 million, respectively, and the intrinsic value of options exercised during the nine months ended September 30, 2017 and 2016 was $14.6 million and $5.0 million, respectively,

As of September 30, 2017, total unrecognized compensation cost related to unvested stock options was $13.7 million, which is expected to be recognized over a weighted-average vesting period of 2.8 years.

Restricted stock activity

The following table summarizes the restricted stock activity under the Company’s equity incentive plans during the nine months ended September 30, 2017:

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	Number of Shares	Weighted-Average Grant Date Fair Value	Weighted-Average Remaining Years	Aggregate Intrinsic Value
	(In thousands, except per share data)			
Restricted Stock Units ("RSUs")				
Outstanding at December 31, 2016	505	$ 31.42	1.6	$ 17,135
Granted	93	37.86		
Vested	(126)	29.19		
Forfeited	(16)	32.17		
Outstanding and unvested at September 30, 2017	456	$ 33.33	1.2	$ 23,257

The weighted-average grant date fair value per share of RSUs granted during the nine months ended September 30, 2017 and September 30, 2016 was $37.86 and $29.19, respectively.

As of September 30, 2017, total unrecognized compensation expense related to RSUs was $11.4 million, which is expected to be recognized over the remaining weighted-average vesting period of 2.4 years.

	Number of Shares	Weighted-Average Grant Date Fair Value
	(In thousands, except per share data)	
Restricted Stock Awards ("RSAs")		
Outstanding at December 31, 2016	30	$ 31.57
Granted	24	41.10
Vested	(30)	31.58
Forfeited	—	—
Outstanding and unvested at September 30, 2017	24	$ 41.05

As of September 30, 2017, total unrecognized compensation cost related to RSAs was $0.6 million, which is expected to be recognized over the remaining weighted-average vesting period of 0.64 years.

Performance-based restricted stock unit activity

The following table summarizes the performance-based restricted stock activity under the Company’s equity incentive plans during the nine months ended September 30, 2017:

	Number of Shares	Weighted-Average Grant Date Fair Value Per Unit
	(In thousands, except per share data)	
Performance-based Restricted Stock Units ("PSUs")		
Outstanding at December 31, 2016	184	$ 24.89
Granted	146	33.89
Vested	(69)	24.43
Forfeited	—	—
Outstanding and unvested at September 30, 2017	261	$ 30.06

The weighted-average grant date fair value per share of PSUs granted during the nine months ended September 30, 2017 and 2016 was $33.89 and $24.66, respectively. As of September 30, 2017, total unrecognized compensation cost related to PSUs was $3.5 million, which is expected to be recognized over the remaining weighted-average period of 1.3 years.

Employee Stock Purchase Plan activity

For the nine months ending September 30, 2017 and 2016, purchases under the ESPP were approximately 465,696 and 420,000 shares at weighted average prices of $25.78 and $23.23, respectively. As of September 30, 2017, the unrecognized

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compensation cost related to the shares to be purchased under the ESPP was approximately $1.6 million and is expected to be recognized over a weighted-average period of 1.6 years.

Summary of shares reserved for future issuance under equity incentive plans

The Company had the following ordinary shares reserved for future issuance under its equity incentive plans as of September 30, 2017:

	Number of Shares (In thousands)
Share options outstanding	2,965
Non-vested restricted share awards	741
Shares authorized for future issuance	2,191
ESPP shares available for future issuance	2,365
Total shares reserved for future issuance	8,262

Stock Repurchase Program

On August 2, 2016, the Company's Board of Directors (the "Board") authorized a stock repurchase program providing for the repurchase of up to $50.0 million of the Company’s common stock (the “2016 Repurchase Program”). The 2016 Repurchase Program is in addition to the stock repurchase program approved by the Board on November 4, 2014 (the “2014 Repurchase Program”). As of September 30, 2017, the maximum dollar value of shares that may yet be purchased under the two repurchase programs was $54.9 million. The stock repurchase programs do not obligate the Company to repurchase any specific number of shares, and the Company may terminate or suspend the repurchase program at any time.

During the three and nine months period ended September 30, 2017 and 2016, the Company did not repurchase any of its outstanding common stock.

Note 13. Segment and Geographical Information

The Company's Chief Operating Decision Maker ("CODM") is its Chief Executive Officer. The CODM allocates resources and evaluates the performance of the Company's segments using information about its revenues, gross profit, and income from operations. Such evaluation excludes general corporate-level costs that are not specific to either of the reportable segments and are managed separately at the corporate level. Corporate-level costs include expenses related to executive management, finance and accounting, human resources, legal, training and development, and certain administrative expenses. The two operating segments, which are the same as the Company's two reportable segments, are as follows:

Automation and Analytics

The Automation and Analytics segment is organized around the design, manufacturing, selling and servicing of medication and supply dispensing systems, pharmacy inventory management systems, and related software. The Automation and Analytics products are designed to enable the Company's customers to enhance and improve the effectiveness of the medication-use process, the efficiency of the medical-surgical supply chain, overall patient care and clinical and financial outcomes of medical facilities. Through modular configuration and upgrades, the Company's systems can be tailored to specific customer needs.

Medication Adherence

The Medication Adherence segment includes primarily the manufacturing and selling of consumable medication blister cards, packaging equipment and ancillary products and services. These products are used to manage medication administration outside of the hospital setting and include medication adherence products, which consist of proprietary medication packaging systems and related products for use by institutional pharmacies servicing long-term care, and correctional facilities or retail pharmacies serving patients in their local communities.

The following tables summarize the financial performance of the Company's reportable segments, including a reconciliation of income from segment operations to income from total operations:

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	Three months ended September 30, 2017			September 30, 2016		
	Automation and Analytics	Medication Adherence	Total	Automation and Analytics	Medication Adherence	Total
	(In thousands)					
Revenues	$154,651	$ 32,131	$186,782	$152,437	$ 24,300	$176,737
Cost of revenues	79,740	22,189	101,929	77,828	17,401	95,229
Gross profit	74,911	9,942	84,853	74,609	6,899	81,508
Operating expenses	46,849	9,901	56,750	49,123	6,137	55,260
Income (loss) from segment operations	$28,062	$ 41	$28,103	$25,486	$ 762	$26,248
Corporate costs			18,389			21,320
Income (loss) from operations			$9,714			$4,928

	Nine months ended September 30, 2017			September 30, 2016		
	Automation and Analytics	Medication Adherence	Total	Automation and Analytics	Medication Adherence	Total
	(In thousands)					
Revenues	$427,250	$ 90,971	$518,221	$450,043	$ 70,605	$520,648
Cost of revenues	229,218	61,983	291,201	233,401	47,777	281,178
Gross profit	198,032	28,988	227,020	216,642	22,828	239,470
Operating expenses	146,651	31,196	177,847	151,108	17,518	168,626
Income (loss) from segment operations	$51,381	$ (2,208)	$49,173	$65,534	$ 5,310	$70,844
Corporate costs			59,099			64,182
Income (loss) from operations			$(9,926)			$6,662

Significant customers

There were no customers that accounted for more than 10% of our total revenues for the three and nine months ended September 30, 2017 and 2016. Also, there were no customers that accounted for more than 10% of our accounts receivable as of September 30, 2017 and December 31, 2016.

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Geographical Information

Revenues

	Three months ended	
	September 30, 2017	September 30, 2016
	(In thousands)	
United States	$164,190	$ 155,989
Rest of world [1]	22,592	20,748
Total revenues	$186,782	$ 176,737

	Nine months ended	
	September 30, 2017	September 30, 2016
	(In thousands)	
United States	$449,755	$ 445,470
Rest of world [1]	68,466	75,178
Total revenues	$518,221	$ 520,648

[1] No individual country represented more than 10% of the respective totals.

Property and equipment, net

	September 30, 2017	December 31, 2016
	(In thousands)	
United States	$33,620	$ 36,497
Rest of world [1]	6,599	5,514
Total property and equipment, net	$40,219	$ 42,011

[1] No individual country represented more than 10% of the respective totals.

Property and equipment, net is attributed to the geographic location in which it is located.

Note 14. Restructuring Expenses

On February 15, 2017, the Company announced its plan to reduce its workforce by approximately 100 full-time employees and close the Company’s Nashville, Tennessee and Slovenia facilities. The plan is expected to be completed in fiscal year 2017. The estimated total cost for the plan is $4.3 million, which includes estimated employee severance cost of approximately $3.8 million, and facility-related costs of approximately $0.5 million.

During the nine months ended September 30, 2017, the Company accrued $3.8 million of severance and related expenses, and paid out $3.2 million. The remaining unpaid balance of $0.6 million accrued severance and related expenses as of September 30, 2017 is presented as a component of accrued compensation in the Condensed Consolidated Balance Sheet.

There were $0.6 million of facility-related costs incurred during the nine months ended September 30, 2017, of which $0.2 million was paid out. The remaining unpaid balance of $0.4 million accrued facilities-related expenses as of September 30, 2017 is presented as a component of accrued liabilities in the Condensed Consolidated Balance Sheet.

For the three and nine months periods ending September 30, 2017, the total restructuring expense was $0 and $4.3 million, respectively.

During the second quarter of 2016, the Company integrated its Sales and Field organizations in North America to better serve its customers which resulted in a reduction in headcount of 36 employees. Accordingly, the Company incurred approximately $1.7 million of restructuring expenses in the nine months ended September 30, 2016, based on

agreements with

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terminated employees covering salary and benefit continuation. As of September 30, 2016 the restructuring program has been concluded.

Note 15. Subsequent Event

On October 2, 2017 and October 10, 2017, the Company borrowed $12.0 million and $10.0 million, respectively, under the Revolving Credit Facility to fund its operations.

ITEM 2. MANAGEMENT'S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING STATEMENTS AND FACTORS THAT MAY AFFECT FUTURE RESULTS

This quarterly report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the United States Securities Act of 1933, as amended, Section 21E of the Securities Exchange Act of 1934 and the Private Securities Litigation Reform Act of 1995. Statements other than statements of historical facts are forward-looking statements and are contained principally in the sections entitled “Risk Factors” and “Management's Discussion and Analysis of Financial Condition and Results of Operations.” These statements involve known and unknown risks, uncertainties and other factors which may cause our actual results, performance or achievements to be materially different from any future results, performances or achievements expressed or implied by the forward-looking statements. Forward-looking statements include, but are not limited to, statements about:

- our expectations regarding our future product bookings;
- our ability to acquire companies, businesses, products or technologies on commercially reasonable terms and integrate such acquisitions effectively;
- the extent and timing of future revenues, including the amounts of our current backlog, which represents firm orders that have not completed installation and therefore have not been recognized as revenue;
- the size or growth of our market or market share;
- the opportunity presented by new products, emerging markets and international markets;
- our ability to align our cost structure and headcount with our current business expectations;
- the operating margins or earnings per share goals we may set;
- our ability to protect our intellectual property and operate our business without infringing upon the intellectual property rights of others; and
- our ability to generate cash from operations and our estimates regarding the sufficiency of our cash resources.

In some cases, you can identify forward-looking statements by terms such as "anticipates," "believes," "could," "estimates," "expects," "intends," "may," "plans," "potential," "predicts," "projects," "should," "will," "would" and similar expressions intended to identify forward-looking statements. Forward-looking statements reflect our current views with respect to future events, are based on assumptions and are subject to risks and uncertainties. We discuss many of these risks in this annual report in greater detail in Part II - Item 1A. “Risk Factors” below. Given these uncertainties, you should not place undue reliance on these forward-looking statements. Also, forward-looking statements represent our estimates and assumptions only as of the date of this annual report. You should also read this annual report and the documents that we reference in this annual report and have filed as exhibits, completely and with the understanding that our actual future results may be materially different from what we expect. All references in this report to "Omnicell," "our," "us," "we," or the "Company" collectively refer to Omnicell, Inc., a Delaware corporation, and its subsidiaries. The term "Omnicell, Inc.," refers only to Omnicell, Inc., excluding its subsidiaries. Except as required by law, we assume no obligation to update any forward-looking statements publicly, or to update the reasons actual results could differ materially from those anticipated in any forward-looking statements, even if new information becomes available in the future.

We own various trademarks, copyrights and trade names used in our business, including the following: Omnicell®, the Omnicell logo, OmniRx®, OmniCenter®, OmniSupplier®, OmniBuyer®, SafetyStock®, WorkflowRx™, OmniLinkRx™, Optiflex™, SinglePointe™, AnywhereRN™, Anesthesia Workstation™ , Savvy™, MTS Medication Technologies, the MTS Medication Technologies logo, Medlocker®, AccuFlex®, Autobond ™, AutoGen ™, easyBLIST™, PanoDose®, OmniDemand®, Multi-Med™, RxMap®, MTS-350 ™, MTS-400 ™, MTS-500 ™ SureMed, ROBOT-Rx®, MedCarousel®, MedShelf-Rx™, PROmanager-Rx™, PACMED™, NarcStation™, PakPlus-Rx®, i.v.STATION™, i.v.SOFT®, Enterprise Medication Manager

XT Anesthesia Workstation™, Performance Center™, Time My Meds® and Automation Decision Support™ . This report also includes other trademarks, service marks and trade names of other companies. All other trademarks used in this report are trademarks of their respective holders.

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OVERVIEW

Our Business

We are a leading provider of comprehensive automation and business analytics software solutions for patient-centric medication and supply management across the entire healthcare continuum, from the acute care hospital setting to post-acute skilled nursing and long-term care facilities to the home. Our Omnicell Automation and Analytic customers worldwide use our medication automation, supply chain and analytics solutions to help enable them to increase operational efficiency, reduce errors, deliver actionable intelligence and improve patient safety.

Omnicell Medication Adherence solutions, including the MTS and Ateb brands, provide innovative medication adherence packaging solutions that can help reduce costly hospital readmissions and enable institutional and retail pharmacies worldwide to maintain high accuracy and quality standards in medication dispensing and administration while optimizing productivity and controlling costs.

We sell our product and consumable solutions together with related service offerings. Revenue generated in the United States represented 88% and 88% of total revenue for the three months ended September 30, 2017 and 2016, respectively, and 87% and 86% of total revenue for the nine months ended September 30, 2017 and 2016. We expect our revenues from international operations to increase in future periods as we continue to grow our international business. We have not sold in the past, and have no future plans to sell our products either directly or indirectly, to customers located in countries that are identified as state sponsors of terrorism by the U.S. Department of State, and are subject to economic sanctions and export controls.

Operating Segments

We manage our business as two operating segments, which are the same as our two reportable segments: Automation and Analytics, and Medication Adherence.

Automation and Analytics

The Automation and Analytics segment is organized around the design, manufacturing, selling, and servicing of medication and supply dispensing systems, pharmacy inventory management systems, and related software. Our Automation and Analytics products are designed to enable our customers to enhance and improve the effectiveness of the medication-use process, the efficiency of the medical-surgical supply chain, overall patient care and clinical and financial outcomes of medical facilities. Through modular configuration and upgrades, our systems can be tailored to specific customer needs.

Medication Adherence

The Medication Adherence segment includes the development, manufacturing and selling of consumable medication blister cards, packaging equipment, pharmacy-based patient care software solutions including a medication synchronization platform, and ancillary products and services. These products are used to manage medication administration outside of the hospital setting and include medication adherence products sold under the brand name MTS, SureMed, Ateb, and the Omnicell brands. MTS products consist of proprietary medication packaging systems and related products for use by institutional pharmacies servicing long-term care and correctional facilities, or retail pharmacies serving patients in their local communities. Recently acquired Ateb is a provider of pharmacy-based patient care solutions and medication synchronization to independent and chain pharmacies.

For further description of our operating segments, refer to Note 13, Segment and Geographical Information, of the Notes to Consolidated Financial Statements in this quarterly report.

Strategy

The healthcare market is experiencing a period of substantive change. The adoption of electronic healthcare records, new regulatory constraints, and changes in the reimbursement structure have caused healthcare institutions to re-examine their operating structures, re-prioritize their investments, and seek efficiencies. We believe our customers' evolving operating environment creates challenges for any supplier, but also affords opportunities for suppliers that are able to partner with customers to help them meet the changing demands. We have, and intend to continue to, invest in the strategies which we believe have generated and will continue to generate our revenue and earnings growth, while supporting our customers' initiatives and needs. These strategies include:

- Development of differentiated solutions. We invest in the development of products that we believe bring patient safety and workflow efficiency to our customers' operations that they cannot get from other competing solutions.

These differentiators may be as small as how a transaction operates or information provided on a report or as large

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as the entire automation of a workflow that would otherwise be completed manually. We intend to continue our focus on differentiating our products, and we carefully assess our investments regularly as we strive to ensure those investments provide the solutions most valuable to our customers.

- Deliver our solutions to new markets. Areas of healthcare where work is done manually may benefit from our existing solutions. These areas include hospitals that continue to employ manual operations, healthcare segments of the U.S. market outside hospitals and markets outside the United States. We weigh the cost of entering these new markets against the expected benefits and focus on the markets that we believe are most likely to adopt our products.
- Expansion of our solutions through acquisitions and partnerships. Our acquisitions have generally been focused on automation of manual workflows or data analytics, which is the enhancement of data for our customers' decision-making processes. We believe that expansion of our product lines through acquisition and partnerships to meet our customers changing and evolving expectations is a key component to our historical and future success.

Our investments have been consistent with the strategies outlined above. To differentiate our solutions from others available in the market, in December 2016 we introduced the XT Series, our new generation of medication and supply automation that is fully integrated on our Unity enterprise platform. The XT Series includes automated medication and supply dispensing cabinets, the Anesthesia Workstation, and Controlled Substance Manager. The XT Automated Medication Cabinets have been integrated with Connect-Rx® from Aesynt, so customers in the United States who use AcuDose-Rx® cabinets can take advantage of the XT Series hardware without changing their software or server infrastructure. As part of this product introduction, we developed a new hardware and electronics architecture for the XT Series. Additionally, in February 2017 we introduced VBM 200F, an automated pharmacy solution that fills and checks SureMed® multiple medication blister cards utilizing guided light, barcode and RFID technologies to allow the filled tray to be audited throughout the entire packing process. This technology helps ensure that pharmacies have the competitive advantage to easily scale their business to help improve adherence and patient outcomes.

Consistent with our strategy to enter new markets, we have made investments in our selling, general and administrative expenses to expand our sales team and market to new customers. Our international efforts have focused primarily on Western Europe, where we sell solutions through a direct sales team in the United Kingdom, France, and Germany and through resellers in other markets; and in the Middle Eastern countries of the Arabian Peninsula. We have also expanded our sales efforts to medication adherence customers in the United States which has allowed us to sell our automated dispensing solutions and other products to this market.

Expansion of our solutions through acquisitions and partnerships include our acquisition of MTS in 2012, our acquisition of Surgichem in August 2014, our acquisitions of Mach4 and Avantec in April 2015, our acquisition of Aesynt in January 2016, our acquisition of Ateb in December 2016, and most recently, our acquisition of InPharmics in April 2017. Surgichem is a provider of medication adherence products in the United Kingdom. Mach4 is a provider of automated medication management systems to retail and hospital pharmacy customers primarily in Europe, with additional installations in China, the Middle East and Latin America. Avantec develops medication and supply automation products that complement our solutions for configurations suited to the United Kingdom marketplace, and has been the exclusive United Kingdom distributor for our medication and supply automation solutions since 2005. Aesynt is a provider of automated medication management systems, including dispensing robots with storage solutions, medication storage and dispensing carts and cabinets, I.V. sterile preparation robotics and software, including software related to medication management. Ateb is a provider of pharmacy-based patient care solutions and medication synchronization to independent and chain pharmacies. InPharmics is a technology and services company that provides advanced pharmacy informatics solutions to hospital pharmacies. We have also developed relationships with major providers of hospital information management systems with the goal of enhancing the interoperability of our products with their systems. We believe that enhanced interoperability will help reduce implementation costs, time, and maintenance for shared clients, while providing new clinical workflows designed to enhance efficiency and patient safety.

We believe that the success of our three leg strategy of differentiated products, expansion into new markets and acquisition and partnership in future periods, will be based on, among other factors:

- Our expectation that the overall market demand for healthcare services will increase as the population grows, life expectancies continue to increase and the quality and availability of healthcare services increases;

- Our expectation that the environment of increased patient safety awareness, increased regulatory control, increased demand for innovative products that improve the care experience and increased need for workflow efficiency through the adoption of technology in the healthcare industry will make our solutions a priority in the capital budgets of healthcare facilities; and

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- Our belief that healthcare customers will continue to value a consultative customer experience from their suppliers.

Among other financial measures, we utilize product bookings to assess the current success of our strategies. Product bookings consist of all firm orders, as evidenced by a contract and purchase order for equipment and software, and by a purchase order for consumables. Equipment and software bookings are installable within twelve months and, other than subscription based sales, generally are recorded as revenue upon customer acceptance of the installation. Consumables are recorded as revenue upon shipment to a customer or receipt by the customer, depending upon contract terms. Consumable bookings are generally recorded as revenue within one month.

In addition to product solution sales, we provide services to our customers. Our healthcare customers expect a high degree of partnership involvement from their technology suppliers throughout their ownership of the products. We provide extensive installation planning and consulting as part of every product sale and included in the initial price of the solution. Our customers' medication control systems are mission critical to their success and our customers require these systems to be functional at all times. To help assure the maximum availability of our systems, our customers typically purchase maintenance and support contracts in one, two or five year increments. As a result of the growth of our installed base of customers, our service revenues have also grown. We strive to provide the best service possible, as measured by third-party rating agencies and by our own surveys, to assure our customers continue to seek service maintenance from us.

In the future, we expect our strategies to evolve as the business environment of our customers evolves, but for our focus to remain on improving healthcare with solutions that help change the practices in ways that improve patient and provider outcomes. We expect our investment in differentiated products, new markets, and acquisitions and partnerships to continue. In 2017, we also intend to manage our business to operating profit margins similar to those achieved in 2016, bringing our strategies to bear in all the markets in which we participate.

On February 15, 2017, we announced our intention to create Centers of Excellence (“COE”) for product development, engineering and manufacturing, with the Point of Use COE located at our facilities in California, the Robotics and Central Pharmacy COE located at our facilities near Pittsburgh, Pennsylvania, and the Medication Adherence Consumables COE located at our facilities in St. Petersburg, Florida. As part of this initiative, we reduced our workforce by approximately 100 full-time employees, or about 4% of the total headcount, closed our Nashville, Tennessee facility, and plan to close our Slovenia facilities in the fourth quarter of 2017. Our full-time headcount was approximately 2,331 and 2,444 on September 30, 2017 on December 31, 2016, respectively.

Recent Acquisitions

On January 5, 2016, we completed the acquisition of all of the membership interests of Aesynt. Aesynt is a provider of automated medication management systems, including dispensing robots with storage solutions, medication storage and dispensing carts and cabinets, I.V. sterile preparation robotics and software, including software related to medication management. The purchase price consideration was $271.5 million, net of cash acquired of $8.2 million. The results of Aesynt's operations have been included in our consolidated results of operations since January 6, 2016, and presented as part of the Automation and Analytics segment.

On December 8, 2016, we completed our acquisition of ateb, Inc., and Ateb Canada Ltd. (together, “Ateb”). Ateb is a provider of pharmacy-based patient care solutions and the medication synchronization solutions leader to independent and chain pharmacies with over one million active pharmacy patients. The purchase price consideration was $40.7 million, net of cash acquired of $0.9 million. The results of Ateb's operations have been included in our consolidated results of operations beginning December 9, 2016, and presented as part of the Medication Adherence segment.

On April 12, 2017, we completed the acquisition of InPharmics, a technology and services company that provides advanced pharmacy informatics solutions to hospital pharmacies. The purchase price consideration was $5.0 million, net of cash acquired of $0.3 million. The results of InPharmics' operations have been included in our consolidated results of operations beginning April 13, 2017, and presented as part of the Automation and Analytics segment.

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CRITICAL ACCOUNTING POLICIES AND ESTIMATES

Our discussion and analysis of our financial condition and results of operations are based on our Condensed Consolidated Financial Statements, which have been prepared in accordance with U.S. GAAP. The preparation of these financial statements requires us to make certain estimates and assumptions that affect the reported amounts of assets and liabilities, disclosure of any contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting periods. We regularly review our estimates and assumptions, which are based on historical experience and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of certain assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates and assumptions. We believe the following critical accounting policies are affected by significant judgments and estimates used in the preparation of our Condensed Consolidated Financial Statements:

- Revenue recognition;
- Accounts receivable and notes receivable (net investment in sales-type leases);
- Inventory valuation;
- Capitalized software development cost;
- Valuation and impairment of goodwill, intangible assets and other long-lived assets;
- Business combinations;
- Valuation of share-based awards; and
- Accounting for income taxes.

There have been no material changes in the matters for which we make critical accounting estimates in the preparation of our Condensed Consolidated Financial Statements during the nine months ended September 30, 2017 as compared to those disclosed in Management's Discussion and Analysis of Financial Condition and Results of Operations included in our annual report on Form 10-K for the year ended December 31, 2016.

Recently adopted and issued authoritative guidance

Refer to Note 1, Organization and Summary of Significant Accounting Policies, of the Notes to Condensed Consolidated Financial Statements in this quarterly report for a description of recently adopted and issued accounting pronouncements, including the expected dates of adoption and estimated effects on our results of operations, financial positions and cash flows.

RESULTS OF OPERATIONS

Total Revenues

	Three months ended September 30,			
			Change in	
	2017	2016	$	%
	(Dollars in thousands)			
Product revenues	$135,103	$133,621	$1,482	1 %
Percentage of total revenues	72 %	76 %		
Service and other revenues	51,679	43,116	8,563	20%
Percentage of total revenues	28 %	24 %		
Total revenues	$186,782	$176,737	$10,045	6 %

Product revenues represented 72% and 76% of total revenues for the three months ended September 30, 2017 and September 30, 2016, respectively. Product revenues increased by $1.5 million due to increased sales for the Medication Adherence segment of $2.9 million, offset by decreased sales for the Automation and Analytics segment of $1.4 million. The decrease in the Automation and Analytics segment was attributed to a slower conversion of bookings and backlog into revenue due to the introduction of the new XT series of products introduced in the fourth quarter of 2016. The increase in the Medication Adherence segment was attributed to higher completed installations compared to the three months ended September 30, 2016, primarily due to the introduction in the fourth quarter of 2016 our VBM product line. In addition, $1.1 million of the increase was attributed to the Ateb acquisition in the fourth quarter of 2016.

Service and other revenues represented 28% and 24% of total revenues for the three months ended September 30, 2017 and September 30, 2016, respectively. Service and other revenues include revenues from service and maintenance contracts and rentals of automation systems. Service and other revenues increased by $8.6 million primarily due to an increase from our

Automation and Analytics segment of $3.7 million attributed to higher service renewal fees, driven mainly by an increase in our installed customer base. Service and other revenues from the Medication Adherence segment increased $4.9 million, primarily attributed to Ateb, acquired in the fourth quarter of 2016, which contributed $5.0 million to the service revenue during the three months ended September 30, 2017.

Our international sales represented 12% and 12% of total revenues for the three months ended September 30, 2017 and 2016, respectively, and are expected to be affected by foreign currency exchange rates fluctuations. We are unable to predict the extent to which revenue in future periods will be impacted by changes in foreign currency exchange rates.

	Nine months ended September 30,			
			Change in	
	2017	2016	$	%
	(Dollars in thousands)			
Product revenues	$362,089	$392,190	$(30,101)	(8)%
Percentage of total revenues	70 %	75 %		
Service and other revenues	156,132	128,458	27,674	22 %
Percentage of total revenues	30 %	25 %		
Total revenues	$518,221	$520,648	$(2,427)	— %

Product revenues represented 70% and 75% of total revenues for the nine months ended September 30, 2017 and September 30, 2016, respectively. Product revenues decreased by $30.1 million due to decreased sales for the Automation and Analytics segment of $35.4 million, partially offset by increased sales for the Medication Adherence segment of $5.3 million. The decrease in the Automation and Analytics segment was attributed to slower conversion of bookings and backlog into revenue as a result of the introduction of the XT series products in the fourth quarter of 2016. The increase in the Medication Adherence segment was attributed to higher machine sales compared to the nine months ended September 30, 2016, primarily due to the introduction of VBM product series in the fourth quarter of 2016. In addition, $2.7 million of the increase was attributed to Ateb.

Service and other revenues represented 30% and 25% of total revenues for the nine months ended September 30, 2017 and September 30, 2016, respectively. Service and other revenues include revenues from service and maintenance contracts and rentals of automation systems. Service and other revenues increased by $27.7 million primarily due to an increase from our Automation and Analytics segment of $12.6 million attributed to higher service renewal fees driven mainly by an increase in our installed customer base. Service and other revenues from the Medication Adherence segment increased $15.1 million, primarily attributed to Ateb, which contributed $15.5 million to the service revenue during the nine months ended September 30, 2017.

International revenues represented 13% and 14% of total revenues for the nine months ended September 30, 2017 and 2016, respectively, and are expected to be affected by foreign currency exchange rates fluctuations. The decrease as a percentage of our total revenues in international revenues were primarily related to our recently acquired companies, Aesynt and Ateb, which have a higher market presence in United States compared to international markets. We are unable to predict the extent to which revenue in future periods will be impacted by changes in foreign currency exchange rates.

Our ability to continue to grow revenue is dependent on our ability to continue to obtain orders from customers, our ability to produce quality products and consumables to fulfill customer demand, the volume of installations we are able to complete, our ability to meet customer needs by providing a quality installation experience, and our flexibility in manpower allocations among customers to complete installations on a timely basis. The timing of our product revenues for equipment is primarily dependent on when our customers' schedules allow for installations.

Financial Information by Segment

Revenues

	Three months ended September 30,			
			Change in	
	2017	2016	$	%
Revenues:	(Dollars in thousands)			
Automation and Analytics	$154,651	$152,437	$2,214	1.5%
Percentage of total revenues	83 %	86 %		
Medication Adherence	32,131	24,300	7,831	32 %
Percentage of total revenues	17 %	14 %		
Total revenues	$186,782	$176,737	$10,045	6 %

The $2.2 million increase in Automation and Analytics revenues for the three months ended September 30, 2017 in comparison to the three months ended September 30, 2016 was due to an increase in service revenues of $3.7 million, partially offset by a decrease in product revenue of $1.4 million. The decrease in product revenue in the Automation and Analytics segment was attributed to slower conversion of bookings and backlog into revenue as result of the introduction of the XT series products in the fourth quarter of 2016. The service revenue increase of $3.7 million was primarily attributed to higher service renewal fees driven mainly by an increase in installed customer base.

Medication Adherence revenues increased by $7.8 million for the three months ended September 30, 2017 in comparison to the three months ended September 30, 2016. The increase in revenue was due to an increase in product revenue of $2.9 million and an increase in service revenue of $4.9 million. The product revenue increase of $2.9 million was attributed primarily to the introduction of the VBM product series in the fourth quarter of 2016. The service revenue increase of $4.9 million was primarily attributed to Ateb, which contributed $5.0 million to the service revenue during the three months ended September 30, 2017.

	Nine months ended September 30,			
			Change in	
	2017	2016	$	%
Revenues:	(Dollars in thousands)			
Automation and Analytics	$427,250	$450,043	$(22,793)	(5)%
Percentage of total revenues	82 %	86 %		
Medication Adherence	90,971	70,605	20,366	29 %
Percentage of total revenues	18 %	14 %		
Total revenues	$518,221	$520,648	$(2,427)	— %

The $22.8 million decrease in Automation and Analytics revenues for the nine months ended September 30, 2017 in comparison to the nine months ended September 30, 2016 was due to a decrease in product revenue of $35.4 million, partially offset by an increase in service revenues of $12.6 million. The decrease in the Automation and Analytics segment was attributed to a slower conversion of bookings and backlog into revenue due to the introduction of the new XT series of products in the fourth quarter of 2016. While we have experienced larger deal sizes, the administrative process of converting our existing bookings of G4 products into XT series products has decelerated revenue recognition during the nine months ended September 30, 2017 compared to the nine months ended September 30, 2016. Service revenue increase of $12.6 million was primarily attributed to higher service renewal fees driven mainly by an increase in installed customer base.

Medication Adherence revenues increased by $20.4 million for the nine months ended September 30, 2017 in comparison to the nine months ended September 30, 2016. The increase in revenue was comprised of an increase in product revenue of $5.3 million and increase in service revenue of $15.1 million. Product revenue increase of $5.3 million was attributed primarily to the introduction of the VBM product series in the fourth quarter of 2016. The service revenue increase of $15.1 million was primarily attributed to Ateb, which contributed $15.5 million to the service revenue during the nine months ended September 30, 2017.

Cost of Revenues and Gross Profit

Cost of revenues is primarily comprised of three general categories: (i) standard product costs which accounts for the majority of the product cost of revenues that are provided to customers, and are inclusive of purchased material, labor to build the product and overhead costs associated with production; (ii) installation costs as we install our equipment at the customer site and include costs of the field installation personnel, including labor, travel expense, and other expenses; and (iii) other costs, including variances in standard costs and overhead, scrap costs, rework, warranty, provisions for excess and obsolete inventory and amortization of software development costs and intangibles.

	Three months ended September 30,			
			Change in	
	2017	2016	$	%
Cost of revenues:	(Dollars in thousands)			
Automation and Analytics	$79,740	$77,828	$1,912	2 %
As a percentage of related revenues	52 %	51 %		
Medication Adherence	22,189	17,401	4,788	28 %
As a percentage of related revenues	69 %	72 %		
Total cost of revenues	$101,929	$95,229	$6,700	7 %
As a percentage of total revenues	55 %	54 %		
Gross profit:				
Automation and Analytics	$74,911	$74,609	$302	— %
Automation and Analytics gross margin	48 %	49 %		
Medication Adherence	9,942	6,899	3,043	44 %
Medication Adherence gross margin	31 %	28 %		
Total gross profit	$84,853	$81,508	$3,345	4 %
Total gross margin	45 %	46 %		

	Nine months ended September 30,			
			Change in	
	2017	2016	$	%
Cost of revenues:	(Dollars in thousands)			
Automation and Analytics	$229,218	$233,401	$(4,183)	(2)%
As a percentage of related revenues	54 %	52 %		
Medication Adherence	61,983	47,777	14,206	30 %
As a percentage of related revenues	68 %	68 %		
Total cost of revenues	$291,201	$281,178	$10,023	4 %
As a percentage of total revenues	56 %	54 %		