Inogen Inc
Form 10-Q
November 03, 2016

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2016

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the Transition Period From to

Commission file number: 001-36309

INOGEN, INC.

(Exact name of registrant as specified in its charter)

Delaware	33-0989359
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
326 Bollay Drive Goleta, California	93117
(Address of principal executive offices)	(Zip Code)

(805) 562-0500

(Registrant’s telephone number, including area code)

None

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

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

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

As of October 31, 2016, the registrant had 20,260,695 shares of common stock, par value $0.001, outstanding.

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INOGEN, INC.

PART I – FINANCIAL INFORMATION

Item 1. Financial Statements

Inogen, Inc.

Balance Sheets

(unaudited)

(amounts in thousands)

	September 30, 2016	December 31, 2015
Assets		
Current assets		
Cash and cash equivalents	$ 86,009	$ 66,106
Marketable securities	22,331	16,793
Accounts receivable, net	29,717	19,872
Inventories, net	16,499	8,648
Deferred cost of revenue	439	397
Income tax receivable	1,612	2,158
Prepaid expenses and other current assets	1,470	870
Total current assets	158,077	114,844
Property and equipment		
Rental equipment, net	54,684	54,677
Manufacturing equipment and tooling	5,850	4,680
Computer equipment and software	4,663	4,503
Furniture and equipment	757	732
Leasehold improvements	811	978
Land and building	125	125
Construction in process	430	578
Total property and equipment	67,320	66,273
Less accumulated depreciation	(40,485)	(35,593)
Property and equipment, net	26,835	30,680
Intangible assets, net	268	229
Deferred tax asset - noncurrent	9,514	15,464
Other assets	97	97
Total assets	$ 194,791	$ 161,314

See accompanying condensed notes to the financial statements.

Inogen, Inc.

Balance Sheets (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

	September 30, 2016	December 31, 2015
Liabilities and stockholders' equity		
Current liabilities		
Accounts payable and accrued expenses	$ 20,710	$ 12,867
Accrued payroll	5,844	5,271
Current portion of long-term debt	80	315
Warranty reserve - current	1,559	1,226
Deferred revenue - current	2,035	2,323
Income tax payable	—	11
Total current liabilities	30,228	22,013
Long-term liabilities		
Warranty reserve - noncurrent	1,838	747
Deferred revenue - noncurrent	6,343	4,199
Other noncurrent liabilities	300	337
Total liabilities	38,709	27,296
Commitments and contingencies (Note 9)		
Stockholders' equity		
Common stock, $0.001 par value per share; 200,000,000 authorized; 20,244,243 and 19,782,403 shares issued and outstanding as of September 30, 2016 and December 31, 2015, respectively	20	20
Additional paid-in capital	190,202	179,143
Accumulated deficit	(34,146)	(45,108)
Accumulated other comprehensive income (loss)	6	(37)
Total stockholders' equity	156,082	134,018
Total liabilities and stockholders' equity	$ 194,791	$ 161,314

See accompanying condensed notes to the financial statements.

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Inogen, Inc.

Statements of Comprehensive Income

(unaudited)

(amounts in thousands, except share and per share amounts)

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Revenue				
Sales revenue	$47,177	$29,248	$125,566	$84,682
Rental revenue	7,245	11,530	26,412	33,877
Total revenue	54,422	40,778	151,978	118,559
Cost of revenue				
Cost of sales revenue	24,271	16,046	63,824	46,501
Cost of rental revenue, including depreciation of $2,878 and $3,029 for the three months ended and $8,733 and $8,929 for the nine months ended, respectively	5,023	5,357	15,532	15,838
Total cost of revenue	29,294	21,403	79,356	62,339
Gross profit				
Gross profit-sales revenue	22,906	13,202	61,742	38,181
Gross profit-rental revenue	2,222	6,173	10,880	18,039
Total gross profit	25,128	19,375	72,622	56,220
Operating expense				
Research and development	1,350	1,116	3,897	2,954
Sales and marketing	9,679	8,132	28,220	22,623
General and administrative	8,702	6,413	23,812	19,066
Total operating expense	19,731	15,661	55,929	44,643
Income from operations	5,397	3,714	16,693	11,577
Other income (expense)				
Interest expense	(1)	(5)	(6)	(18)
Interest income	61	28	126	66
Other income (expense)	(8)	(59)	78	(215)
Total other income (expense), net	52	(36)	198	(167)
Income before provision for income taxes	5,449	3,678	16,891	11,410
Provision for income taxes	1,994	982	5,929	3,683
Net income	3,455	2,696	10,962	7,727
Other comprehensive income, net of tax				
Unrealized gain (loss) on foreign currency hedging during the period	10	—	(24)	—
	2	—	51	—

Add: reclassification adjustment for losses included in net income				
Total unrealized gain on foreign currency hedging	12	—	27	—
Unrealized gain (loss) on available-for-sale investments during the period	(4)	—	16	—
Total other comprehensive income, net of tax	8	—	43	—
Comprehensive income	$3,463	$2,696	$11,005	$7,727
Basic net income per share attributable to common stockholders (Note 5)	$0.17	$0.14	$0.55	$0.40
Diluted net income per share attributable to common stockholders (Note 5)	$0.16	$0.13	$0.52	$0.37
Weighted-average number of shares used in calculating net income per share attributable to common stockholders:				
Basic common shares	20,157,688	19,428,653	19,986,544	19,303,057
Diluted common shares	21,100,725	20,783,550	20,924,022	20,690,499

See accompanying condensed notes to the financial statements.

Inogen, Inc.

Statement of Stockholders' Equity

(unaudited)

(amounts in thousands, except share amounts)

	Common stock Shares	Amount	Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive income (loss)	Total stockholders' equity
Balance, December 31, 2014	19,059,364	$ 19	$ 174,824	$ (56,693)	$ —	$ 118,150
Stock-based compensation	—	—	2,343	—	—	2,343
Employee stock purchases	31,106	—	701	—	—	701
Stock options exercised	496,203	—	1,001	—	—	1,001
Net income	—	—	—	7,727	—	7,727
Balance, September 30, 2015	19,586,673	$ 19	$ 178,869	$ (48,966)	$ —	$ 129,922
Balance, December 31, 2015	19,782,403	20	179,143	(45,108)	(37)	134,018
Stock-based compensation	—	—	5,404	—	—	5,404
Employee stock purchases	37,378	—	1,055	—	—	1,055
Stock options exercised	424,462	—	4,600	—	—	4,600
Net income	—	—	—	10,962	—	10,962
Other comprehensive income	—	—	—	—	43	43
Balance, September 30, 2016	20,244,243	$ 20	$ 190,202	$ (34,146)	$ 6	$ 156,082

See accompanying condensed notes to the financial statements.

Inogen, Inc.

Statements of Cash Flows

(unaudited)

(amounts in thousands)

	Nine months ended September 30,	
	2016	2015
Cash flows from operating activities		
Net income	$10,962	$7,727
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	10,290	10,468
Loss on rental units and other fixed assets	891	889
Gain on sale of former assets	(224)	—
Provision for sales returns and doubtful accounts	8,177	5,346
Provision for rental revenue adjustments	7,783	6,364
Provision for inventory obsolescence and other inventory losses, net of recoveries	141	131
Stock-based compensation expense	5,404	2,343
Deferred tax assets	5,950	3,682
Changes in operating assets and liabilities:		
Accounts receivable	(25,812)	(13,251)
Inventories	(9,220)	(3,167)
Deferred cost of revenue	(42)	41
Income tax receivable	546	(32)
Prepaid expenses and other current assets	(600)	(774)
Accounts payable and accrued expenses	7,801	3,030
Accrued payroll	573	573
Warranty reserve	1,424	673
Deferred revenue	1,856	1,615
Income tax payable	(11)	—
Other noncurrent liabilities	(37)	(54)
Net cash provided by operating activities	25,852	25,604
Cash flows from investing activities		
Purchases of available-for-sale investments	(26,321)	(33,557)
Maturities of available-for-sale investments	20,799	14,529
Investment in intangible assets	(112)	(21)
Investment in property and equipment	(6,071)	(9,780)
Proceeds from sale of former assets	328	—
Net cash used in investing activities	(11,377)	(28,829)

(continued on next page)

See accompanying condensed notes to the financial statements.

Inogen, Inc.

Statements of Cash Flows (continued)

(unaudited)

(amounts in thousands)

	Nine months ended September 30,	
	2016	2015
Cash flows from financing activities		
Proceeds from stock options exercised	4,600	1,001
Proceeds from employee stock purchases	1,055	701
Repayment of debt from investment in intangible assets	(235)	(223)
Net cash provided by financing activities	5,420	1,479
Effect of exchange rates on cash	8	—
Net increase (decrease) in cash and cash equivalents	19,903	(1,746)
Cash and cash equivalents, beginning of period	66,106	56,836
Cash and cash equivalents, end of period	$86,009	$55,090
Supplemental disclosures of cash flow information		
Cash paid during the period for interest	$9	$21
Cash paid (received) during the period for income taxes, net	(533)	32

See accompanying condensed notes to the financial statements.

Inogen, Inc.

Condensed Notes to the Financial Statements

(unaudited)

(amounts in thousands, except share and per share amounts)

1. Business overview

Inogen, Inc. (Company or Inogen) was incorporated in Delaware on November 27, 2001. The Company is a medical technology company that primarily develops, manufactures and markets innovative portable oxygen concentrators used to deliver supplemental long-term oxygen therapy to patients suffering from chronic respiratory conditions. Traditionally, these patients have relied on stationary oxygen concentrator systems for use in the home and oxygen tanks or cylinders for mobile use, which the Company calls the delivery model. The tanks and cylinders must be delivered regularly and have a finite amount of oxygen, which requires patients to plan activities outside of their homes around delivery schedules and a finite oxygen supply. Additionally, patients must attach long, cumbersome tubing to their stationary concentrators simply to enable mobility within their homes. The Company's proprietary Inogen One® systems concentrate the air around the patient to offer a single source of supplemental oxygen anytime, anywhere with a portable device weighing 2.8, 4.8 or 7.0 pounds with a single battery. The Company's Inogen One G4®, Inogen One G3® and Inogen One G2® have up to 2.5, 5 and 5 hours of battery life, respectively, with a single battery and can be plugged into an outlet when at home, in a car, or in a public place with outlets available. The Company's Inogen One systems reduce the patient's reliance on stationary concentrators and scheduled deliveries of tanks with a finite supply of oxygen, thereby improving patient quality of life and fostering mobility.

Portable oxygen concentrators represented the fastest-growing segment of the Medicare oxygen therapy market between 2012 and 2015. The Company estimates based on 2015 Medicare data that patients using portable oxygen concentrators represent approximately 8% of the total addressable oxygen market in the United States, although the Medicare data does not account for cash-pay sales into the market. Based on 2015 industry data, the Company believes it was the leading worldwide manufacturer of portable oxygen concentrators, as well as the largest provider of portable oxygen concentrators to Medicare patients, as measured by dollar volume. The Company believes it is the only manufacturer of portable oxygen concentrators that employs a direct-to-consumer strategy in the United States, meaning the Company markets its products to patients, processes their physician paperwork, provides clinical support as needed and bills Medicare or insurance on their behalf. To pursue a direct-to-consumer strategy, the Company's manufacturing competitors would need to meet national accreditation and state-by-state licensing requirements and secure Medicare billing privileges, as well as compete with the home medical equipment providers that many rely on across their entire homecare business.

Since adopting the Company's direct-to-consumer strategy in 2009 following its acquisition of Comfort Life Medical Supply, LLC, which had an active Medicare billing number but few other assets and limited business activities, the Company has directly sold or rented its Inogen oxygen concentrators to more than 196,000 patients as of September 30, 2016.

2. Basis of presentation and summary of significant accounting policies

The accompanying financial statements are unaudited. The balance sheet at December 31, 2015 has been derived from the audited financial statements of the Company. The accompanying financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America (U.S. GAAP) for interim financial information, and in management's opinion, includes all adjustments, consisting of only normal recurring adjustments, necessary for the fair statement of the Company's financial position, its results of operations, stockholders' equity and cash flows for the interim periods presented. The results of operations for the three and nine months ended September 30, 2016 are not necessarily indicative of the results to be expected for the full fiscal year or any other period.

The accompanying financial statements should be read in conjunction with the financial statements and notes thereto contained in the Company's Annual Report on Form 10-K filed with the Securities and Exchange Commission (SEC) on March 14, 2016. There have been no significant changes in the Company's accounting policies from those disclosed in its Annual Report on Form 10-K filed with the SEC on March 14, 2016.

Inogen, Inc.

Condensed Notes to the Financial Statements (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

Use of estimates

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period. Actual results could differ from those estimates. Management bases these estimates and assumptions upon historical experience, existing and known circumstances, authoritative accounting pronouncements and other factors that management believes to be reasonable. Significant areas requiring the use of management estimates relate to revenue recognition, inventory and rental asset valuations and write-downs, accounts receivable allowances for bad debts, returns and adjustments, stock compensation expense, impairment assessments, depreciation and amortization, income tax provision and uncertain tax positions, fair value of financial instruments, and fair values of acquired intangibles. Actual results could differ from these estimates.

Reclassifications

Certain reclassifications have been made to prior years' financial statements to conform to current period financial statements' presentation with no effect on previously reported financial position, results of operations or cash flows. These changes consisted of reclassifications to certain line items in the accompanying Statement of Cash Flows and did not change total operating, financing or investing activities as previously reported.

Recent accounting pronouncements

Income taxes pronouncements:

In November 2015, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2015-17, Balance Sheet Classification of Deferred Taxes, which simplifies the presentation of deferred income taxes. This ASU requires that deferred tax assets and liabilities be classified as noncurrent in a statement of financial position. The Company early adopted ASU No. 2015-17 effective December 31, 2015 on a prospective basis. Adoption of this ASU resulted in a reclassification of the Company's net current deferred tax asset to the net noncurrent deferred tax asset in the Company's balance sheet as of December 31, 2015. No prior periods were retrospectively adjusted.

Revenue recognition pronouncements:

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers, which supersedes nearly all existing revenue recognition guidance under U.S. GAAP. The core principle of ASU No. 2014-09 is to recognize revenues when promised goods or services are transferred to customers in an amount that reflects the consideration to which an entity expects to be entitled for those goods or services. ASU No. 2014-09 defines a five-step process to achieve this core principle and, in doing so, more judgment and estimates may be required within the revenue recognition process than are required under existing U.S. GAAP.

In August 2015, the FASB decided to delay the effective date of ASU No. 2014-09 by one year. The FASB also agreed to allow entities to choose to adopt the standard as of the original effective date. As such, the updated standard will be effective for the Company in the first quarter of 2018, with the option to adopt it in the first quarter of 2017. The Company is currently evaluating the impact of the Company's pending adoption of ASU No. 2014-09 on the Company's financial statements and has not yet determined the method by which the Company will adopt the standard.

In March 2016, the FASB issued ASU No. 2016-08, Revenue with Contracts with Customers: Principal versus Agent Considerations (Reporting Revenue Gross versus net), which is an amendment to ASU No. 2014-09 that improved the operability and understandability of implementation guidance versus agent considerations by clarifying the determination of principal versus agent. The implementation guidelines follow ASU No. 2014-09.

In April 2016, the FASB issued ASU No. 2016-10, Revenue with Contracts with Customers: Identifying Performance Obligations and Licensing, which is an amendment to ASU No. 2014-09 that clarifies the aspects of identifying performance obligations and the licensing implementing guidance, while retaining the related principles within those areas. The implementation guidelines follow ASU No. 2014-09.

Inogen, Inc.

Condensed Notes to the Financial Statements (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

In May 2016, the FASB issued ASU No. 2016-12, Revenue with Contracts with Customers: Narrow-scope Improvements and Practical Expedients, which is an amendment to ASU No. 2014-09 that clarifies the objective of the collectability criterion, to allow entities to exclude amounts collected from customers from all sales taxes from the transaction price, to specify the measurement date for noncash consideration is contract inception, variable consideration guidance applies only to variability resulting from reasons other than the form of the consideration, and clarification on contract modifications at transition. The implementation guidelines follow ASU No. 2014-09.

Inventory pronouncements:

In July 2015, the FASB issued ASU No. 2015-11, Simplifying the Measurement of Inventory. The ASU requires entities to measure most inventory “at the lower of cost and net realizable value” thereby simplifying the current guidance under which an entity must measure inventory at the lower of cost or market. The ASU is effective prospectively for annual periods beginning after December 15, 2016, and interim periods within annual periods. Early application is permitted and should be applied prospectively. The adoption of ASU No. 2015-11 is not expected to have a material effect on the Company’s financial statements.

Leases pronouncements:

On February 25, 2016, the FASB issued ASU No. 2016-02, Leases (Topic 842). The new guidance will require organizations that lease assets—referred to as “lessees”—to recognize on the balance sheet the assets and liabilities for the rights and obligations created by those leases with lease terms of more than 12 months. This will increase the reported assets and liabilities – in some cases very significantly. ASU No. 2016-02 will take effect for public companies for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. Early adoption will be permitted for all entities. The Company is currently evaluating the effect of the new lease recognition guidance and has not yet determined the impact on the Company’s results of operations and financial condition.

Stock compensation pronouncements:

In March 2016, the FASB issued ASU No. 2016-09, Compensation – Stock Compensation, which simplifies 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 ASU is effective for annual periods beginning after December 15, 2016, and interim periods within those annual periods. Certain amendments related to ASU No. 2016-09 are implemented with changes recognized on a modified retrospective transition method, retrospectively as well as prospectively. Early application is permitted for any entity in any interim or annual period. If early adoption is elected during an interim period, any adjustments should be reflected as of the beginning of the fiscal year that includes that interim period. If early adoption is elected, all of the amendments must be adopted in the same period. The adoption of ASU No. 2016-09 and its impact to the financial statements is still being reviewed by the Company, and early adoption has not yet been determined.

Financial instruments pronouncements:

In June 2016, the FASB issued ASU No. 2016-13, Accounting for Credit Losses (Topic 326). The new standard requires the use of an “expected loss” model on certain types of financial instruments. The standard also amends the impairment model for available-for-sale debt securities and requires estimated credit losses to be recorded as allowances instead of reductions to amortized cost of the securities. The ASU is effective for fiscal years beginning after December 15, 2019, and interim periods within those years, with early adoption permitted. The Company is evaluating the new guidance but does not expect it to have a significant impact on the Company’s financial statement presentation or results.

Statement of cash flows pronouncements:

In August 2016, the FASB issued ASU No. 2016-15, Statement of Cash Flows (Topic 230). The standard is intended to reduce diversity in practice in how certain transactions are classified in the statement of cash flows. The ASU is effective for fiscal years beginning after December 15, 2017, and interim periods within those years, with early adoption permitted. The Company is evaluating the new guidance but does not expect it to have a significant impact on the Company’s financial statement presentation or results.

Inogen, Inc.

Condensed Notes to the Financial Statements (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

Business segments

The Company operates and reports in only one operating and reportable segment – development, manufacturing, marketing, sales, and rental of respiratory products.

3. Fair value of financial instruments

The Company's financial instruments consist of cash and cash equivalents, marketable securities, accounts receivable, accounts payable and accrued expenses, debt and warrants. The carrying values of cash and cash equivalents, marketable securities, accounts receivable and accounts payable and accrued expenses approximate fair values based on the short-term nature of these financial instruments.

The fair value of the Company's debt approximates carrying value based on the Company's current incremental borrowing rate for similar types of borrowing arrangements. Imputed interest associated with the Company's non-interest bearing debt is insignificant and has been appropriately recognized in the respective periods.

Fair value accounting

ASC 820—Fair Value Measurements and Disclosures, creates a single definition of fair value, establishes a framework for measuring fair value in U.S. GAAP and expands disclosures about fair value measurements. ASC 820 emphasizes that fair value is a market-based measurement, not an entity-specific measurement, and states that a fair value measurement is to estimate the price at which an orderly transaction to sell an asset or to transfer the liability would take place between market participants at the measurement date under current market conditions. Assets and liabilities adjusted to fair value in the balance sheet are categorized based upon the level of judgment associated with the inputs used to measure their fair value. Level inputs, as defined by ASC 820, are as follows:

Level input	Input definition
Level 1	Inputs are unadjusted, quoted prices for identical assets or liabilities in active markets at the measurement date.
Level 2	Inputs, other than quoted prices included in Level 1 that are observable for the asset or liability through corroboration with market data at the measurement date.
Level 3	Unobservable inputs that reflect management's best estimate of what market participants would use in pricing the asset or liability at the measurement date.

The Company obtained the fair value of its available-for-sale investments, which are not in active markets, from a third-party professional pricing service using quoted market prices for identical or comparable instruments, rather than direct observations of quoted prices in active markets. The Company's professional pricing service gathers observable inputs for all of its fixed income securities from a variety of industry data providers (e.g., large custodial institutions) and other third-party sources. Once the observable inputs are gathered, all data points are considered and the fair value is determined. The Company validates the quoted market prices provided by its primary pricing service by comparing their assessment of the fair values against the fair values provided by its investment managers. The Company's investment managers use similar techniques to its professional pricing service to derive pricing as described above. As all significant inputs were observable, derived from observable information in the marketplace or supported by observable levels at which transactions are executed in the marketplace, the Company has classified its available-for-sale investments within Level 2 of the fair value hierarchy.

Inogen, Inc.

Condensed Notes to the Financial Statements (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

The following table summarizes fair value measurements by level for the assets measured at fair value on a recurring basis for cash, cash equivalents and marketable securities:

	As of September 30, 2016				
	Adjusted cost	Gross unrealized losses	Fair value	Cash and cash equivalents	Marketable securities
Cash	$43,454	$ —	$43,454	$ 43,454	$ —
Level 1:					
Money market accounts	39,793	—	39,793	39,793	—
Level 2:					
Certificates of deposit	14,782	—	14,782	2,762	12,020
Corporate bonds	10,321	(10)	10,311	—	10,311
Total	$108,350	$ (10)	$108,340	$ 86,009	$ 22,331

	As of December 31, 2015				
	Adjusted cost	Gross unrealized losses	Fair value	Cash and cash equivalents	Marketable securities
Cash	$52,164	$ —	$52,164	$ 52,164	$ —
Level 1:					
Money market accounts	6,725	—	6,725	6,725	—
Level 2:					
Certificates of deposit	24,047	(37)	24,010	7,217	16,793
Total	$82,936	$ (37)	$82,899	$ 66,106	$ 16,793

The following table summarizes the estimated fair value of the Company’s investments in marketable securities, accounted for as available-for-sale securities and classified by the contractual maturity date of the securities:

	September 30, 2016

Due within one year	$ 15,081
Due in one year through five years	7,250
Total	$ 22,331

Derivative instruments and hedging activities

The Company transacts business in foreign currencies and has international sales and expenses denominated in foreign currencies, subjecting the Company to foreign currency risk. The Company has entered into foreign currency forward contracts, generally with maturities of twelve months or less, to reduce the volatility of cash flows primarily related to forecasted revenue denominated in certain foreign currencies. These contracts allow the Company to sell Euros in exchange for U.S. dollars at specified contract rates. Forward contracts are used to hedge forecasted sales over specific months. Changes in the fair value of these forward contracts designed as cash flow hedges are recorded as a component of accumulated other comprehensive income (loss) within stockholders' equity and are recognized in the statements of comprehensive income during the period which approximates the time the corresponding sales occur. The Company may also enter into foreign exchange contracts that are not designated as hedging instruments for financial accounting purposes. These contracts are generally entered into to offset the gains and losses on certain asset and liability balances until the expected time of repayment. Accordingly, any gains or losses resulting from changes in the fair value of the non-designated contracts are reported in other income (expense), net in the statements of comprehensive income. The gains and losses on these contracts generally offset the gains and losses associated with the underlying foreign currency-denominated balances, which are also reported in other income (expense), net.

Inogen, Inc.

Condensed Notes to the Financial Statements (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

The Company records the assets or liabilities associated with derivative instruments and hedging activities at fair value based on Level 2 inputs in other current assets or other current liabilities, respectively, in the balance sheet. The Company had a receivable of $6 as of September 30, 2016 and a payable of $24 as of December 31, 2015. The Company classifies the foreign currency derivative instruments within Level 2 in the fair value hierarchy as the valuation inputs are based on quoted prices and market observable data of similar instruments. The accounting for gains and losses resulting from changes in fair value depends on the use of the derivative and whether it is designated and qualifies for hedge accounting.

The Company documents the hedging relationship and its risk management objective and strategy for undertaking the hedge, the hedging instrument, the hedged transaction, the nature of the risk being hedged, how the hedging instrument's effectiveness in offsetting the hedged risk will be assessed prospectively and retrospectively, and a description of the method used to measure ineffectiveness. The Company assesses hedge effectiveness and ineffectiveness at a minimum quarterly but may assess it monthly. For derivative instruments that are designed and qualify as part of a cash flow hedging relationship, the effective portion of the gain or loss on the derivative is reported in other comprehensive income (loss) and reclassified into earnings in the same period or periods during which the hedged transaction affects earnings. Gains and losses on the derivative representing either hedge ineffectiveness or hedge components excluded from the assessment of effectiveness are recognized in current period earnings.

The Company will discontinue hedge accounting prospectively when it determines that the derivative is no longer effective in offsetting cash flows attributable to the hedge risk. The cash flow hedge is de-designated because a forecasted transaction is not probable of occurring, or management determines to remove the designation of the cash flow hedge. In all situations in which hedge accounting is discontinued and the derivative remains outstanding, the Company continues to carry the derivative at its fair value on the balance sheet and recognizes any subsequent changes in the fair value in earnings. When it is probable that a forecasted transaction will not occur, the Company will discontinue hedge accounting and recognize immediately in earnings gains and losses that were accumulated in other comprehensive income related to the hedging relationship.

Accumulated other comprehensive income (loss)

The components of accumulated other comprehensive income (loss), net of tax, were as follows:

	Unrealized gains (losses) on available-for-sale investments	Unrealized gains (losses) on cash flow hedges	Accumulated other comprehensive income (loss)
Balance as of December 31, 2015	$ (23)	$ (14)	$ (37)

Other comprehensive gain, net of tax	16	27	43
Balance as of September 30, 2016	$ (7)	$ 13	$ 6

Comprehensive income (loss) is the total net earnings and all other non-owner changes in equity. Except for net income and unrealized gains and losses on cash flow hedges and available-for-sale investments, the Company does not have any transactions or other economic events that qualify as comprehensive income (loss).

4. Balance sheet components

Cash, cash equivalents, and marketable securities

The Company considers all short-term highly liquid investments with a maturity of three months or less to be cash equivalents. Cash equivalents are recorded at cost plus accrued interest (adjusted cost), which approximates fair value which includes the unrealized gains (losses). Certificates of deposit are included in cash equivalents and marketable securities based on the maturity date of the security. Short-term investments are included in marketable securities in the current period presentation.

The Company considers investments with maturities greater than three months to be marketable securities. Investments are classified as available-for-sale and are reported at fair value with unrealized gains or losses, if any, reported, net of tax, in accumulated other comprehensive income (loss). All income generated and realized gains or losses from investments are recorded to other income (expense), net.

Inogen, Inc.

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(amounts in thousands, except share and per share amounts)

The Company reviews its investments to identify and evaluate investments that have an indication of possible impairment. Factors considered in determining whether a loss is temporary include the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, and the Company's intent and ability to hold the investment for a period of time sufficient to allow for any anticipated recovery in market value. Credit losses and other-than-temporary impairments are declines in fair value that are not expected to recover and are charged to other income (expense), net. During the three and nine months ended September 30, 2016 and 2015, respectively, no losses were recognized for other-than-temporary impairments. Cash, cash equivalents and marketable securities consist of the following:

Cash and cash equivalents	September 30, 2016	December 31, 2015
Cash	$ 43,454	$ 52,164
Money market accounts	39,793	6,725
Certificates of deposit	2,762	7,217
Total cash and cash equivalents	$ 86,009	$ 66,106
Marketable securities		
Certificates of deposit	$ 12,020	$ 16,793
Corporate bonds	10,311	—
Total marketable securities	$ 22,331	$ 16,793

Accounts receivable and allowance for bad debts, returns, and adjustments

Accounts receivable are customer obligations due under normal sales and rental terms. The Company performs credit evaluations of the customers' financial condition and generally does not require collateral. The allowance for doubtful accounts is maintained at a level that, in management's opinion, is adequate to absorb potential losses related to accounts receivable and is based upon the Company's continuous evaluation of the collectability of outstanding balances. Management's evaluation takes into consideration such factors as past bad debt experience, economic conditions and information about specific receivables. The Company's evaluation also considers the age and composition of the outstanding amounts in determining their net realizable value.

The allowance for doubtful accounts is based on estimates, and ultimate losses may vary from current estimates. As adjustments to these estimates become necessary, they are reported in earnings in the periods in which they become known. This allowance is increased by bad debt provisions charged to bad debt expense, net of recoveries, in operating expense and is reduced by direct write-offs.

The Company generally does not allow returns from providers for reasons not covered under its standard warranty. Therefore, provision for sales returns applies primarily to direct-to-consumer sales. This reserve is calculated based on

actual historical return rates under the Company's 30-day return program and is applied to the related sales revenue for the last month of the quarter reported.

The Company also records an allowance for rental revenue adjustments, which is recorded as a reduction of rental revenue and net rental accounts receivable balances. These adjustments result from contractual adjustments, including untimely claims filings, or billings not paid due to another provider performing same or similar functions for the patient in the same period, all of which prevent billed revenue from becoming realizable. The reserve is based on historical revenue adjustments as a percentage of rental revenue billed and unbilled during the related period.

When recording the allowance for doubtful accounts, the bad debt expense account (general and administrative expense account) is charged; when recording allowance for sales returns, the sales returns account (contra sales revenue account) is charged; and when recording the allowance for rental reserve adjustments, the rental revenue adjustments account (contra rental revenue account) is charged.

As of September 30, 2016 and December 31, 2015, included in accounts receivable on the balance sheets were earned but unbilled receivables of $5,272 and $5,155, respectively. These balances reflect gross unbilled receivables prior to any allowances for adjustments and write-offs. The Company consistently applies its allowance estimation methodology from period-to-period. The Company's best estimate is made on an accrual basis and adjusted in future periods as required. Any adjustments to the prior period estimates are included in the current period. As additional information becomes known, the Company adjusts its assumptions accordingly to change its estimate of the allowance.

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(amounts in thousands, except share and per share amounts)

Gross accounts receivable balance concentrations by major category as of September 30, 2016 and December 31, 2015 were as follows:

Gross accounts receivable	September 30, 2016	December 31, 2015
Medicare	$ 11,204	$ 10,510
Medicaid/other government	555	683
Private insurance	3,312	4,852
Patient responsibility	2,856	3,603
Business-to-business & other receivables	18,698	6,369
Total gross accounts receivable	$ 36,625	$ 26,017

Net accounts receivable (gross accounts receivable net of allowances) balance concentrations by major category as of September 30, 2016 and December 31, 2015 were as follows:

Net accounts receivable	September 30, 2016	December 31, 2015
Medicare	$ 6,668	$ 7,441
Medicaid/other government	394	550
Private insurance	2,738	3,895
Patient responsibility	1,907	2,060
Business-to-business & other receivables	18,010	5,926
Total net accounts receivable	$ 29,717	$ 19,872

The following tables set forth the accounts receivable allowances as of September 30, 2016 and December 31, 2015:

Allowances - accounts receivable	September 30, 2016	December 31, 2015
Doubtful accounts	$ 1,192	$ 1,664
Rental revenue adjustments	5,137	4,115
Sales returns	579	366
Total allowances - accounts receivable	$ 6,908	$ 6,145

Concentration of credit risk

Financial instruments that potentially subject the Company to concentration of credit risk consist principally of cash, cash equivalents, marketable securities and accounts receivable. At times, cash account balances may be in excess of the amounts insured by the Federal Deposit Insurance Corporation (FDIC). However, management believes the risk of loss to be minimal. The Company performs periodic evaluations of the relative credit standing of these institutions and has not experienced any losses on its cash and cash equivalents to date. The Company has entered into hedging relationships with a single counterparty to offset a portion of the forecasted Euro based revenues. The credit risk has been reduced due to a net settlement arrangement whereby the Company is allowed to net settle transactions with a single net amount payable by one party to the other.

Concentration of customers and vendors

The Company primarily sells its products to traditional home medical equipment providers, distributors, and resellers in the United States and in foreign countries on a credit basis. The Company primarily sells its products to consumers on a prepayment basis. No single customer represented more than 10% of the Company’s total revenue for the nine months ended September 30, 2016 and September 30, 2015. One customer represented more than 10% of the Company’s total net accounts receivable balance as of September 30, 2016, and no single customer represented more than 10% of the Company’s total net accounts receivable balance as of December 31, 2015.

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The Company also rents products directly to consumers for insurance reimbursement, which resulted in a customer concentration relating to Medicare's service reimbursement programs. Medicare's service reimbursement programs accounted for 71.0% and 75.9% of rental revenue for the three months ended September 30, 2016 and September 30, 2015, respectively, and based on total revenue was 9.5% and 21.5% for the three months ended September 30, 2016 and September 30, 2015, respectively. Medicare's service reimbursement programs accounted for 71.6% and 74.0% of rental revenue for the nine months ended September 30, 2016 and September 30, 2015, respectively, and based on total revenue was 12.4% and 21.1% for the nine months ended September 30, 2016 and September 30, 2015, respectively. One customer represented more than 10% of the Company's total revenue for the three months ended September 30, 2016. Accounts receivable balances relating to Medicare's service reimbursement programs (including held and unbilled, net of allowances) amounted to $6,668 or 22.4% of total net accounts receivable as of September 30, 2016 as compared to $7,441, or 37.4% of total net accounts receivable as of December 31, 2015.

The Company currently purchases raw materials from a limited number of vendors, which resulted in a concentration of three major vendors. The three major vendors supply the Company with raw materials used to manufacture the Company's products. For the nine months ended September 30, 2016, the Company's three major vendors accounted for 22.0%, 14.9%, and 7.9%, respectively, of total raw material purchases. For the nine months ended September 30, 2015, the Company's three major vendors accounted for 23.0%, 17.4% and 8.9%, respectively, of total raw material purchases.

A portion of revenue is earned from sales outside the United States. Approximately 72.8% and 87.5% of the non-U.S. revenue for the three months ended September 30, 2016 and September 30, 2015, respectively, were invoiced in Euros. Approximately 70.7% and 74.6% of the non-U.S. revenue for the nine months ended September 30, 2016 and September 30, 2015, respectively, were invoiced in Euros. A breakdown of the Company's revenue from U.S. and non-U.S. sources for the three months and nine months ended September 30, 2016 and September 30, 2015 is as follows:

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2016	2015	2016	2015
U.S. revenue	$39,470	$32,907	$113,963	$91,719
Non-U.S. revenue	14,952	7,871	38,015	26,840
Total revenue	$54,422	$40,778	$151,978	$118,559

Inventories

Inventories are stated at the lower of cost or market. Cost is determined using a standard cost method, including material, labor and manufacturing overhead, whereby the standard costs are updated at least quarterly to reflect approximate actual costs using the first-in, first-out (FIFO) method and market represents the lower of replacement cost or estimated net realizable value. The Company records adjustments at least quarterly to inventory for potentially excess, obsolete, slow-moving or impaired items. Inventories consist of the following:

	September 30, 2016	December 31, 2015
Raw materials and work-in-progress	$ 14,497	$ 7,097
Finished goods	2,162	1,679
Less: reserves	(160)	(128)
Inventories	$ 16,499	$ 8,648

Inogen, Inc.

Condensed Notes to the Financial Statements (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

Property and equipment

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

Rental equipment	1.5-5 years
Manufacturing equipment and tooling	2-5 years
Computer equipment and software	2-3 years
Furniture and equipment	3-5 years
Leasehold improvements	Lesser of estimated useful life or remaining lease term

Expenditures for additions, improvements and replacements are capitalized and depreciated to a salvage value of $0. Repair and maintenance costs on rental equipment are included in cost of rental revenue on the statements of comprehensive income. Repair and maintenance expense, which includes labor, parts and freight, for rental equipment was $497 and $686 for the three months ended September 30, 2016 and September 30, 2015, respectively, and $1,930 and $1,897 for the nine months ended September 30, 2016 and September 30, 2015, respectively.

Included within property and equipment is construction in process, primarily related to the design and engineering of tooling, jigs and other machinery. In addition, this item also includes computer software or development costs that have been purchased, but have not completed the final configuration process for implementation into the Company's systems. These items have not been placed in service; therefore, no depreciation or amortization was recognized for these items in the respective periods.

Depreciation and amortization expense related to property and equipment and rental equipment are summarized below for the three and nine months ended September 30, 2016 and September 30, 2015, respectively.

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Rental equipment	$2,878	$3,029	$8,733	$8,929
Other property and equipment	510	510	1,484	1,475
Total depreciation and amortization	$3,388	$3,539	$10,217	$10,404

Property and equipment and rental equipment with associated accumulated depreciation is summarized below for September 30, 2016 and December 31, 2015, respectively.

Property and equipment	September 30, 2016	December 31, 2015
Rental equipment, net of allowances of $600 and $850, respectively	$ 54,684	$ 54,677
Other property and equipment	12,636	11,596
Property and equipment	67,320	66,273
Accumulated depreciation		
Rental equipment	32,731	28,894
Other property and equipment	7,754	6,699
Accumulated depreciation	40,485	35,593
Net property and equipment		
Rental equipment	21,953	25,783
Other property and equipment	4,882	4,897
Property and equipment, net	$ 26,835	$ 30,680

Inogen, Inc.

Condensed Notes to the Financial Statements (continued)

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(amounts in thousands, except share and per share amounts)

Long-lived assets

The Company accounts for the impairment and disposition of long-lived assets in accordance with ASC 360-Property, Plant, and Equipment. In accordance with ASC 360, long-lived assets to be held are reviewed for events or changes in circumstances that indicate that their carrying value may not be recoverable. The Company periodically reviews the carrying value of long-lived assets to determine whether or not impairment to such value has occurred. No impairments were recorded during the three months or nine months ended September 30, 2016 and September 30, 2015.

Intangible assets

There were no impairments recorded related to the Company's intangible assets during the three months or nine months ended September 30, 2016 and September 30, 2015. Amortization expense for intangible assets for the three months ended September 30, 2016 and September 30, 2015 was $28 and $21, respectively, and for the nine months ended September 30, 2016 and September 30, 2015 was $73 and $64, respectively.

The following tables represent the changes in net carrying values of the intangibles as of the respective dates:

September 30, 2016	Average estimated useful lives (in years)	Gross carrying amount	Accumulated amortization	Net amount
Licenses	10	$ 185	$ 114	$ 71
Patents and websites	5	873	801	72
Commercials	2	286	161	125
Total		$ 1,344	$ 1,076	$ 268

December 31, 2015	Average estimated useful lives (in years)	Gross carrying amount	Accumulated amortization	Net amount
Licenses	10	$ 185	$ 100	$ 85
Patents and websites	5	873	779	94
Commercials	2	174	124	50
Total		$ 1,232	$ 1,003	$ 229

The minimum aggregate amortization expense for intangibles for each of the five succeeding fiscal years is summarized as follows:

	September 30, 2016
Remaining 3 months of 2016	$ 28
2017	101
2018	86
2019	33
2020	9
Thereafter	11
	$ 268

Inogen, Inc.

Condensed Notes to the Financial Statements (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

Accounts payable and accrued expenses

Accounts payable and accrued expenses as of September 30, 2016 and December 31, 2015 consisted of the following:

	September 30, 2016	December 31, 2015
Accounts payable	$ 10,214	$ 7,448
Accrued inventory (in-transit and unvouchered receipts) and trade payables	7,570	3,548
Accrued purchasing card liability	2,000	1,581
Accrued franchise and use taxes	32	45
Other accrued expenses	894	245
Accounts payable and accrued expenses	$ 20,710	$ 12,867

5. Earnings per share

Earnings per share (EPS) is computed in accordance with ASC 260—Earnings per Share, and is calculated using the weighted-average number of common shares outstanding during each period. Diluted EPS assumes the conversion, exercise or issuance of all potential common stock equivalents (which can include dilution of outstanding stock options and common stock warrants) unless the effect is to reduce a loss or increase the income per share. For purposes of this calculation, common stock subject to repurchase by the Company, options and warrants are considered to be common stock equivalents and are only included in the calculation of diluted earnings per share when their effect is dilutive.

Basic earnings per share is calculated using the Company’s weighted-average outstanding common shares. Diluted earnings per share is calculated using the Company’s weighted-average outstanding common shares including the dilutive effect of stock awards as determined under the treasury stock method.

The computation of EPS is as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Numerator—basic and diluted:				

Net income	$3,455	$2,696	$10,962	$7,727
Denominator:				
Weighted-average common shares - basic common stock	20,157,688	19,428,653	19,986,544	19,303,057
Weighted-average common shares - diluted common stock	21,100,725	20,783,550	20,924,022	20,690,499
Net income per share - basic common stock	$0.17	$0.14	$0.55	$0.40
Net income per share - diluted common stock	$0.16	$0.13	$0.52	$0.37
Denominator calculation from basic to diluted:				
Weighted-average common shares - basic common stock	20,157,688	19,428,653	19,986,544	19,303,057
Warrants	—	15,122	—	15,102
Stock options	943,037	1,339,775	937,478	1,372,340
Weighted-average common shares - diluted common stock	21,100,725	20,783,550	20,924,022	20,690,499
Shares excluded from diluted weighted-average shares:				
Stock options	663,175	627,688	1,284,424	629,136
Shares excluded from diluted weighted-average shares	663,175	627,688	1,284,424	629,136

The computations of diluted net income attributable to common stockholders exclude common stock options which were anti-dilutive for the three months and nine months ended September 30, 2016 and September 30, 2015, respectively.

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Condensed Notes to the Financial Statements (continued)

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6. Long-term debt

JPMorgan Chase Bank debt

As of September 30, 2016 and December 31, 2015, the Company had no outstanding borrowings under its revolving line of credit.

Patent purchase obligation

The contractual obligations schedule below relates to the acquisition of patents which are reflected in intangible assets and were acquired in 2011.

	September 30, 2016	December 31, 2015
Contractual obligation, bearing imputed interest at prime plus two, quarterly payments of $53 beginning May 2011 through October 2014 and quarterly payments of $81 beginning January 2015 through October 2016	$ 80	$ 315
Less: current maturities	(80)	(315)
Long-term debt, net of current portion	$ —	$ —

As of September 30, 2016, the minimum aggregate payments due under non-cancelable debt are summarized as follows:

	September 30, 2016
Remaining 3 months of 2016	$ 80
Total	$ 80

7. Income taxes

The Company accounts for income taxes in accordance with ASC 740—Income Taxes. Under ASC 740, income taxes are recognized for the amount of taxes payable or refundable for the current period and deferred tax liabilities and assets are recognized for the future tax consequences of transactions that have been recognized in the Company's financial statements or tax returns. A valuation allowance is provided when it is more likely than not that some portion, or all, of the deferred tax asset will not be realized.

The Company accounts for uncertainties in income tax in accordance with ASC 740-10—Accounting for Uncertainty in Income Taxes. ASC 740-10 prescribes a recognition threshold and measurement attribute for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. This accounting standard also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition.

The Company recognizes interest and penalties on taxes, if any, within its income tax provision. No significant interest or penalties were recognized during the periods presented.

The Company operates in multiple states. The statute of limitations has expired for all tax years prior to 2012 for federal and 2011 to 2012 for various state tax purposes. However, the net operating loss generated on the Company's federal and state tax returns in prior years may be subject to adjustments by the federal and state tax authorities.

Income tax expense was $1,994 and $982, an effective tax rate 36.6% and 26.7%, for the three months ended September 30, 2016 and September 30, 2015, respectively. Income tax expense was $5,929 and $3,683, an effective tax rate 35.1% and 32.3%, for the nine months ended September 30, 2016 and September 30, 2015, respectively. The increase in the effective tax rate was primarily due to the tax benefit adjustments that occurred in the third quarter of 2015 partially offset by research and development credits allowed in the third quarter of 2016, but not in the comparative period in 2015.

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Condensed Notes to the Financial Statements (continued)

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(amounts in thousands, except share and per share amounts)

8. Stockholders' equity

The Company has a 2012 Equity Incentive Plan (2012 Plan) under which the Company granted options to purchase shares of its common stock. As of September 30, 2016, options to purchase 461,821 shares of common stock remained outstanding under the 2012 Plan. The 2012 Plan was terminated in connection with the Company's initial public offering, and accordingly, no new options are available for issuance under this plan. The 2012 Plan continues to govern outstanding awards granted thereunder.

The Company has a 2002 Stock Incentive Plan (2002 Plan) as amended, under which the Company granted options to purchase shares of its common stock. As of September 30, 2016, options to purchase 161,657 shares of common stock remained outstanding under the 2002 Plan. The 2002 Plan was terminated in March 2012 in connection with the adoption of the 2012 Plan, and, accordingly, no new options are available for issuance under this plan. The 2002 Plan continues to govern outstanding awards granted thereunder.

The Company's board of directors adopted and its stockholders approved a 2014 Equity Incentive Plan (2014 Plan) effective immediately prior to the effectiveness of its initial public offering. The 2014 Plan provides for the grant of incentive stock options, within the meaning of Section 422 of the Internal Revenue Code, to the Company's employees and any parent and subsidiary corporation's employees, and for the grant of nonstatutory stock options, restricted stock, restricted stock units, stock appreciation rights, performance units and performance shares to its employees, directors and consultants and its parent and subsidiary corporations' employees and consultants.

As of September 30, 2016, options to purchase 1,875,277 shares of the Company's common stock were outstanding, and 436,549 shares of common stock remained available for issuance under the 2014 Plan. The shares available for issuance under the 2014 Plan will be increased by any shares returned to the 2002 Plan, 2012 Plan and the 2014 Plan as a result of expiration or termination of awards (provided that the maximum number of shares that may be added to the 2014 Plan pursuant to such previously granted awards under the 2002 Plan and 2012 Plan is 2,328,569 shares). The number of shares available for issuance under the 2014 Plan also is increased annually on the first day of each fiscal year by an amount equal to the least of:

- 895,346 shares;
- 4% of the outstanding shares of common stock as of the last day of the Company's immediately preceding fiscal year; or
- such other amount as the Company's board of directors may determine.

For 2016, an additional 791,296 shares were added to the 2014 Plan share reserve pursuant to the provision described above.

Options typically expire between seven and ten years from the date of grant and vest over one to four year terms. Options have been granted to employees, directors and consultants of the Company, as determined by the board of directors, at the deemed fair market value of the shares underlying the options at the date of grant.

The activity for stock options under the Company's stock plans is as follows:

	Options	Price per share	Weighted-average exercise price	Remaining weighted-average contractual terms (in years)	Per share average intrinsic value
Outstanding as of December 31, 2015	2,295,370	$0.60-$46.66	$ 19.36	5.98	$ 21.07
Granted	672,998	44.19-56.72	44.47		
Exercised	(424,462)	0.60-46.66	10.84		
Forfeited	(44,636)	8.37-44.19	27.99		
Expired	(515)	8.70	8.70		
Outstanding as of September 30, 2016	2,498,755	0.60-56.72	27.41	5.65	32.49
Vested and exercisable as of September 30, 2016	1,039,364	0.60-56.72	15.63	5.18	44.27
Vested and expected to vest as of September 30, 2016	2,390,297	$0.60-$56.72	$ 27.18	5.63	$ 32.72

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Condensed Notes to the Financial Statements (continued)

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The Company's board of directors adopted and its stockholders approved a 2014 Employee Stock Purchase Plan (ESPP) effective immediately prior to the effectiveness of its initial public offering. The ESPP provides for the grant to all eligible employees an option to purchase stock under the ESPP, within the meaning Section 423 of the Internal Revenue Code. The ESPP permits participants to purchase common stock through payroll deductions of up to 15% of their eligible compensation, which includes a participant's base straight time gross earnings, incentive compensation, bonuses, overtime and shift premium, but exclusive of payments for equity compensation and other similar compensation. A participant may purchase a maximum of 1,500 shares during a purchase period. Amounts deducted and accumulated by the participant are used to purchase shares of the Company's common stock at the end of each six-month period. The purchase price of the shares will be 85% of the lower of the fair market value of the Company's common stock on the first trading day of each offering period or on the exercise date. The offering periods are currently approximately six months in length beginning on the first business day on or after March 1 and September 1 of each year and ending on the first business day on or after September 1 and March 1 approximately six months later.

As of September 30, 2016, a total of 438,365 shares of common stock were available for sale pursuant to the ESPP. The number of shares available for sale under the ESPP is increased annually on the first day of each fiscal year by an amount equal to the least of:

- 179,069 shares;
- 1.5% of the outstanding shares of the Company's common stock on the last day of the Company's immediately preceding fiscal year; or
- such other amount as may be determined by the administrator.

For 2016, an additional 179,069 shares were added to the ESPP share reserve pursuant to the provision described above.

Stock-based compensation expense recognized for the three months and nine months ended September 30, 2016 and September 30, 2015 was as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Stock-based compensation expense by type of award:				
Stock option plan awards	$1,858	$941	$5,063	$2,078
Employee stock purchase plan	95	75	341	265
Total stock-based compensation expense	$1,953	$1,016	$5,404	$2,343

Employee stock-based compensation expense recognized for the nine months ended September 30, 2016 and September 30, 2015 was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures at a rate of 7.3% and 7.5%, respectively, based on the Company's historical option cancellations. ASC 718 requires forfeitures to be estimated at the time of grant and revised, if necessary, in subsequent periods if actual

forfeitures differ from those estimates.

For the three months and nine months ended September 30, 2016 and September 30, 2015, stock-based compensation expense recognized under ASC 718, included in cost of revenues, sales and marketing expense, general and administrative expense, and research and development expense was as follows:

	Three months ended September 30,		Nine months ended September 30,	
	2016	2015	2016	2015
Cost of revenue	$175	$128	$454	$294
Sales and marketing	318	297	859	677
General and administrative	1,237	459	3,530	1,068
Research and development	223	132	561	304
Total stock-based compensation expense	$1,953	$1,016	$5,404	$2,343

The unrecognized compensation expense related to non-vested share based compensation granted under the Plans as of September 30, 2016 and September 30, 2015 was $17,607 and $11,579, respectively.

Inogen, Inc.

Condensed Notes to the Financial Statements (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

9. Commitments and contingencies

Leases

The Company leases its offices and certain equipment under operating leases that expire through January 2022. As of September 30, 2016, the minimum aggregate payments due under non-cancelable leases are summarized as follows:

	September 30, 2016
Remaining 3 months of 2016	$ 291
2017	1,169
2018	1,157
2019	1,155
2020	755
Thereafter	270
	$ 4,797

Rent expense of $263 and $221 for the three months ended September 30, 2016 and September 30, 2015, respectively, and $766 and $661 for the nine months ended September 30, 2016 and September 30, 2015, respectively, was included in the accompanying statements of comprehensive income.

Purchase obligations

The Company had approximately $40,200 of outstanding purchase orders with its outside vendors and suppliers as of September 30, 2016. In addition, the Company entered into agreements for other services. Future commitments under these purchase orders and other agreements do not extend beyond twelve months.

Warranty obligation

The following table identifies the changes in the Company’s aggregate product warranty liabilities for the nine and twelve-month periods ended September 30, 2016 and December 31, 2015, respectively:

	September 30, 2016	December 31, 2015
Product warranty liability at beginning of period	$ 1,973	$ 1,115

Accruals for warranties issued	2,367	1,871
Adjustments related to preexisting warranties (including changes in estimates)	318	510
Settlements made (in cash or in kind)	(1,261)	(1,523)
Product warranty liability at end of period	$ 3,397	$ 1,973

Legislation and HIPAA

The healthcare industry is subject to numerous laws and regulations of federal, state and local governments. These laws and regulations include, but are not necessarily limited to, matters such as licensure, accreditation, government healthcare program participation requirements, reimbursement for patient services, and Medicare and Medicaid fraud and abuse. Government activity has continued with respect to investigations and allegations concerning possible violations of fraud and abuse statutes and regulations by healthcare providers. Violations of these laws and regulations could result in expulsion from government healthcare programs together with the imposition of significant fines and penalties, as well as significant repayments for patient services previously billed.

The Company believes that it is in compliance in all material respects with applicable fraud and abuse regulations and other applicable government laws and regulations. Compliance with such laws and regulations can be subject to future government review and interpretation as well as regulatory actions unknown or unasserted at this time. The Company believes that it complies in all material respects with the provisions of those regulations that are applicable to the Company’s business.

Inogen, Inc.

Condensed Notes to the Financial Statements (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

The Health Insurance Portability and Accountability Act of 1996 (HIPAA) assures health insurance portability, reduces healthcare fraud and abuse, guarantees security and privacy of health information, and enforces standards for health information. The Health Information Technology for Economic and Clinical Health Act (HITECH Act) imposes notification requirements of certain security breaches relating to protected health information. The Company may be subject to significant fines and penalties if found not to be compliant with the provisions outlined in the regulations.

Legal proceedings

Inova Labs lawsuit

On November 4, 2011, the Company filed a lawsuit in the United States District Court for the Central District of California against Inova Labs Inc., or Defendant, for infringement of two of the Company's patents. The case, Inogen Inc. v. Inova Labs Inc., Case No. 8:11-cv-01692-JGB-AN, or the Inova Labs Lawsuit, involves U.S. Patent Nos. 7,841,343, entitled "Systems and Methods For Delivering Therapeutic Gas to Patients", or the '343 patent, and 6,605,136 entitled "Pressure Swing Adsorption Process Operation And Optimization", or the '136 patent. The Company alleged in the Inova Labs Lawsuit that certain of Defendant's oxygen concentrators infringe various claims of the '343 and '136 patents. The Inova Labs Lawsuit sought damages, injunctive relief, costs and attorneys' fees.

The Defendant answered the complaint, denying infringement and asserting various sets of defenses including non-infringement, invalidity and unenforceability, patent misuse, unclean hands, laches and estoppel. The Defendant also filed counterclaims against the Company alleging patent invalidity, non-infringement and inequitable conduct. The Company denied the allegations in the Defendant's counterclaims and filed a motion to dismiss Defendant's inequitable conduct counterclaim.

The Defendant filed requests with the U.S. Patent and Trademark Office seeking an inter partes reexamination of the '343 and '136 patents. The Defendant also filed a motion to stay the Inova Labs Lawsuit pending outcome of the reexamination. On March 20, 2012, the Court granted the Defendant's motion to stay the Inova Labs Lawsuit pending outcome of the reexamination and also granted the Company's motion to dismiss the Defendant's inequitable conduct counterclaim. On December 7, 2015, the U.S. Patent and Trademark Office issued an inter partes Reexamination Certificate for the '343 patent. Reexamination proceedings for the '136 patent have not concluded.

On February 4, 2016, ResMed Inc. announced the completion of the acquisition of Inova Labs Inc. The parties reached a mutually agreeable settlement in June 2016. On June 30, 2016, the parties filed a Stipulated Dismissal with Prejudice of all claims in this lawsuit and a Joint Motion to Dismiss the reexamination proceeding for the '136 patent. The Company recognized a gain of $1,000 related to the settlement during the three months ended June 30, 2016 classified within general and administrative expense and the receivable was recorded in prepaid expenses and other current assets as of June 30, 2016. In addition, the settlement included a gain contingency of $250 for future services and licensing fees charged by the Defendant. The Company received $1,250 on July 26, 2016 finalizing the payment of this settlement. The Company recorded a gain of $72 during the three months ended September 30, 2016 classified within general and administrative expense. The remaining deferred gain contingency of $178 as of September 30,

2016 was recorded within accounts payable and accrued expenses and will be recognized when services are rendered or incurred. The parties are also collaborating on a study of the use of portable oxygen concentrators.

Securities class action lawsuit

On March 13 and March 19, 2015, plaintiffs Brad Christi and Roger D. Holford each filed, respectively, a lawsuit against Inogen, Raymond Huggenberger, Inogen's Chief Executive Officer, and Alison Bauerlein, Inogen's Executive Vice President and Chief Financial Officer, in the United States District Court for the Central District of California on behalf of a purported class of purchasers of the Company's securities between November 12, 2014 and March 11, 2015. The complaints alleged that Inogen, Mr. Huggenberger and Ms. Bauerlein violated Section 10(b) of the Securities Exchange Act of 1934, as amended, or the Exchange Act, and Rule 10b-5 promulgated thereunder, and that Mr. Huggenberger and Ms. Bauerlein violated Section 20(a) of the Exchange Act. Specifically, the complaints alleged that during the purported class period the Company's financial statements and disclosures concerning internal controls over financial reporting were materially false and misleading. The complaints sought compensatory damages in an unspecified amount, costs and expenses, including attorneys' fees and expert fees, prejudgment and post-judgment interest and such other relief as the court deemed proper. On May 7, 2015, plaintiff Roger D. Holford filed a notice of voluntary dismissal without prejudice pursuant to Federal Rule of Civil Procedure Rule 41(a)(1)(A) in the second filed action. On June 29, 2015, plaintiff Brad Christi filed a notice of voluntary dismissal without prejudice pursuant to Federal Rule of Civil Procedure Rule 41(a)(1)(A) in the first filed action. The case was closed by the Court as of June 29, 2015.

Inogen, Inc.

Condensed Notes to the Financial Statements (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

Separation Design Group lawsuit

On October 23, 2015, Separation Design Group IP Holdings, LLC (SDGIP) filed a lawsuit against the Company in the United States District Court for the Central District of California. On December 7, 2015, SDGIP filed a First Amended Complaint in the SDGIP Lawsuit.

SDGIP alleges that the Company willfully infringes U.S. Patent Nos. 8,894,751 and 9,199,055, both of which are titled “Ultra Rapid Cycle Portable Oxygen Concentrator.” SDGIP also alleges misappropriation of trade secrets and breach of contract stemming from a meeting in September 2010. The Company never received any communication from SDGIP related to patent infringement, misuse of trade secrets, or breach of the mutual non-disclosure agreement prior to SDGIP filing the lawsuit. SDGIP seeks to recover an unspecified amount of damages (including compensatory and treble damages), costs and expenses (including attorneys’ fees), pre-judgment and post-judgment interest, and other relief that the Court deems proper. SDGIP also seeks a permanent injunction against the Company.

The Company has and continues to vigorously contest SDGIP’s claims. The Company has answered SDGIP’s First Amended Complaint, denying SDGIP’s allegations of patent infringement, trade secret misappropriation, and breach of contract and asserting several affirmative defenses. The Company has also filed counterclaims against SDGIP alleging that the patents-in-suit are unenforceable due to inequitable conduct.

Labor law dispute

On April 13, 2016, Ryan Casper and Shane Hoefer (Plaintiffs) filed a lawsuit against the Company on behalf of themselves and all other similarly situated employees in the Superior Court for Santa Barbara County, California. The complaint alleges failure to pay overtime wages, failure to allow and pay for meal periods, and other alleged violations of California wage and hour law. The Plaintiffs and class members are seeking compensatory damages in the amount of all wages, interest, and penalties allegedly due, as well as liquidated damages, attorney’s fees and other relief. The parties successfully mediated the claims and reached a settlement in April 2016. While the Company disputes the claims, it agreed to the settlement with no admission of liability to avoid the risks and costs associated with litigating the claims. As of September 30, 2016, the Company had accrued approximately $980 for the settlement costs within accounts payable and accrued expenses. On August 2, 2016, the Court granted preliminary approval of the settlement. The parties anticipate final approval of the settlement in late November 2016, and distribution of the settlement funds in December 2016.

CAIRE Inc. lawsuit

On September 12, 2016, CAIRE Inc. (CAIRE) filed a lawsuit in the United States District Court for the Northern District of Georgia against the Company. CAIRE alleges that the Company infringes U.S. Patent No. 6,949,133, entitled “Portable Oxygen Concentrator.” CAIRE alleges willful infringement and seeks damages, injunctive relief, pre-judgment and post-judgment interest, costs, and attorneys’ fees. The Company denies CAIRE’s allegations and plans to vigorously contest CAIRE’s claims. The Company’s response to CAIRE’s complaint is due in early November

2016.

Other legal proceedings

The Company is party to various legal proceedings arising in the normal course of business. The Company carries insurance, subject to specified deductibles under the policies, to protect against losses from certain types of legal claims. At this time, the Company does not anticipate that any of these other proceedings will have a material adverse effect on the Company's business. Regardless of the outcome, litigation can have an adverse impact on the Company because of defense and settlement costs, diversion of management resources, and other factors.

Inogen, Inc.

Condensed Notes to the Financial Statements (continued)

(unaudited)

(amounts in thousands, except share and per share amounts)

10. Foreign currency exchange contracts and hedging

As of September 30, 2016, the Company's total non-designated and designated derivative contracts had notional amounts totaling approximately $736 and $2,839, respectively. These contracts were comprised of offsetting contracts with the same counterparty, each expires within one to six months of September 30, 2016, and the designated contracts had an unrealized gain of approximately $27, net of tax, during the nine months ended September 30, 2016.

The nonperformance risk of the Company and the counterparty did not have a material impact on the fair value of the derivatives. During the nine months ended September 30, 2016, the ineffective portion relating to these hedges was immaterial and the hedges remained effective through their respective settlement dates. As of September 30, 2016, the Company had fourteen designated hedges and four non-designated hedges.

Item 2: Management's Discussion and Analysis of Financial Condition and Results of Operations

Forward-Looking Statements

The following discussion and analysis should be read together with our financial statements and the condensed notes to those statements included elsewhere in this Quarterly Report on Form 10-Q. This Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, that are based on our management's beliefs and assumptions and on information currently available to our management. The forward-looking statements are contained principally in the section entitled "Risk Factors" and this Management's Discussion and Analysis of Financial Condition and Results of Operations. Forward-looking statements include, but are not limited to, statements concerning the following:

- information concerning our possible or assumed future cash flow, revenue, sources of revenue and results of operations, operating and other expenses;
- our assessment of reduced reimbursement rates, the continued impact from competitive bidding, and future declines in rental revenue;
- our expectations regarding regulatory approvals and government and third-party payor coverage and reimbursement;
- our ability to develop new products, improve our existing products and increase the value of our products;
- our expectations regarding the timing of new product and product improvement launches;
- market share expectations, unit sales, business strategies, financing plans, expansion of our business, competitive position, industry environment, potential growth opportunities;
- our expectations regarding the market size, market growth and the growth potential for our business;
- our ability to sustain and manage growth, including our ability to develop new products and enter new markets;
- our expectations regarding the average selling price and manufacturing costs of our products, including our expectations to continue to reduce average unit costs for our systems;
- our expectation to expand our sales and marketing channels, including through hiring additional sales representatives and securing contracts with healthcare payors and insurers;
- our internal control environment;
- the effects of seasonal trends on our results of operations;
- our expectations regarding the manufacturing ramp-up, domestic and international launch expectations, and market acceptance of our Inogen One G4 portable oxygen concentrator;
- our expectations regarding the time during which we will be an emerging growth company under the Jumpstart Our Business Startups Act of 2012;
- our expectation that our existing capital resources, available borrowings under our revolving credit and term loan agreement, and the cash to be generated from expected product sales and rentals will be sufficient to meet our projected operating and investing requirements for at least the next 12 months; and
- the effects of competition.

Forward-looking statements include statements that are not historical facts and can be identified by terms such as "anticipates," "believes," "could," "seeks," "estimates," "expects," "intends," "may," "plans," "potential," "predicts," "projects" "would," or similar expressions and the negatives of those terms.

Forward-looking statements involve known and unknown risks, uncertainties, and other factors that may cause our actual results, performance, or achievements to be materially different from any future results, performance, or achievements expressed or implied by the forward-looking statements. We discuss these risks in greater detail in Part II, Item 1A, "Risk Factors," elsewhere in this Quarterly Report on Form 10-Q and in our Annual Report on Form 10-K filed with the Securities and Exchange Commission, or SEC. Given these uncertainties, you should not place undue reliance on these forward-looking statements.

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Except as required by law, we assume no obligation to update these forward-looking statements, or to update the reasons actual results could differ materially from those anticipated in these forward-looking statements, even if new information becomes available in the future. You should read this Quarterly Report on Form 10-Q completely and with the understanding that our actual future results may be materially different from what we expect.

This Quarterly Report on Form 10-Q also contains estimates, projections and other information concerning our industry, our business, and the markets for certain diseases, including data regarding the estimated size of those markets, and the incidence and prevalence of certain medical conditions. Information that is based on estimates, forecasts, projections, market research or similar methodologies is inherently subject to uncertainties and actual events or circumstances may differ materially from events and circumstances reflected in this information. Unless otherwise expressly stated, we obtained this industry, business, market and other data from reports, research surveys, studies and similar data prepared by market research firms and other third parties, industry, medical and general publications, government data and similar sources.

“Inogen,” “Inogen One,” “Inogen One G2,” “Inogen One G3,” “G4,” “Oxygenation,” “Live Life in Moments, not Minutes,” “N Run Out of Oxygen,” “Oxygen Therapy on Your Terms,” “Oxygen.Anytime.Anywhere,” “Reclaim Your Independence,” “Intelligent Delivery Technology,” “Inogen At Home,” and the Inogen design are pending applications and/or registered trademarks with the United States Patent and Trademark Office of Inogen, Inc. We own trademark registrations for the mark “Inogen” in Australia, Canada, South Korea, Mexico, Europe (European Union registration), and Japan. We own a registration for “ ” in Japan. We own trademark registrations for the mark “Inogen One” in Australia, Canada, Ch South Korea, Mexico, and Europe (European Union registration). We own trademark registrations for the mark “Satellite Conserver” in Canada and China. We own a trademark registration for the mark “Inogen At Home” in Europe (European Union Registration). Other service marks, trademarks, and trade names referred to in this Quarterly Report on Form 10-Q are the property of their respective owners.

In this Quarterly Report on Form 10-Q, “we,” “us” and “our” refer to Inogen, Inc.

The following discussion of our financial condition and results of operations should be read together with our financial statements and the accompanying condensed notes to those statements included elsewhere in this document. Also, forward-looking statements represent our management’s beliefs and assumptions only as of the date of this Quarterly Report on Form 10-Q.

Critical accounting policies and significant estimates

Our discussion and analysis of our financial condition and results of operations is based upon our financial statements which have been prepared in accordance with generally accepted accounting principles in the United States, or U.S. GAAP. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets and liabilities and related disclosure of contingent assets and liabilities, revenue and expenses at the date of the financial statements. Generally, we base our estimates on historical experience and on various other assumptions in accordance with U.S. GAAP that we believe to be reasonable under the circumstances. Actual results may differ from these estimates and such differences could be material to the financial position and results of operations.

There have been no material changes in our critical accounting policies and estimates in the preparation of our financial statements during the three and nine months ended September 30, 2016 compared to those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the SEC on March 14, 2016.

Overview

We are a medical technology company that primarily develops, manufactures and markets innovative portable oxygen concentrators used to deliver supplemental long-term oxygen therapy to patients suffering from chronic respiratory conditions. Traditionally, these patients have relied on stationary oxygen concentrator systems for use in the home and oxygen tanks or cylinders for mobile use, which we call the delivery model. The tanks and cylinders must be delivered regularly and have a finite amount of oxygen, which requires patients to plan activities outside of their homes around delivery schedules and a finite oxygen supply. Additionally, patients must attach long, cumbersome tubing to their stationary concentrators simply to enable mobility within their homes. Our proprietary Inogen One® systems concentrate the air around the patient to offer a single source of supplemental oxygen anytime, anywhere with a portable device weighing approximately 2.8, 4.8 or 7.0 pounds with a single battery. Our Inogen One G2®, Inogen One G3®, and Inogen One G4® have up to 5, 5, and 2.5 hours of battery life, respectively, with a single battery and can be plugged into an outlet when at home, in a car, or in a public place with outlets available. Our Inogen One systems reduce the patient’s reliance on stationary concentrators and scheduled deliveries of tanks with a finite supply of oxygen, thereby improving patient quality of life and fostering mobility.

In May 2004, we received 510(k) clearance from the U.S. Food and Drug Administration, or the FDA, for our Inogen One G1. From our launch of the Inogen One G1 in 2004, through 2008, we derived our revenue almost exclusively from sales to healthcare providers and distributors. In December 2008, we acquired Comfort Life Medical Supply, LLC in order to secure access to the Medicare rental market and began accepting Medicare reimbursement for our oxygen solutions in certain states. At the time of the acquisition, Comfort Life Medical Supply, LLC had an active Medicare billing number but few other assets and limited business activities. In January 2009, following the acquisition of Comfort Life Medical Supply, LLC, we initiated our direct-to-consumer marketing strategy and began selling Inogen One systems directly to patients and building our Medicare rental business in the United States. In April 2009, we became a Durable, Medical Equipment, Prosthetics, Orthotics, and Supplies accredited Medicare supplier by the Accreditation Commission for Health Care for our Goleta, California facility for Home/Durable Medical Equipment Services for oxygen equipment and supplies. In addition, in May 2015, we again received notice of accreditation approval from the Accreditation Commission for Health Care for all six locations in which we conduct business, effective from May 8, 2015 through May 7, 2018. We believe we are the only portable oxygen concentrator manufacturer that employs a direct-to-consumer marketing strategy in the United States, meaning we advertise directly to patients, process their physician paperwork, provide clinical support as needed and bill Medicare or insurance on their behalf.

We derive a majority of our revenue from the sale and rental of our Inogen One systems and related accessories to patients, insurance carriers, home healthcare providers and distributors. We sell multiple configurations of our Inogen One systems with various batteries, accessories, warranties, power cords and language settings. We also rent our products to Medicare beneficiaries and patients with other insurance coverage to support their oxygen needs as prescribed by a physician as part of a care plan. Our goal is to design, build and market oxygen solutions that redefine how oxygen therapy is delivered. To accomplish this goal and to grow our revenue, we intend to continue to:

- Expand our sales and marketing channels. During the year ended December 31, 2015, we increased our internal sales representatives from 129 to 166. Typically, we expect new sales representatives to take 4-6 months to reach full productivity. Additionally, we are building a physician referral channel that consists of 14 sales representatives as of December 31, 2015 up from 12 as of December 31, 2014. Lastly, we are focused on building our international and domestic business-to-business partnerships, including relationships with distributors, key accounts, resellers, private label partners, and traditional home medical equipment (HME) providers.
- Invest in our product offerings to develop innovative products. We expended $1.4 million and $1.1 million for the three months ended September 30, 2016 and September 30, 2015, respectively, and $3.9 million and $3.0 million for the nine months ended September 30, 2016 and September 30, 2015, respectively, in research and development expenses, and we intend to continue to make such investments in the foreseeable future. We launched our upgraded Inogen One G3 product in December 2015, which has 25% increased oxygen output (1,050 ml/minute versus 840 ml/minute previously), is less expensive to manufacture than our current Inogen One G3 product, and features improvements in sound level (from 42 dBA to 39 dBA). We also launched our fourth-generation portable oxygen concentrator, the Inogen One G4, in May 2016. The Inogen One G4 weighs 2.8 pounds versus 4.8 pounds for our Inogen One G3, and is approximately half the size of the Inogen One G3. The sound level is 40 dBA at setting 2 and it produces up to 630 ml/minute of oxygen output. We estimate that it will be suitable for more than 85% of supplemental long-term ambulatory oxygen therapy patients who contact us. The Inogen One G4 is also less expensive to manufacture than our Inogen One G3 product. We also launched an upgraded battery option for the Inogen One G3 system to increase battery life by approximately 10% in the fourth quarter of 2016.
- Secure contracts with healthcare payors and insurers. Based on our patient population, we estimate that at least 30% of oxygen therapy patients are covered by non-Medicare payors, and that these patients often represent a younger, more active patient segment. By becoming an in-network provider with more insurance companies, we can reduce the patients' co-insurance and deductible obligations on their oxygen services, which we believe will allow us to attract additional patients to our Inogen One and Inogen At Home solutions.

We have been developing and refining the manufacturing of our Inogen One systems over the past twelve years. While nearly all of our manufacturing and assembly processes were originally outsourced, assembly of the compressor, sieve bed, concentrator and certain manifolds is now conducted in-house in order to improve quality control and reduce cost. Additionally, we use lean manufacturing practices to maximize manufacturing efficiency. We rely on third-party manufacturers to supply several components of our Inogen One and Inogen At Home systems. We typically enter into supply agreements for these components that specify quantity and quality requirements and delivery terms. In certain cases, these agreements can be terminated by either party upon relatively short notice. We have elected to source certain key components from single sources of supply, including our batteries, motors, valves, and some molded plastic components. While alternative sources of supply are readily available for these components, we believe that maintaining a single source of supply allows us to control production costs and inventory levels and to manage component quality. We launched the Inogen One G4 in a portion of our domestic business-to-business channel in the third quarter of 2016 and completely in our domestic business-to-business channel in the fourth quarter of 2016, and expect to launch it in our international business-to-business channel in the first half of 2017, depending on the timing of product regulatory and reimbursement approvals.

Historically, we have generated a majority of our revenue from sales and rentals to customers in the United States. For the three months ended September 30, 2016 and September 30, 2015, approximately 27.5% and 19.3%, respectively, and 25.0% and 22.6% for the nine months ended September 30, 2016 and September 30, 2015, respectively, of our total revenue was from customers outside the United States, primarily in Europe. Approximately 72.8% and 87.5% of the non-U.S. revenue for the three months ended September 30, 2016 and September 30, 2015, respectively, and 70.7% and 74.6% for the nine months ended September 30, 2016 and September 30, 2015, respectively, were invoiced in Euros with the remainder invoiced in United States dollars. As of September 30, 2016, we sold our products in 44 countries outside the United States through distributors or directly to large “house” accounts, which include gas companies, HME oxygen providers, and resellers. In those instances, we sell to and bill the distributor or “house” accounts directly, leaving responsibility for the patient billing, support and clinical setup to the local provider.

Our total revenue increased $13.6 million to $54.4 million for the three months ended September 30, 2016 from $40.8 million for the three months ended September 30, 2015, and increased $33.4 million to $152.0 million for the nine months ended September 30, 2016 from $118.6 million for the nine months ended September 30, 2015, primarily due to growth in sales revenue associated with the increases in business-to-business sales and direct-to-consumer sales of our Inogen One and Inogen At Home systems, and partially offset by a decline in rental revenue primarily associated with decreased reimbursement rates and an increase in provision for rental revenue adjustments. We generated net income of $3.5 million and $2.7 million for the three months ended September 30, 2016 and September 30, 2015, respectively. We generated net income of $11.0 million and $7.7 million for the nine months ended September 30, 2016 and September 30, 2015, respectively. We generated Adjusted EBITDA of $10.8 million and $8.2 million for the three months ended September 30, 2016 and September 30, 2015, respectively, and $32.5 million and $24.2 million for the nine months ended September 30, 2016 and September 30, 2015, respectively (see “Non-GAAP financial measures” for reconciliations between U.S. GAAP and non-GAAP results). As of September 30, 2016, our accumulated deficit was $34.1 million.

Sales revenue

Our future financial performance will be driven in part by the growth in sales of our Inogen One systems, and, to a lesser extent, sales of batteries, other accessories, and sales of our Inogen At Home stationary oxygen concentrators. We plan to grow our system sales in the coming years through multiple strategies including: expanding our direct-to-consumer sales efforts through hiring additional sales representatives, investing in consumer awareness, expanding our sales infrastructure and efforts outside of the United States, expanding our business-to-business sales through key partnerships, and enhancing our product offerings through additional product launches. As our product offerings grow, we solicit feedback from our customers and focus our research and development efforts on continuing to improve patient preference and reduce the total cost of the product, in order to further drive sales of our products.

Our direct-to-consumer sales process involves numerous interactions with the individual patient, the physician and the physician’s staff, and includes an in-depth analysis and review of our product, the patient’s diagnosis and prescribed oxygen therapy, including procuring an oxygen prescription. The patient may consider whether to finance the product through an Inogen-approved third-party or purchase the equipment. Product is not deployed until both the prescription and payment are received. Once product is deployed, the patient has 30 days to return the product, subject to the payment of a minimal processing and handling fee. Approximately 9-13% of consumers who purchase a system return the system during this 30-day return period.

Our business-to-business efforts are focused on selling to distributors, HME oxygen providers, resellers, and private label partners who are based inside and outside of the United States. This process involves interactions with various key customer stakeholders, including sales, purchasing, product testing, and clinical personnel. Businesses that have patient demand that can be met with our oxygen concentrator systems place purchase orders to secure product deployment. This may be influenced based on outside factors, including the result of tender offerings, changes in

insurance plan coverage, and overall changes in the net oxygen therapy patient population. Products are shipped freight on board (FOB) Inogen dock domestically, and based on financial history and profile, businesses may either prepay or receive extended terms. Products are shipped both FOB Inogen dock and Delivery Duty Paid (DDP) for certain international shipments depending on the shipper used. DDP shipments are Inogen's property until title has changed which is upon duty being paid. As a result of these factors, product purchases can be subject to changes in demand by customers.

We sold approximately 26,600 systems in the three months ended September 30, 2016 compared to 14,700 systems for the same period in 2015. We sold approximately 68,700 systems in the nine months ended September 30, 2016 compared to 42,100 systems for the same period in 2015. Management focuses on system sales as an indicator of current business success.

Rental revenue

Our direct-to-consumer rental process involves numerous interactions with the individual patient, the physician and the physician's staff. The process includes an in-depth analysis and review of our product, the patient's diagnosis and prescribed oxygen therapy, and their medical history to confirm the appropriateness of our product for the patient's oxygen therapy and compliance with Medicare and private payor billing requirements, which often necessitates additional physician evaluation and/or testing as well as a Certificate of Medical Necessity. Once the product is deployed, the patient receives direction on product use and receives a clinical titration from our licensed staff to confirm the product meets the patient's medical oxygen needs prior to billing. As a result, the time from initial contact with a customer to billing can vary significantly and be up to one month or longer.

We plan to grow our rental patients on service in the coming years through multiple strategies, including expanding our direct-to-consumer marketing efforts through hiring additional sales representatives and investing in patient and physician awareness, and securing additional insurance contracts. However, we expect declining rental revenue in 2016 and 2017 primarily associated with reimbursement rate declines, increased provision for rental revenue adjustments and a continued focus on sales versus rentals. In addition, patients may come off of our services due to death, a change in their condition, a change in location, a change in provider or other factors. In each case, we maintain asset ownership and can redeploy assets as appropriate following such events. Given the length and uncertainty of our patient acquisition cycle and potential returns we have in the past experienced, and likely will in the future experience, fluctuations in our net new patient setups will occur on a period-to-period basis. We do not plan to offer our Inogen One G4 system to rental patients and will use the upgraded Inogen One G3 product as the primary ambulatory solution deployed in our rental fleet at this time.

As the rental patient base increases, this rental model generates recurring revenue with minimal additional sales and general and administrative expenses. A portion of rentals include a capped rental period when no additional reimbursement will be allowed unless additional criteria are met. In this scenario, the ratio of billable patients to patients on service is critical to maintaining rental revenue growth as patients on service increases. Medicare has noted a certain percentage of beneficiaries, approximately 25%, based on their review of Medicare claims, reach the 36th month and enter the capped rental period. Our capped patients as a percentage of total patients on service was approximately 16.0% as of September 30, 2016, which is slightly higher than the capped patients as a percentage of total patients on service of approximately 15.0% as of September 30, 2015. The percentage of capped patients may fluctuate over time as new patients come on service, patients come off of service before and during the capped rental period, and existing patients enter the capped rental period.

As of September 30, 2016, we had approximately 33,700 oxygen rental patients, an increase from approximately 32,400 oxygen rental patients as of September 30, 2015. Management focuses on rental revenue and the number of patients serviced as an indicator of current success of our rental business and a leading indicator of likely future rental revenue; however, actual rental revenue recognized is subject to a variety of other factors, including reimbursement levels by payor, patient zip code, the number of capped patients, write-offs for uncollectable balances, and adjustments for patients in transition.

Reimbursement

We rely heavily on reimbursement from CMS, and secondarily, from private payors, Medicaid and patients, for our rental revenue. For the three months and nine months ended September 30, 2016, approximately 71.0% and 71.6%, respectively, of our rental revenue was derived from Medicare's service reimbursement programs. The U.S. list price for our stationary oxygen rentals (HCPCS E1390) is $260 per month and the U.S. list price for our oxygen generating portable equipment (OGPE) rentals (HCPCS E1392) is $70 per month. Effective January 1, 2016, the current standard Medicare allowable varies by state instead of the one national standard allowable as in previous years. The

national standard allowable in 2015 for stationary oxygen rentals (E1390) was $180.92 per month and for OGPE rentals (E1392) was $51.63 per month. Effective January 1, 2016, the Medicare allowable for stationary oxygen rentals (E1390) ranges from $135.14 to $145.61 per month and the OGPE rentals (E1392) ranges from $46.69 to $49.52 per month. These are the two primary codes that we bill to Medicare and other payors for our oxygen product rentals. These rates were subject to additional cuts effective July 1, 2016, in accordance with the competitive bidding program (discussed below).

As of January 1, 2011, Medicare phased in the competitive bidding program. The competitive bidding program impacts the amount Medicare reimburses suppliers of durable medical equipment rentals, including portable oxygen concentrators. The program is defined geographically, with suppliers submitting bids to provide medical equipment for specific product categories within a specified geographic region called competitive bidding areas, or CBAs. Once bids have been placed, an individual company's bids within a product category are aggregated and weighted by each product's market share in the category. The weighted-average price is then indexed against all bidding suppliers. Medicare determines a "clearing price" out of these weighted-average prices, at which a sufficient number of suppliers have indicated they will support patients in the category. This threshold is typically designed to generate theoretical supply that is twice the expected demand. Bids for each modality among the suppliers that made the cut are then arrayed to determine what Medicare will reimburse for each product category and geographic area. The program has strict anti-collusion guidelines to ensure bidding is truly competitive. A competitive bidding contract lasts up to three years once implemented, after which the contract is subject to a new round of bidding. Discounts off the standard Medicare allowable occur in CBAs where contracts have been awarded as well as in cases where private payors pay less than this allowable. Competitive bidding rates are based on the zip code where the patient resides. Rental revenue includes payments for product, disposables, and customer service/support.

In the CBAs covered under round two re-compete of the competitive bidding program, which began July 1, 2016, the Medicare allowable for stationary oxygen rentals (E1390) ranges from $70.00 to $89.86 per month (average of $76.84 per month) and the OGPE rentals (E1392) ranges from $33.97 to $42.00 per month (average of $37.90 per month). In the CBAs covered under round one re-compete 2017 of the competitive bidding program, which begins January 1, 2017, the Medicare allowable for stationary oxygen rentals (E1390) ranges from $70.04 to $90.01 per month (average of $77.97 per month) and the OGPE rentals (E1392) ranges from $35.11 to $37.15 per month (average of $36.06 per month).

As of January 1, 2016, competitive bidding rates were nationalized. All areas previously not subject to competitive bidding experienced rate reductions. The fee schedules in the non-CBAs are adjusted based on regional averages of the single payment amounts for areas already under competitive bidding. The regional prices are limited by a national ceiling (110% of the average of the regional prices) and a floor (90% of the average regional prices). For dates of service from January 1, 2016 to June 30, 2016, the reimbursement rates for the non-CBAs were based on 50% of the un-adjusted 2015 fee schedule amount and 50% of the adjusted (reduced) fee schedule amount which was based on the regional competitive bidding rates. As of July 1, 2016, reimbursement rates are set at 100% of the adjusted fee schedule amount, which is based on regional competitive bidding rates, including the adjustments associated with round two re-compete.

The regions are defined as follows:

Region Name	States Covered
Far West	CA, NV, OR, WA
Great Lakes	IL, IN, MI, OH, WI
Mideast	DC, DE, MD, NJ, NY, PA
New England	CT, MA, NH, RI
Plains	IA, KS, MN, MO, NE
Rocky Mountain	CO, ID, UT
Southeast	AL, AR, FL, GA, KY, LA, NC, SC, TN, VA
Southwest	AZ, NM, OK, TX

In addition to regional pricing, CMS imposed different pricing on “frontier states” and rural areas. CMS defines frontier states as states where more than 50% of the counties in the state have a population density of 6 people or less per square mile and rural states are defined as states where more than 50% of the population lives in rural areas per census data. Current frontier states include MT, ND, SD and WY; rural states include ME, MS, VT and WV; and non-contiguous United States areas include AK, HI, Guam and Puerto Rico. For frontier and rural states, and frontier and rural zip codes in non-frontier/rural states, the single payment amount will be the national ceiling (110% of the average of the regional prices) to account for higher servicing costs in these areas. For non-contiguous United States areas, single payment amounts will be the higher of the national ceiling, or the average of competitive bidding pricing from these areas, if the areas had been bid through competitive bidding. We estimate that less than 10% of our patients would be eligible to receive the 110% of the regional prices for rural and frontier areas based on the geographic locations of our current patient population.

CMS has also re-bid for competitive bidding round two re-compete, which is associated with approximately 50% of the Medicare market, with contracts which began on July 1, 2016 and will continue through December 31, 2018. CMS updated the product categories and the competitive bidding areas. Respiratory equipment now includes oxygen, oxygen equipment, continuous positive airway pressure devices, respiratory assist devices and related supplies and accessories. Nebulizers are now their own separate product category instead of being included in the respiratory equipment category. Round two re-compete is in the same geographic areas that were included in the original round two. However, as a result of the Office of Management and Budget’s updates to the original 91 round two metropolitan statistical areas, there are now 90 metropolitan statistical areas for round two re-compete and 117 competitive bidding areas (CBAs). Any CBA that was previously located in multi-state metropolitan statistical areas was redefined so that no CBA is included in more than one state. The round two re-compete competitive bidding areas have nearly the same zip codes as the round two competitive bidding areas; the associated changes in the zip codes since competitive bidding was implemented are reflective in this round two re-compete. Pricing was announced in March 2016, and impacts both the zip codes covered under round two and also the rates for the un-bid areas effective July 1, 2016.

CMS has also re-bid for the round one re-compete 2017 contracts effective January 1, 2017 through December 31, 2018. In round one re-compete 2017, there are 9 metropolitan statistical areas and 13 CBAs to ensure there are no multi-state CBAs. We estimate approximately 9% of the Medicare market will be impacted by the round one re-compete 2017 contracts. Pricing was announced in September 2016, and impacts both the zip codes covered under round one and also the rates for the un-bid areas effective January 1, 2017.

The following table sets forth the current Medicare standard allowable reimbursement rates and the average of reimbursement rates applicable in Metropolitan Statistical Areas covered by rounds one and two of competitive bidding.

	Round two average 7/1/13-6/30/16	Round one re-compete average 1/1/14-12/31/16	Round two re-compete average 7/1/16-12/31/18	Round one re-compete 2017 average 1/1/17-12/31/18
E1390 (stationary oxygen rentals)	$93.07	$ 95.74	$ 76.84	$ 77.97
E1392 (portable oxygen rentals)	42.72	38.08	37.90	36.06
Total	$135.79	$ 133.82	$ 114.74	$ 114.03

In addition to reducing the Medicare reimbursement rates in the Metropolitan Statistical Areas, the competitive bidding program has effectively reduced the number of oxygen suppliers that can participate in the Medicare program. We believe that more than 75% of existing oxygen suppliers were eliminated as Medicare suppliers in round one of competitive bidding, which was implemented January 1, 2011 in 9 Metropolitan Statistical Areas. Round two of competitive bidding was implemented July 1, 2013 in 91 Metropolitan Statistical Areas and we believe the impact on the number of Medicare oxygen suppliers was similar to round one. We believe that approximately 59% of the Medicare market was covered by round one and round two of competitive bidding.

Cumulatively in round one, round two, round one re-compete, round two re-compete and round one re-compete 2017, we were offered contracts for a substantial majority of the CBAs and product categories for which we submitted bids. However, there is no guarantee that we will garner additional market share as a result of these contracts. The contracts include products that may require us to subcontract certain services or products to third parties, which must be approved by CMS. We currently operate in 49 of the 50 states in the U.S. We do not operate in Hawaii due to the licensure requirements. However, we anticipate that due to the new Hawaii Durable Medical Equipment Supplier Licensure program effective January 1, 2017, we will be able to service patients in Hawaii in 2017.

Moreover, we cannot guarantee that we will be offered contracts in subsequent rounds of competitive bidding. In all five rounds of competitive bidding in which we have participated, we have gained access to and been excluded from various CBAs.

Following round one of competitive bidding, we were excluded from providing services to Medicare beneficiaries in the Kansas City-MO-KS, Miami-Fort Lauderdale-Pompano Beach-FL, and Orlando-Kissimmee-FL CBAs. We had access to six CBAs of the nine regions subject to competitive bidding round one for the respiratory product category.

After round one re-compete of competitive bidding, we were excluded from providing services to Medicare beneficiaries in the following CBAs: Cleveland-Elyria-Mentor-OH, Cincinnati-Middleton-OH-KY-IN, Miami-Fort Lauderdale-Pompano Beach-FL, Orlando-Kissimmee-Sanford-FL, Pittsburg-PA, and Riverside-San Bernardino-Ontario-CA. We gained access to the Kansas City-MO -KS CBA. We had access to three CBAs of the nine regions subject to competitive bidding round one re-compete for the respiratory product category.

After round one re-compete 2017 of competitive bidding, we will be excluded from the Chester-Lancaster and York Counties-SC CBA, which we previously won under round one re-compete. We will also be excluded from the Miami-Fort Lauderdale-West Palm Beach-FL and Orlando-Kissimmee-Sanford-FL CBAs. We will have access to 10 of the 13 CBAs in which we bid for the respiratory product category: Charlotte-Concord-Gastonia-NC, Cincinnati-OH, Cleveland-Elyria-OH, Covington-Florence-Newport-KY, Dallas-Fort Worth-Arlington-TX, Dearborn-Franklin-Ohio, and Union Counties-IN, Kansas City-MO, Kansas City-Overland Park-Ottawa-KS, Pittsburgh-PA, and Riverside-San Bernardino-Ontario-CA. We will have access to ten CBAs of the thirteen regions subject to competitive bidding round one re-compete 2017 for the respiratory product category.

After round two of competitive bidding, we were excluded from 12 CBAs: Akron-OH, Cape Coral-Fort Myers-FL, Deltona-Daytona Beach-Ormond Beach-FL, Honolulu-HI, Jacksonville-FL, Lakeland-Winter Haven-FL, Memphis-TN-MS-AR, North Port-Bradenton-Sarasota-FL, Ocala-FL, Palm Bay-Melbourne-Titusville-FL, Tampa-St. Petersburg-Clearwater-FL, and Toledo-OH. We had access to 88 CBAs of the 100 regions subject to competitive bidding round two for the respiratory product category.

After round two re-compete of competitive bidding, we were excluded from the following CBAs that we had previously won under round two: Allentown-Bethlehem-Easton-PA, Asheville-NC, Augusta-Richmond County-GA, Camden-NJ, Catoosa-Dade-Walker Counties-GA, Elizabeth-Lakewood-New Brunswick-NJ, Flint-MI, Greensboro-High Point-NC, Greenville-Anderson-Mauldin-SC, Jersey City-Newark-NJ, Las Vegas-Henderson-Paradise-NV, Little Rock-North Little Rock-Conway-AR, Louisville-Jefferson County-KY, Mercer County-PA, Poughkeepsie-Newburgh-Middletown-NY, Raleigh-NC, Scranton-Wilkes-Barre-Hazelton-PA, Stockton-Lodi-CA, Syracuse-NY, Wilmington-DE, and Youngstown-Warren-Boardman-OH. We were also excluded from the following CBAs in both round two and round two re-compete: Akron-OH and Toledo-OH. We gained access to certain Medicare markets in Cape-Coral-Fort Myers-FL, Deltona-Daytona Beach-Ormond Beach-FL, Jacksonville-FL, Lakeland-Winter Haven-FL, North Port-Sarasota-Bradenton-FL, Ocala-FL, Palm Bay-Melbourne-Titusville-FL, and Tampa-St. Petersburg-Clearwater-FL. We have access to 93 CBAs of the 117 regions subject to competitive bidding round two re-compete for the respiratory product category.

Effective July 1, 2016, we believe we have access to over 90% of the Medicare market based on our analysis of the 96 CBAs that we have won out of the 126 total CBAs. These 126 CBAs represent 59% of the market with the remaining 41% of the market not subject to competitive bidding. The loss of access to the CBAs where we were not awarded contracts is not expected to lead to a material adverse impact on our rental business. Medicare revenue, including patient co-insurance and deductible obligations, represented 9.5% of our total revenue in the three months ended September 30, 2016 and 12.4% of our total revenue in the nine months ended September 30, 2016. We expect the decline in total revenue resulting from the loss of competitive bidding contracts in the areas that we were excluded

from to be partially offset by the “grandfathering” of existing Medicare patients (discussed below), direct sales to former Medicare patients with third-party insurance coverage, or Medicare patients paying out-of-pocket to purchase our products. Our revenue from Medicare in the 30 CBAs where we were not offered contracts as of July 1, 2016 was approximately $0.3 million and $0.5 million in the three months ended September 30, 2016 and September 30, 2015, respectively, and $1.4 million and $1.6 million in the nine months ended September 30, 2016 and September 30, 2015, respectively.

Under the competitive bidding program, DME suppliers that are not awarded a competitive bid contract in a CBA and product category which the DME supplier had previously been awarded a competitive bid contract may “grandfather” existing patients on service beginning on the effective date of the competitive bidding round. This means DME suppliers may retain all existing patients and continue to receive reimbursement for them, so long as the new reimbursement rate is accepted by the DME supplier and the beneficiary chooses to continue to receive equipment from the supplier. For example, a supplier that received a round two contract but not a round two re-compete contract may elect to “grandfather’ the patients that it serviced through the round two contract period. Suppliers must either keep or release all patients under this “grandfathering” arrangement in each CBA; a supplier may not select specific individuals to retain or release. Suppliers can continue to sell equipment in CBAs where they were not awarded contracts to patients paying out-of-pocket or with third-party insurance coverage.

We have elected to “grandfather” and retain all patients in CBAs in which we were not awarded contracts. In addition, we continue to accept patients in CBAs where we did not receive contracts through private insurance. We also pursue retail sales of our equipment to patients in those areas.

Medicare reimbursement for oxygen rental equipment is limited to a maximum of 36 months within a 60-month service period, and the equipment remains the property of the home oxygen supplier. The supplier that billed Medicare for the 36th month of service continues to be responsible for the patient’s oxygen therapy needs for months 37 through 60, and there is generally no additional reimbursement for oxygen generating portable equipment for these later months. CMS does not separately reimburse suppliers for oxygen tubing, cannulas and supplies that may be required for the patient. The supplier is required to keep the equipment provided in working order and in some cases, CMS will reimburse for repair costs. At the end of the five-year useful life of the equipment, the patient may request replacement equipment and, if he or she can be re-qualified for the Medicare benefit, a new maximum 36-month payment cycle out of the next 60 months of service would begin. The supplier may not arbitrarily issue new equipment. We have analyzed the potential impact to revenue associated with patients in the capped rental period and have deferred $0 associated with the capped rental period for the three months and nine months ended September 30, 2016 and September 30, 2015, respectively.

Our obligations to service Medicare patients over the contract rental period include supplying working equipment that meets each patient’s oxygen needs pursuant to his/her doctor’s prescription and certificate of medical necessity form and supplying all disposables required for the patient to operate the equipment, including cannulas, filters, replacement batteries, carts and carry bags, as needed. If the equipment malfunctions, we must repair or replace the equipment. We determine what equipment the patient receives, as long as that equipment meets the physician’s prescription, and we can deploy used assets in working order as long as the prescription requirements are met. We must also procure a recertification of the certificate of medical necessity from the patient’s doctor to confirm the patient’s need for oxygen therapy one year after the patient first receives oxygen therapy and one year after each new 36-month reimbursement period begins. The patient can choose to receive oxygen supplies and services from another supplier at any time, but the supplier may only transition the patient to another supplier in certain circumstances.

In addition to the adoption of the competitive bidding program, from 2010 through 2015, Medicare reimbursement rates for oxygen rental services in non-CBAs were eligible to receive mandatory annual updates based upon the Consumer Price Index for all Urban Consumers, or CPI-U. For 2014, the CPI-U was +1.8%, but the multi-factor productivity adjustment (the “adjustment”) was -0.8%, so the net result was a 1.0% increase in fee schedule payments in 2014 for items and services provided in areas not subject to competitive bidding. However, by law, the stationary oxygen equipment codes payment amounts must be adjusted on an annual basis, as necessary, to ensure budget neutrality of the new payment class for oxygen generating portable equipment. Thus, the increase in allowable payment amounts for stationary oxygen equipment codes increased 0.5% from 2013 to 2014. For 2015, the CPI-U was +2.1%, but the adjustment was -0.6%, so the net result was a 1.5% increase in fee schedule payments in 2015 for stationary oxygen equipment for items and services not included in an area subject to competitive bidding. Beginning in 2016, the standard allowable for all areas is set based on regional averages of the competitive bidding prices as described previously and no fees are based on non-competitive bidding. Accordingly, we do not anticipate future adjustments to the reimbursable fees based upon changes in CPI-U.

In addition, the President’s proposed federal budget for fiscal year 2017 includes multiple provisions that could impact us if they were enacted. The budget proposed eliminating the 36-month cap for oxygen equipment, and reducing the monthly payment amount for oxygen and oxygen equipment by the necessary percentage to be budget neutral. Our patient population may materially differ from the Medicare population, which could lead to either more or less revenue if this budget is enacted. In addition, this change would likely also impact the number of patients interested in a cash purchase and could shift patients from out-of-pocket purchases toward renting units instead. The proposed budget also proposes to extend the authority to require prior authorization to all Medicare fee-for-service items and

services, particularly those that are at the highest risk for improper payment. The proposed budget also contains multiple provisions related to the Medicare appeals process including establishing a refundable filing fee (non-refundable if denied), providing the Office of Medicare Hearings and Appeals and Department Appeals Board Authority to use Recover Audit Contractor collections, and increasing minimum amount in controversy for administrative law judge adjudication of claims to equal the amount required for judicial review. In addition, this proposal includes the ability to remand appeals to the redetermination level with the introduction of new evidence and the ability to sample and consolidate similar claims for administrative efficiency.

A ruling from CMS has outlined the expansion of competitive bidding to certain previous non-CBAs by applying regional pricing averages to non-CBAs with 110% of regional prices to be paid for defined rural and frontier areas. Medicare represented 21.0% of our total revenue in the year ended December 31, 2015, and we estimate that 41.0% of the Medicare markets will be subject to this reimbursement reduction. We also estimate that, on average, the rates will be reduced to the average of the regional prices under round one re-compete 2017 and round two re-compete. We estimate that less than 10% of our patients would be eligible to receive the 110% of the regional prices for rural and frontier areas based on the geographic locations of our current patient population. CMS has also re-bid the round two re-compete for contracts from July 1, 2016 through December 31, 2018 and round one re-compete for contracts from January 1, 2017 through December 31, 2018 as discussed previously.

On October 28, 2016, CMS released a final rule which will be published in the Federal Register on November 4, 2016. The final rule imposes additional regulations on the competitive bidding process. The final rule requires bidders choosing to participate in the competitive bidding program to obtain a $0.05 million surety bond for each CBA in which they bid. If a bidder does not accept a contract offer when its composite bid is at or below the median composite bid rate for suppliers used in the calculation of the single payment amount, the bid surety bond for the applicable CBA will be forfeited to CMS. In instances where the bidder does not meet the forfeiture conditions specified in the final rule, the bid surety bond liability will be returned to the bidder within 90 days of the public announcement of the contract suppliers for the CBA. Currently, there are 130 CBAs, which would mean a bidding supplier could incur a surety bond obligation with forfeiture conditions of up to $6.5 million. The final rule also changes the bid limits for individual items for future rounds of competitive bidding to reflect the 2015 unadjusted fee schedule to avoid a downward trend in bid pricing, to ensure the long-term viability of the competitive bidding program, and to allow suppliers to take into account both decreases and increases in costs in determining their bids. The rule also finalizes an appeals process for all breach of contract actions that CMS may take under the competitive bidding program. Lastly, the final rule sets forth a provision for lead item bidding for certain product categories in future bidding rounds to prevent the creation of price inversions, which occurred in round two of competitive bidding. Lead item bidding means that all HCPCS codes for similar items will be grouped together and priced relative to the bid for the “lead item,” as calculated by CMS. For additional discussion of the impact of the recent competitive bidding proposals, see “Risk Factors” herein.

As of September 30, 2016, we had 91 contracts with Medicaid and private payors. These contracts qualify us as an in-network provider for these payors. As a result, patients can rent or purchase our systems at the same patient obligation as other in-network oxygen suppliers. Based on our patient population, we believe at least 30% of all oxygen therapy patients are covered by private payors. Private payors typically provide reimbursement at a rate between 60% and 100% of Medicare allowables for in-network plans, and although private payor plans can have 36-month capped rental periods similar to Medicare, they typically do not. We anticipate that private payor reimbursement levels will generally be reset in accordance with Medicare payment amounts established through competitive bidding.

We cannot predict the full extent to which reimbursement for our products will be affected by competitive bidding, the President’s proposed budget for 2017, or by initiatives to reduce costs for private payors. We believe that we are well positioned to respond to the changing reimbursement environment because our product offerings are innovative, patient-focused and cost-effective. We have historically been able to reduce our costs through scalable manufacturing, better sourcing, continuous innovation, and reliability improvements, as well as innovations that reduce our product service costs by minimizing exchanges, such as user replaceable batteries and oxygen filtration cartridges. As a result of bringing manufacturing and assembly largely in-house and our commitment to driving efficient manufacturing processes, we have reduced our overall system cost by 54% from 2009 to September 30, 2016. We intend to continue to seek ways to reduce our cost of revenue through manufacturing and design improvements.

Basis of presentation

The following describes the line items set forth in our statements of comprehensive income.

Revenue

We classify our revenue in two main categories: sales revenue and rental revenue. There will be fluctuations in mix between business-to-business sales, direct-to-consumer sales and rentals from period-to-period. Inogen One and Inogen At Home system selling prices and gross margins may fluctuate as we introduce new products, reduce our product costs, have changes in purchase volumes, and as currency variations occur. For example, the gross margin for our Inogen One G3 is higher than our Inogen One G2 due to lower manufacturing costs and similar average selling

prices. Thus, to the extent our sales of our Inogen One G3 systems are higher than sales of our Inogen One G2 systems, our overall gross margins should improve and, conversely, to the extent our sales of our Inogen One G2 systems are higher than sales of our Inogen One G3 systems, our overall gross margins should decline. Similarly, the gross margin for our Inogen One G4 is higher than our Inogen One G3 due to lower manufacturing costs and similar average selling prices. Quarter over quarter results may vary due to seasonality in both the international and domestic markets. For example, we typically experience higher total sales in the second and third quarters as a result of consumers traveling and vacationing during warmer weather in the spring and summer months, but this may vary year-over-year in certain domestic and international locations in our business-to-business channels. In particular, we have previously seen lower international revenue in the third quarter due to reduced economic activity in Europe in the summer months, but this trend did not continue in 2016.

Sales revenue

Our sales revenue is derived from the sale of our Inogen One systems, Inogen At Home systems, and related accessories to patients, HME providers, distributors, private label partners and resellers worldwide. Sales revenue is classified into two areas: business-to-business sales and direct-to-consumer sales. For the three months ended September 30, 2016 and September 30, 2015,

business-to-business sales as a percentage of total sales revenue were 66.0% and 60.4%, respectively. For the nine months ended September 30, 2016 and September 30, 2015, business-to-business sales as a percentage of total sales revenue were 63.4% and 61.9%, respectively. Generally, our direct-to-consumer sales have higher gross margins than our business-to-business sales.

We also offer a lifetime warranty for direct-to-consumer sales. For a fixed price, we agree to provide a fully functional oxygen concentrator for the remaining life of the patient. Lifetime warranties are only offered to patients upon the initial sale of oxygen equipment by us and are non-transferable. Product sales with lifetime warranties are considered to be multiple element arrangements within the scope of the Accounting Standards Codification (ASC) 605-25—Revenue Recognition-Multiple-Element Arrangements.

There are two deliverables when a product that includes a lifetime warranty is sold. The first deliverable is the oxygen concentrator equipment which comes with a standard warranty of three years. The second deliverable is the lifetime warranty that provides for a functional oxygen concentrator for the remaining life of the patient. These two deliverables qualify as separate units of accounting.

The revenue is allocated to the two deliverables on a relative selling price method. We have vendor-specific objective evidence of selling price for the equipment including the standard warranty. To determine the selling price of the lifetime warranty, we use our best estimate of the selling price for that deliverable as the lifetime warranty is neither separately priced nor is selling price available through third-party evidence. To calculate the selling price associated with the lifetime warranties, management considered the profit margins of the overall business, the average estimated cost of lifetime warranties and the price of extended warranties. A significant estimate used to calculate the price and expense of lifetime warranties is the life expectancy of patients. Based on clinical studies, we estimate that 60% of patients will succumb to their disease within three years. Given the approximate mortality rate of 20% per year, we estimate on average all patients will succumb to their disease within five years. We have taken into consideration that when patients decide to buy an Inogen portable oxygen concentrator with a lifetime warranty, they typically have already been on oxygen for a period of time, which can have a large impact on their life expectancy from the time our product is deployed.

After applying the relative selling price method, revenue from equipment sales is recognized when all other revenue recognition criteria for product sales are met. Lifetime warranty revenue is deferred for the first three years and is recognized using the straight-line method during the fourth and fifth year after the delivery of the equipment which is the estimated usage period of the contract based on the average patient life expectancy.

For certain business-to-business sales, we offer an extended warranty from our standard 3-year warranty to a 5-year total warranty, for a fixed price. Product sales with 5-year warranties are considered to be multiple element arrangements within the scope of ASC 605-25 and the additional service component is broken out from the product sales and deferred and recognized in years four and five to correspond with the service period.

Freight revenue consists of fees associated with the deployment of products internationally or domestically, when expedited freight options or minimum order quantities are not met. Freight revenue is a percentage markup of freight costs.

Rental revenue

Our rental revenue is primarily derived from the rental of our Inogen One and Inogen At Home systems to patients through reimbursement from Medicare, private payors and Medicaid, which typically also includes a patient responsibility component for patient co-insurance and deductibles. We expect our rental revenue per patient to decline in future periods due to lower reimbursement rates due to competitive bidding reimbursement declines, the

nationalization of competitive bidding, continued reimbursement declines across third-party payors, increases in capped patients on service, and increases in provisions for rental revenue adjustments.

We recognize equipment rental revenue over the non-cancelable lease term, which is one month, less estimated adjustments, per ASC 840 — Leases. We have a separate contract with each patient that is not subject to a master lease agreement with any payor. The lease term begins on the date products are shipped to patients and is recorded at amounts estimated to be received under reimbursement arrangements with third-party payors, including Medicare, private payors, and Medicaid. Due to the nature of the industry and the reimbursement environment in which we operate, certain estimates are required to record net revenue and accounts receivable at their net realizable values. Inherent in these estimates is the risk that they will have to be revised or updated as additional information becomes available. Specifically, the complexity of many third-party billing arrangements and the uncertainty of reimbursement amounts for certain services from certain payors may result in adjustments to amounts originally recorded. Such adjustments are typically identified and recorded at the point of cash application, claim denial or account review. Amounts billed but not earned due to the timing of the billing cycle are deferred and recognized in revenue on a straight-line basis over the monthly billing period. For example, if the first day of the billing period does not fall on the first of the month, then a portion of the monthly billing period will fall in the subsequent month and the related revenue and cost would be deferred based on the service days in the following month. Included in rental revenue are unbilled amounts for which the revenue recognition criteria had been met as of

period-end but were not billed. The estimate of unbilled rental revenue accrual is reported net of adjustments that are based on historical trends and estimates of future collectability.

Cost of revenue

Cost of sales revenue

Cost of sales revenue consists primarily of costs incurred in the production process, including costs of component materials, assembly labor and overhead, warranty, provisions for slow-moving and obsolete inventory, rework and delivery costs for items sold. Labor and overhead expenses consist primarily of personnel-related expenses, including wages, bonuses, benefits, and stock-based compensation for manufacturing, logistics, repair, quality assurance employees, and facility costs. They also include manufacturing freight in, materials, temporary labor, outside services, consulting, facility costs, and depreciation expense. We provide a three-year, five-year or lifetime warranty on Inogen One systems sold and a three-year warranty on Inogen At Home systems sold. We established a reserve for future warranty repairs based on historical warranty repair costs incurred. Provisions for warranty obligations, which are included in cost of sales revenue, are provided for at the time of revenue recognition.

We expect the average unit costs of our Inogen One and Inogen At Home systems to continue to decline in future periods as a result of our ongoing efforts to develop lower-cost systems and to improve our manufacturing processes, and increase production volume and yields.

Cost of rental revenue

Cost of rental revenue consists primarily of depreciation expense and service costs for rental patients, including rework costs, material, labor, freight, consumable disposables and logistics costs.

We expect the average rental service costs per patient to decline in future periods as a result of our ongoing efforts to reduce average unit costs of our systems, including reductions in logistics costs, material, labor and depreciation.

Operating expense

Research and development

Our research and development expense consists primarily of personnel-related expenses, including wages, bonuses, benefits and stock-based compensation for research and development and engineering employees, allocated facility costs, laboratory supplies, product development materials, consulting fees and related costs, and testing costs for new product launches. We have made substantial investments in research and development since our inception. Our research and development efforts have focused primarily on the tasks required to enhance our technologies and to support development and commercialization of new and existing products. We expect research and development expense to increase in absolute dollars in future periods as we continue to invest in our engineering and technology teams to support our new and enhanced product research and development efforts and manufacturing line support. We plan to continue to invest in research and development activities to stay at the forefront of patient preference in oxygen therapy devices and as a result expect our research and development expense to increase in future periods.

Sales and marketing

Our sales and marketing expense primarily supports our direct-to-consumer strategy and consists primarily of personnel-related expenses, including wages, bonuses, commissions, benefits, and stock-based compensation for sales, marketing, customer service and clinical service employees, and allocated facilities costs. It also includes expenses for

media and advertising, printing, informational kits, dues and fees, including credit card fees, sales promotional and marketing activities, travel and entertainment expenses as well as customer service and clinical services. Sales and marketing expense increased throughout 2015 and the first nine months of 2016, primarily due to an increase in the sales force and marketing expenses, and we expect a further increase in 2017 as we continue to increase sales and marketing activities.

General and administrative

Our general and administrative expense consists primarily of personnel-related expenses, including wages, bonuses, benefits, and stock-based compensation for employees in our compliance, finance, medical billing, human resources, information technology, business development and general management functions, consulting fees, facilities costs, bad debt expense, and board of directors' expenses, including stock-based compensation. In addition, general and administrative expense includes professional services, such as legal, patent registration and defense costs, insurance, consulting and accounting services, including audit and tax services, and travel and entertainment expenses. We expect general and administrative expense to increase in future periods as the number of

administrative personnel grows and we continue to introduce new products, broaden our customer base and grow our business. We also expect legal, accounting and compliance costs to increase due to costs associated with being a public company.

Other income (expense), net

Our other income (expense), net consists primarily of foreign currency translation gains and (losses), and interest income driven by the interest accruing on cash, cash equivalents and marketable securities.

Results of operations

Comparison of three months ended September 30, 2016 and September 30, 2015

Revenue

	Three months ended September 30,		Change 2016 vs. 2015		% of Revenue	
(amounts in thousands)	2016	2015	$	%	2016	2015
Sales revenue	$47,177	$29,248	$17,929	61.3 %	86.7 %	71.7 %
Rental revenue	7,245	11,530	(4,285)	-37.2%	13.3 %	28.3 %
Total revenue	$54,422	$40,778	$13,644	33.5 %	100.0%	100.0%

Sales revenue increased $17.9 million to $47.2 million for the three months ended September 30, 2016 from $29.2 million for the three months ended September 30, 2015, or an increase of 61.3% over the comparable period. The increase was primarily attributable to an 11,900-unit increase in the number of oxygen systems sold. We sold approximately 26,600 oxygen systems during the three months ended September 30, 2016 compared to approximately 14,700 oxygen systems sold during the three months ended September 30, 2015, or an increase of 81.0% over the comparable period. The increase in the number of systems sold resulted from an increase in worldwide business-to-business sales primarily due to traditional HME purchases and continued strong private label demand, as well as an increase in direct-to-consumer sales in the United States primarily due to increased sales and marketing efforts.

Rental revenue decreased $4.3 million to $7.2 million for the three months ended September 30, 2016 from $11.5 million for the three months ended September 30, 2015, or a decrease of 37.2% from the comparable period. The decrease in rental revenue was primarily related to the declines in Medicare reimbursement rates that took effect in the first and third quarters of 2016, declines in private-payor rates which decreased reimbursements in response to lower Medicare rates, and an increase in provision for rental revenue adjustments.

	Three months ended	Change 2016 vs.	
(amounts in thousands)	September 30,	2015	% of Revenue

Revenue by region and category	2016	2015	$	%	2016	2015
Business-to-business domestic sales	$16,173	$9,794	$6,379	65.1 %	29.7 %	24.0 %
Business-to-business international sales	14,952	7,871	7,081	90.0 %	27.5 %	19.3 %
Direct-to-consumer domestic sales	16,052	11,583	4,469	38.6 %	29.5 %	28.4 %
Direct-to-consumer domestic rentals	7,245	11,530	(4,285)	-37.2%	13.3 %	28.3 %
Total revenue	$54,422	$40,778	$13,644	33.5 %	100.0%	100.0%

Domestic sales in both business-to-business and direct-to-consumer increased 65.1% and 38.6%, respectively, for the three months ended September 30, 2016 compared to the three months ended September 30, 2015. The increase in domestic business-to-business sales was primarily the result of increased demand from our traditional HME providers and private label partner, as well as increased consumer demand for our products due to our marketing efforts and marketing efforts of our business partners. The increase in direct-to-consumer sales was primarily due to the hiring of additional internal sales representatives in the fourth quarter of 2015 and in the nine months ended September 30, 2016, our expansion of marketing strategies, and our continued focus on direct-to-consumer sales with more selective new rental patient set-ups.

Business-to-business international sales increased 90.0% for the three months ended September 30, 2016 compared to the three months ended September 30, 2015, primarily due to continued demand in Europe with our distribution partners and key accounts. As of September 30, 2016, we sold our products in 44 countries outside of the United States, and we plan to continue to expand our presence in other countries as the opportunities present themselves. Of our international sales revenue in the three months ended September 30, 2016, 90.8% was sold in Europe, compared to 87.9% in the comparative period in 2015.

In future periods, revenue may be impacted by seasonality resulting in higher total sales in the warmer weather spring and summer months due to patients traveling in those periods and lower revenue in the low travel and colder weather months, but this may vary year-over-year in certain domestic and international locations in our business-to-business channels. For example, we have previously seen lower international revenue in the third quarter due to reduced economic activity in Europe in the summer months, but this trend did not continue in 2016. We also will be impacted by lower Medicare and third-party reimbursement rates, including competitive bidding, the number of sales representatives, the level of and response from potential customers to direct-to-consumer marketing spend, the number and demand of business-to-business partners and distributors, product launches, and other uncontrollable factors such as changes in the market and competition. We expect our rental revenue per patient to decline in future periods due to competitive bidding reimbursement declines, continued reimbursement declines across third-party payors in response to lower Medicare reimbursement rates, increases in capped patients on service, increased provision for rental revenue adjustments and lower net patient additions as we continue to focus on sales versus new rentals. We currently expect total rental revenue to decline as a percentage of total revenue, to decrease approximately 25% to 30% in 2016 as compared to 2015, and to decline in 2017 as compared to 2016.

Cost of revenue and gross profit

	Three months ended September 30,		Change 2016 vs. 2015		% of Revenue	
(amounts in thousands)	2016	2015	$	%	2016	2015
Cost of sales revenue	$24,271	$16,046	$8,225	51.3 %	44.6%	39.3%
Cost of rental revenue	5,023	5,357	(334)	-6.2 %	9.2 %	13.1%
Total cost of revenue	$29,294	$21,403	$7,891	36.9 %	53.8%	52.5%
Gross profit - sales revenue	$22,906	$13,202	$9,704	73.5 %	42.1%	32.4%
Gross profit - rental revenue	2,222	6,173	(3,951)	-64.0%	4.1 %	15.1%
Total gross profit	$25,128	$19,375	$5,753	29.7 %	46.2%	47.5%
Gross margin percentage - sales revenue	48.6 %	45.1 %				
Gross margin percentage- rental revenue	30.7 %	53.5 %				
Total gross margin percentage	46.2 %	47.5 %				

We manufacture our subassemblies and/or products in our Goleta, California and Richardson, Texas facilities. Our manufacturing process includes final assembly, testing, and packaging to quality and customer specifications. The cost of sales revenue increased $8.2 million to $24.3 million for the three months ended September 30, 2016 from $16.0 million for the three months ended September 30, 2015, or an increase of 51.3% over the comparable period. The increase in cost of sales revenue was primarily attributable to an increase in the number of systems sold, partially offset by reduced bill of material costs for our products associated with design changes, better sourcing and increased volumes. We expect the cost of sales revenue as a percentage of sales revenue in future periods to fluctuate based on customer mix, product mix, and changes in sales prices and cost of goods sold.

The cost of rental revenue decreased $0.3 million to $5.0 million for the three months ended September 30, 2016 from $5.4 million for the three months ended September 30, 2015. The slight decrease in cost of rental revenue was primarily attributable to a decrease of depreciation expense and logistics costs per patient on service. Cost of rental

revenue included $2.9 million of rental asset depreciation for the three months ended September 30, 2016 and $3.0 million for the three months ended September 30, 2015.

Gross margin is defined as revenue less costs of revenue divided by revenue. Sales revenue gross margin increased to 48.6% for the three months ended September 30, 2016 from 45.1% for the three months ended September 30, 2015. The increase in sales gross margin was primarily related to lower cost of goods sold per unit due to lower materials and labor costs associated with the Inogen One G3 upgrade product launched in the fourth quarter of 2015 and the Inogen One G4 product launch in May 2016, partially offset by a higher sales mix toward lower margin business-to-business sales which accounted for 66.0% of total sales revenue in the third quarter of 2016 versus 60.4% in the third quarter of 2015. We expect sales gross margin to fluctuate over time based on the sales channel mix, product mix, and changes in average selling prices and cost of goods sold per unit.

Rental revenue gross margin decreased to 30.7% for the three months ended September 30, 2016 from 53.5% for the three months ended September 30, 2015, primarily due to lower net revenue per rental patient resulting from the reimbursement reductions and increased provisions for rental revenue adjustments in the third quarter of 2016, partially offset by lower cost of rental revenues associated with lower depreciation and servicing costs per patient. We expect rental gross margin to continue to decline in the fourth quarter of 2016 and in full year 2017 due to rental reimbursement rate reductions, increase in provision for rental revenue adjustments, and lower net patient additions as we continue to focus on sales versus new rentals, partially offset by lower cost of rental revenue per patient on service.

Research and development expense

(amounts in thousands)	Three months ended September 30, 2016	2015	Change 2016 vs. 2015 $	%	% of Revenue 2016	2015
Research and development expense	$1,350	$1,116	$234	21.0%	2.5%	2.7 %

Research and development expense increased $0.2 million to $1.4 million for the three months ended September 30, 2016 from $1.1 million for the three months ended September 30, 2015, or an increase of 21.0% over the comparable period. The increase was primarily attributable to a $0.2 million increase in personnel-related expenses and product development expenses for engineering projects.

We expect research and development expense to increase in absolute dollars in future periods as we continue to invest in our engineering and technology teams to support our new and enhanced product research and development efforts and manufacturing line support.

Sales and marketing expense

(amounts in thousands)	Three months ended September 30, 2016	2015	Change 2016 vs. 2015 $	%	% of Revenue 2016	2015
Sales and marketing expense	$9,679	$8,132	$1,547	19.0%	17.8%	19.9%

Sales and marketing expense increased $1.5 million to $9.7 million for the three months ended September 30, 2016 from $8.1 million for the three months ended September 30, 2015, or an increase of 19.0% over the comparable period. The increase was primarily attributable to $1.1 million of sales and marketing personnel-related expenses as a result of increased headcount to support the growth of our business (which included $0.6 million of wages, benefits and payroll tax expense and $0.5 million of commissions expense), $0.3 million in credit card processing fees, $0.2 million of media and printing expenses, and $0.1 million for dues, fees and license costs. In the three months ended September 30, 2016, we spent $1.5 million in media and advertising costs compared to $1.3 million in the comparative period in 2015.

We expect sales and marketing expenses to increase in absolute dollars in future periods as we continue to invest in our business, including expanding our sales and sales support team, increasing media spend to drive consumer awareness, and increasing patient support costs as our patient base increases.

General and administrative expense

(amounts in thousands)	Three months ended September 30, 2016	2015	Change 2016 vs. 2015 $	%	% of Revenue 2016	2015
General and administrative expense	$8,702	$6,413	$2,289	35.7%	16.0 %	15.7 %

General and administrative expense increased $2.3 million to $8.7 million for the three months ended September 30, 2016 from $6.4 million for the three months ended September 30, 2015, or an increase of 35.7% over the comparable period. The increase was primarily attributable to $1.4 million of personnel-related expenses as a result of increased headcount in executive administration, billing, finance, information technology, human resources and compliance (which included an additional $0.8 million of stock compensation expense, $0.4 million of wages, benefits and payroll tax expense, and $0.2 million of bonus expense), $0.6 million of patent defense costs, and $0.4 million of bad debt expense. These increases were partially offset by a reduction of $0.3 million for outside services. Bad debt expense, expressed as a percentage of total revenue, was 2.0% and 1.7% in the three months ended September 30, 2016 and September 30, 2015, respectively.

We expect general and administrative expense to increase in absolute dollars as we continue to invest in corporate infrastructure to support our growth and our operation as a public company, including personnel-related expenses, professional services fees and compliance costs. In addition, as our patient base increases, we expect our billing and administration costs to increase in absolute dollars and our bad debt expense to increase in absolute dollars as our revenue increases.

Other income (expense), net

(amounts in thousands)	Three months ended September 30, 2016	2015	Change 2016 vs. 2015 $	%	% of Revenue 2016	2015
Interest expense	$(1)	$(5)	$4	-80.0%	0.0%	0.0%
Interest income	61	28	33	117.9%	0.1%	0.1%
Other expense	(8)	(59)	51	-86.4%	0.0%	-0.1%
Total other income (expense), net	$52	$(36)	$88	244.4%	0.1%	-0.1%

Total other income (expense), net, remained relatively flat for the three months September 30, 2016 compared to the three months September 30, 2015.

Income tax expense

(amounts in thousands)	Three months ended September 30, 2016	2015	Change 2016 vs. 2015 $	%	% of Revenue 2016	2015
Income tax expense	$1,994	$982	$1,012	103.1%	3.7%	2.4%
Effective income tax rate	36.6%	26.7%				

The increase in the provision for income taxes for the three months ended September 30, 2016 compared to the prior year period was primarily due to an increase in income before provision for income taxes to $5.4 million for the three months ended September 30, 2016 compared to $3.7 million for the three months ended September 30, 2015, partially offset by an increase in the effective tax rate to 36.6% for the three months ended September 30, 2016 compared to 26.7% for the three months ended September 30, 2015. This increase in the effective rate was primarily due to the $0.6 million tax benefit adjustment that occurred in the third quarter of 2015, partially offset by research and development credits allowed in the third quarter of 2016, but not in the comparative period in 2015. As a result, the adjusted net income was $3,455 and $2,140 for the three months ended September 30, 2016 and 2015, respectively.

Net income

(amounts in thousands)	Three months ended September 30, 2016	2015	Change 2016 vs. 2015 $	%	% of Revenue 2016	2015
Net income	$3,455	$2,696	$759	28.2%	6.3%	6.6 %

The increase in net income was primarily related to the increase in revenues of 33.5% and improved operating expense leverage over the prior year comparable period, partially offset by lower overall gross margin and higher effective tax rate.

Seasonality

We believe our sales may be impacted by seasonal factors. For example, we typically experience higher total sales in the second and third quarter, as a result of consumers traveling and vacationing during warmer weather in the spring and summer months, but this may vary year-over-year in certain domestic and international locations in our business-to-business channels. In particular, we have previously seen lower international revenue in the third quarter due to reduced economic activity in Europe in the summer months, but this trend did not continue in 2016. The following table summarizes our quarterly net sales, gross profit and income from operations:

(amounts in thousands)				Nine months ended September
Quarterly Results 2016	Q1	Q2	Q3	30, 2016
Net revenue	$42,989	$54,567	$54,422	$151,978
Gross profit	21,279	26,215	25,128	72,622
Net income	2,365	5,142	3,455	10,962

(amounts in thousands)				Nine months ended September
Quarterly Results 2015	Q1	Q2	Q3	30, 2015
Net revenue	$33,752	$44,029	$40,778	$118,559
Gross profit	16,023	20,822	19,375	56,220
Net income	1,572	3,459	2,696	7,727

Comparison of nine months ended September 30, 2016 and September 30, 2015

Revenue

	Nine months ended September 30,		Change 2016 vs. 2015		% of Revenue	
(amounts in thousands)	2016	2015	$	%	2016	2015
Sales revenue	$125,566	$84,682	$40,884	48.3 %	82.6 %	71.4 %
Rental revenue	26,412	33,877	(7,465)	-22.0%	17.4 %	28.6 %
Total revenue	$151,978	$118,559	$33,419	28.2 %	100.0%	100.0%

Sales revenue increased $40.9 million to $125.6 million for the nine months ended September 30, 2016 from $84.7 million for the nine months ended September 30, 2015, or an increase of 48.3% over the comparable period. The increase was primarily attributable to an 26,600-unit increase in the number of oxygen systems sold. We sold approximately 68,700 oxygen systems during the nine months ended September 30, 2016 compared to approximately 42,100 oxygen systems sold during the nine months ended September 30, 2015, or an increase of 63.2% over the comparable period. The increase in the number of systems sold resulted from an increase in worldwide

business-to-business sales primarily due to traditional HME purchases and continued strong private label demand, as well as an increase in direct-to-consumer sales in the United States primarily due to increased sales and marketing efforts.

Rental revenue decreased $7.5 million to $26.4 million for the nine months ended September 30, 2016 from $33.9 million for the nine months ended September 30, 2015, or a decrease of 22.0% from the comparable period. The decrease in rental revenue was primarily related to the declines in Medicare reimbursement rates that took effect in the first and third quarters of 2016, declines in private-payor rates which decreased due to lower Medicare rates, and an increase in provision for rental revenue adjustments.

(amounts in thousands)	Nine months ended September 30,		Change 2016 vs. 2015		% of Revenue	
Revenue by region and category	2016	2015	$	%	2016	2015
Business-to-business domestic sales	$41,647	$25,590	$16,057	62.7 %	27.4 %	21.6 %
Business-to-business international sales	38,015	26,840	11,175	41.6 %	25.0 %	22.6 %
Direct-to-consumer domestic sales	45,904	32,252	13,652	42.3 %	30.2 %	27.2 %
Direct-to-consumer domestic rentals	26,412	33,877	(7,465)	-22.0%	17.4 %	28.6 %
Total revenue	$151,978	$118,559	$33,419	28.2 %	100.0%	100.0%

Domestic sales in both business-to-business and direct-to-consumer increased 62.7% and 42.3%, respectively, for the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015. The increase in domestic business-to-business sales was primarily the result of increased demand from our traditional HME providers and private label partner, as well as increased consumer demand for our products due to our marketing efforts and marketing efforts of our business partners. The increase in direct-to-consumer sales was primarily due to the hiring of additional internal sales representatives in the fourth quarter of 2015 and in the first nine months of 2016, our expansion of marketing strategies, and our continued focus on direct-to-consumer sales with more selective new rental patient set-ups.

Business-to-business international sales increased 41.6% for the nine months ended September 30, 2016 compared to the nine months ended September 30, 2015, primarily due to continued demand in Europe. As of September 30, 2016, we sold our products in 44 countries outside of the United States, and we plan to continue to expand our presence in other countries as the opportunities present themselves. Of our international sales revenue in the nine months ended September 30, 2016, 91.3% was sold in Europe, compared to 89.3% in the comparative period in 2015.

In future periods, revenue may be impacted by seasonality resulting in higher total sales in the warmer weather spring and summer months due to patients traveling in those periods and lower revenue in the low travel and colder weather months, but this may vary year-over-year in certain domestic and international locations in our business-to-business channels. For example, we have previously seen lower international revenue in the third quarter due to reduced economic activity in Europe in the summer months, but this trend did not continue in 2016. We also will be impacted by lower Medicare and third-party reimbursement rates, including competitive bidding, the number of sales representatives, the level of and response from potential customers to direct-to-consumer marketing spend, the number and demand of business-to-business partners and distributors, product launches, and other uncontrollable factors such as changes in the market and competition. We expect our rental revenue per patient to decline in future periods due to competitive bidding reimbursement declines, continued reimbursement declines across third-party payors, increases in capped patients on service, increased provision for rental revenue adjustments and lower net patient additions as we continue to focus on sales versus new rentals. We currently expect total rental revenue to decline as a percentage of total revenue, to decrease approximately 25% to 30% in 2016 as compared to 2015, and to decline in 2017 as compared to 2016.

Cost of revenue and gross profit

	Nine months ended September 30,		Change 2016 vs. 2015		% of Revenue	
(amounts in thousands)	2016	2015	$	%	2016	2015
Cost of sales revenue	$63,824	$46,501	$17,323	37.3 %	42.0%	39.2%
Cost of rental revenue	15,532	15,838	(306)	-1.9 %	10.2%	13.4%
Total cost of revenue	$79,356	$62,339	$17,017	27.3 %	52.2%	52.6%
Gross profit - sales revenue	$61,742	$38,181	$23,561	61.7 %	40.6%	32.2%
Gross profit - rental revenue	10,880	18,039	(7,159)	-39.7%	7.2 %	15.2%
Total gross profit	$72,622	$56,220	$16,402	29.2 %	47.8%	47.4%
Gross margin percentage - sales revenue	49.2 %	45.1 %				
Gross margin percentage- rental revenue	41.2 %	53.2 %				
Total gross margin percentage	47.8 %	47.4 %				

We manufacture subassemblies and/or products in our Goleta, California and Richardson, Texas facilities. Our manufacturing process includes final assembly, testing, and packaging to quality and customer specifications. The cost of sales revenue increased $17.3 million to $63.8 million for the nine months ended September 30, 2016 from $46.5 million for the nine months ended September 30, 2015, or an increase of 37.3% over the comparable period. The increase in cost of sales revenue was primarily attributable to an increase in the number of systems sold, partially offset by reduced bill of material costs for our products associated with design changes, better sourcing and increased volumes. We expect the cost of sales revenue as a percentage of sales revenue in future periods to fluctuate based on customer mix, product mix, and changes in sales prices and cost of goods sold.

The cost of rental revenue decreased $0.3 million to $15.5 million for the nine months ended September 30, 2016 from $15.8 million for the nine months ended September 30, 2015, or a decrease of 1.9% over the comparable period. The decrease in cost of rental revenue was primarily attributable to a decrease in depreciation expense, repair costs, disposables, product exchange and logistics costs per patient on service. Cost of rental revenue included $8.7 million of rental asset depreciation costs for the nine months ended September 30, 2016 versus $8.9 million for the nine months ended September 30, 2015.

Gross margin is defined as revenue less costs of revenue divided by revenue. Sales revenue gross margin increased to 49.2% for the nine months ended September 30, 2016 from 45.1% for the nine months ended September 30, 2015. The increase in sales gross margin was primarily related to lower cost of goods sold per unit due to lower materials and labor costs associated with the Inogen One G3 upgrade product launched in the fourth quarter of 2015 and the Inogen One G4 product launch in May 2016, partially offset by an increase in sales mix toward lower margin business-to-business sales, which accounted for 63.4% of total sales revenue in the first nine months of 2016 versus 61.9% in the first nine months of 2015. We expect sales gross margin to fluctuate over time based on the sales channel mix, product mix, and changes in average selling prices and cost of goods sold per unit.

Rental revenue gross margin decreased to 41.2% for the nine months ended September 30, 2016 from 53.2% for the nine months ended September 30, 2015, primarily due to lower net revenue per rental patient resulting from the reimbursement reductions and increased provisions for rental revenue adjustments in the first nine months of 2016, partially offset by lower cost of rental revenues associated with lower depreciation and servicing costs per patient. We expect rental gross margin to continue to decline in the fourth quarter of 2016 and full year 2017 due to rental reimbursement rate reductions, increase in provision for rental revenue adjustments and lower net patient additions as we continue to focus on sales versus new rentals, partially offset by lower cost of rental revenue per patient on service.

Research and development expense

	Nine months ended September 30,		Change 2016 vs. 2015		% of Revenue	
(amounts in thousands)	2016	2015	$	%	2016	2015
Research and development expense	$3,897	$2,954	$943	31.9%	2.6%	2.5 %

Research and development expense increased $0.9 million to $3.9 million for the nine months ended September 30, 2016 from $3.0 million for the nine months ended September 30, 2015, or an increase of 31.9% over the comparable period. The increase was primarily attributable to $0.6 million in personnel-related expenses for engineering projects and $0.2 million for product development expense.

We expect research and development expense to increase in absolute dollars in future periods as we continue to invest in our engineering and technology teams to support our new and enhanced product research and development efforts and manufacturing line support.

Sales and marketing expense

	Nine months ended September 30,		Change 2016 vs. 2015		% of Revenue	
(amounts in thousands)	2016	2015	$	%	2016	2015
Sales and marketing expense	$28,220	$22,623	$5,597	24.7%	18.6%	19.1%

Sales and marketing expense increased $5.6 million to $28.2 million for the nine months ended September 30, 2016 from $22.6 million for the nine months ended September 30, 2015, or an increase of 24.7% over the comparable period. The increase was primarily attributable to $3.0 million of sales and marketing personnel-related expenses as a result of increased headcount to support the growth of our business (which included $1.5 million of wages and payroll tax expense, $1.1 million of commissions expense, $0.2 million of employee benefits and $0.2 million of stock compensation expense), $1.1 million of media and printing expenses and $0.7 million in credit card processing fees. We also incurred an additional $0.4 million for dues, fees, and license costs, $0.2 million for client and clinical services personnel-related expenses and $0.2 million for non-warranty repair costs done as an accommodation to our customers. In the nine months ended September 30, 2016, we spent $4.5 million in media and advertising costs compared to $3.3 million in the comparative period in 2015.

We expect sales and marketing expenses to increase in absolute dollars in future periods as we continue to invest in our business, including expanding our sales and sales support team, increasing media spend to drive consumer awareness, and increasing patient support costs as our patient base increases.

General and administrative expense

(amounts in thousands)	Nine months ended September 30, 2016	2015	Change 2016 vs. 2015 $	%	% of Revenue 2016	2015
General and administrative expense	$23,812	$19,066	$4,746	24.9%	15.7 %	16.1 %

General and administrative expense increased $4.7 million to $23.8 million for the nine months ended September 30, 2016 from $19.1 million for the nine months ended September 30, 2015, or an increase of 24.9% over the comparable period. The increase was primarily attributable to $4.6 million of personnel-related expenses as a result of increased headcount in executive administration, billing, finance, information technology, human resources and compliance (which included $2.5 million of stock compensation expense, $1.6 million of wages, benefits and payroll tax expense and $0.6 million of bonus expense), $1.1 million of patent defense costs and $0.8 million of bad debt expense primarily related to our rental receivables. These increases were partially offset by decreases of $1.4 million in audit, tax and legal fees (primarily due to the audit committee investigation expense and the related class action lawsuit of $1.8 million in the first half of 2015), $0.6 million of outside services, $0.2 million in net proceeds from sale of assets and $0.2 million of depreciation. Bad debt expense, expressed as a percentage of total revenue, was 1.7% and 1.5% in the nine months ended September 30, 2016 and September 30, 2015, respectively.

We expect general and administrative expense to increase in absolute dollars as we continue to invest in corporate infrastructure to support our growth and our operation as a public company, including personnel-related expenses, professional services fees and compliance costs associated with operating as a public company. In addition, as our patient base increases, we expect our billing and administration costs to increase in absolute dollars and our bad debt expense to increase in absolute dollars as our revenue increases.

Other income (expense), net

(amounts in thousands)	Nine months ended September 30, 2016	2015	Change 2016 vs. 2015 $	%	% of Revenue 2016	2015
Interest expense	$(6)	$(18)	$12	-66.7 %	0.0%	0.0 %
Interest income	126	66	60	90.9 %	0.1%	0.1 %
Other income (expense)	78	(215)	293	136.3%	0.1%	-0.2%
Total other income (expense), net	$198	$(167)	$365	218.6%	0.1%	-0.1%

Total other income (expense), net, increased to $0.2 million of income for the nine months ended September 30, 2016 from $0.2 million of expense for the nine months ended September 30, 2015. The increase was primarily due to gains on foreign currency transactions as the U.S. dollar stabilized.

Income tax expense

(amounts in thousands)	Nine months ended September 30, 2016	2015	Change 2016 vs. 2015 $	%	% of Revenue 2016	2015
Income tax expense	$5,929	$3,683	$2,246	61.0%	3.9%	3.1 %
Effective income tax rate	35.1 %	32.3 %				

The increase in the provision for income taxes for the nine months ended September 30, 2016 compared to the prior year period was primarily due to an increase in income before provision for income taxes to $16.9 million for the nine months ended September 30, 2016 compared to $11.4 million for the nine months ended September 30, 2015, partially offset by an increase in the effective tax rate to 35.1% for the nine months ended September 30, 2016, compared to 32.3% for the nine months ended September 30, 2015. The increase in the effective tax rate was primarily due to the tax benefit adjustments that occurred in the third quarter of 2015 offset by research and development credits allowed in the third quarter of 2016 and a decrease to the rate for stock compensation deductions in 2016 compared to 2015. As a result, the adjusted net income was $10,962 and $7,171 for the nine months ended September 30, 2016 and 2015, respectively.

Net income

(amounts in thousands)	Nine months ended September 30, 2016	2015	Change 2016 vs. 2015 $	%	% of Revenue 2016	2015
Net income	$10,962	$7,727	$3,235	41.9%	7.2%	6.5 %

The increase in net income was primarily related to the increase in revenues of 28.2% over the prior year period and improved operating expense leverage over the prior year period, partially offset by the higher effective tax rate.

Contractual obligations

We obtain individual components for our products from a wide variety of individual suppliers. Consistent with industry practice, we acquire components through a combination of purchase orders, supplier contracts, and open orders based on projected demand information. Where appropriate, the purchases are applied to inventory component prepayments that are outstanding with the respective supplier. As of September 30, 2016, we had purchase obligations of approximately $40.2 million of which the timing varies depending on demand, current supply on hand and other factors. The obligations normally do not extend beyond twelve-month time frames.

Except as indicated above, there have been no other material changes, outside of the ordinary course of business, in our outstanding contractual obligations from those disclosed within “Management’s Discussion and Analysis of Financial Condition and Results of Operations” section contained in our Annual Report on Form 10-K filed with the SEC on March 14, 2016.

Off-balance sheet arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, which would have been established for the purpose of facilitating off-balance sheet arrangements or for any other contractually narrow or limited purpose. However, from time to time we enter into certain types of contracts that contingently require us to indemnify parties against third-party claims including certain real estate leases, supply purchase agreements, and directors and officers. The terms of such obligations vary by contract and in most instances a maximum dollar amount is not explicitly stated therein. Generally, amounts under these contracts cannot be reasonably estimated until a specific claim is asserted thus no liabilities have been recorded for these obligations on our balance sheets for any of the periods presented.

Liquidity and capital resources

As of September 30, 2016, we had cash and cash equivalents of $86.0 million, which consisted of highly-liquid investments with a maturity of three months or less. In addition, we held $22.3 million in certificates of deposits and corporate bonds which had maturities greater than three months, but less than twelve months, and which were classified as marketable securities. Since inception, we have financed our operations primarily through cash from operations, the sale of equity securities and, to a lesser extent, from borrowings. As of September 30, 2016, we had $0.1 million outstanding in patent licensing debt. Since inception, we have received net proceeds of $91.7 million from the issuance of redeemable convertible preferred stock and convertible preferred stock, and $52.5 million ($49.7

million net proceeds) in connection with the sale of common stock in our initial public offering. Since 2013, we have received $9.3 million from proceeds related to stock option exercises and employee stock purchase plans. For the nine months ended September 30, 2016 and September 30, 2015, we received $5.7 million and $1.7 million, respectively, in proceeds related to these stock programs.

In November 2014, we secured a primary banking relationship that provides access to a $15.0 million working capital revolving line of credit and treasury and cash management services through commercial banking with JPMorgan Chase Bank. This agreement is a three-year working capital revolving line of credit which replaced the previous loan facility we maintained with Comerica Bank. The interest rate on outstanding debt balances is the London Interbank Offer Rate (LIBOR) plus 1.25%.

Pursuant to the revolving credit agreement, we are subject to certain financial covenants relating to our net worth and EBITDA. Tangible net worth under the revolving credit agreement is calculated by subtracting the sum of intangible assets and total liabilities from total assets. EBITDA is defined in the revolving credit agreement as our net income plus interest expense, plus depreciation expense, plus amortization expense, plus income tax expense, plus non-cash expense, plus extraordinary losses, minus non-cash income, and minus extraordinary gains, as computed during certain test periods provided in the revolving credit agreement. We are required to maintain at all times a tangible net worth of $90.0 million and EBITDA (i) of $10.0 million for any period of four consecutive quarters commencing with the four-quarter test period ended September 30, 2014 through the four-quarter test period ended March 31, 2016 and (ii) of $12.5 million for any four-quarter test period commencing with the four-quarter test period ended June 30, 2016 and continuing thereafter.

The agreement contains events of default customary for transactions of this type, including nonpayment, misrepresentation, breach of covenants, and bankruptcy. In the event we fail to satisfy our covenants, or otherwise go into default, JPMorgan Chase Bank has a number of remedies, including sale of our assets and acceleration of all outstanding indebtedness. Certain of these remedies would likely have a material adverse effect on our business. As of September 30, 2016, in order to be in compliance with the EBITDA and tangible net worth requirements, we were required to maintain $12.5 million in EBITDA for the preceding test period, and we had $40.8 million in EBITDA for that period. In addition, we were required to maintain a tangible net worth of $90.0 million and we had a tangible net worth of $155.8 million. As of September 30, 2016, we had $15.0 million in available debt capacity under the revolving facility.

Our principal uses of cash in the nine months ended September 30, 2016 consisted of the funding of our capital expenditures including additional rental equipment and other property, plant and equipment of $6.1 million, net purchases of available-for-sale investments of $5.5 million, which were partially offset by $0.3 million of gross proceeds from sale of previously owned assets. We believe that our current cash, cash equivalents, marketable securities, available borrowings under our revolving credit and term loan agreement and the cash to be generated from expected product sales and rentals will be sufficient to meet our projected operating and investing requirements for at least the next twelve months. However, our liquidity assumptions may prove to be incorrect, and we could utilize our available financial resources sooner than we currently expect. Our future funding requirements will depend on many factors, including market acceptance of our products; the cost of our research and development activities; reimbursement from Medicare, and secondarily, from private payors; the cost associated with litigation or disputes relating to intellectual property rights or otherwise; the cost and timing of regulatory clearances or approvals; the cost and timing of establishing additional sales, marketing, and distribution capabilities; and the effect of competing technological and market developments. In the future, we may acquire businesses or technologies from third parties, and we may decide to raise additional capital through debt or equity financing to the extent we believe this is necessary to successfully complete these acquisitions. We currently have no material commitments or agreements relating to any such acquisitions. Our future capital requirements will also depend on many additional factors, including those set forth in the section of this Quarterly Report on Form 10-Q entitled “Risk Factors.”

If we require additional funds in the future, we may not be able to obtain such funds on acceptable terms, or at all. In the future, we may also attempt to raise additional capital through the sale of equity securities or through equity-linked or debt financing arrangements. If we raise additional funds by issuing equity or equity-linked securities, the ownership of our existing stockholders will be diluted. If we raise additional financing by the incurrence of indebtedness, we will be subject to increased fixed payment obligations and could also be subject to restrictive covenants, such as limitations on our ability to incur additional debt, and other operating restrictions that could adversely impact our ability to conduct our business. Any future indebtedness we incur may result in terms that could be unfavorable to equity investors. There can be no assurances that we will be able to raise additional capital, which would adversely affect our ability to achieve our business objectives. In addition, if our operating performance during the next twelve months is below our expectations, our liquidity and ability to operate our business could be adversely

affected.

The following tables show a summary of our cash flows and working capital for the periods indicated:

(amounts in thousands)	Nine months ended September 30,		Change 2016 vs. 2015	
Summary of cash flows	2016	2015	$	%
Cash provided by operating activities	$25,852	$25,604	$248	1.0 %
Cash used in investing activities	(11,377)	(28,829)	17,452	60.5 %
Cash provided by financing activities	5,420	1,479	3,941	266.5 %
Effect of exchange rates on cash	8	—	8	—
Net increase (decrease) in cash and cash equivalents	$19,903	$(1,746)	$21,649	1239.9%

(amounts in thousands) Working capital	September 30, 2016	December 31, 2015
Cash and cash equivalents	$86,009	$66,106
Marketable securities	22,331	16,793
Accounts receivable, net	29,717	19,872
Inventories, net	16,499	8,648
Deferred cost of revenue	439	397
Income tax receivable	1,612	2,158
Prepaid expenses and other current assets	1,470	870
Total current assets	158,077	114,844
Accounts payable and accrued expenses	20,710	12,867
Accrued payroll	5,844	5,271
Current portion of long-term debt	80	315
Warranty reserve	1,559	1,226
Deferred revenue	2,035	2,323
Income tax payable	—	11
Total current liabilities	30,228	22,013
Net working capital	$127,849	$92,831

Operating activities

We derive operating cash flows from cash collected from the sales and rental of our products and services. These cash flows received are partially offset by our use of cash for operating expenses to support the growth of our business. Net income in each period has increased associated with increased sales, improving product mix and lower costs of revenues. In addition, operating expense leverage has increased as expenses have not grown as quickly as revenues due to improved operating efficiencies. The changes in cash related to operating assets and liabilities discussed below were primarily due to the following factors that occurred across all periods: an increase in cash used related to inventory to support our growth in revenue; an increase in cash used by accounts receivable resulting from growth in rental receivables which typically have a longer collection cycle and an increase in business-to-business receivables due to extended payment terms offered; and an increase in cash provided by accounts payable resulting from the higher level of operating expenses needed to support the increased sales level.

Net cash provided by operating activities for the nine months ended September 30, 2016 consisted primarily of our net income of $11.0 million and non-cash expense items such as depreciation and amortization of our equipment and leasehold improvements of $10.3 million, provision for rental revenue adjustments of $7.8 million, provision for sales returns and doubtful accounts of $8.2 million, deferred tax assets of $6.0 million, stock-based compensation expense of $5.4 million, and loss on disposal of rental equipment and other fixed assets of $0.9 million, partially offset by a gain on sale of former assets of $0.2 million. The net changes in operating assets and liabilities resulted in a net decrease in cash of $23.5 million, of which $35.6 million was due to a net increase in accounts receivable, inventory, and other current assets. These were partially offset by net increases of $7.8 million of accounts payable, $1.9 million of deferred revenue, $1.4 million of warranty reserve, $0.6 million of accrued payroll and a net decrease of $0.5 million of income tax receivable.

Net cash provided by operating activities for the nine months ended September 30, 2015 consisted of our net income of $7.7 million and non-cash expense items such as depreciation and amortization of our equipment and leasehold improvements of $10.5 million, provision for rental revenue adjustments of $6.4 million, $3.7 million of deferred tax assets, provision for sales returns of $3.5 million, stock-based compensation expense of $2.3 million, provision for doubtful accounts of $1.8 million, loss on disposal of rental units of $0.9 million and provision for inventory losses of $0.1 million. The net changes in operating assets and liabilities resulted in a net decrease in cash of $11.3 million, of which $17.2 million was due to a net increase in accounts receivable, inventory and other current assets during this period, partially offset by a net increase of $3.0 million of accounts payable, $1.6 million of deferred revenue and $1.2 million of other liabilities.

Investing activities

Net cash used in investing activities for each of the periods presented was primarily related to the production and purchase of rental assets, manufacturing tooling, and computer equipment and software to support our expanding business. Beginning in the second quarter of 2015, net cash used in investing activities also included the net purchase of available-for-sale investments.

For the nine months ended September 30, 2016, we had $26.3 million of purchases that we invested in certificates of deposits with maturities greater than three months and less than twelve months that were classified as marketable securities partially offset by $20.8 million in maturities of available-for-sale investments. In addition, we invested $6.2 million in rental assets and other property, equipment, leasehold improvements, and intangible assets partially offset from gross proceeds from the sale of former assets of $0.3 million.

For the nine months ended September 30, 2015, we invested $33.6 million primarily in certificates of deposits with maturities greater than 90 days and less than twelve months that were classified as marketable securities, partially offset by $14.5 million in maturities of available-for-sale investments. In addition, we invested $9.8 million in rental assets and other property, equipment and intangible assets.

We expect to continue investing in property and equipment as we expand our operations. Our business is inherently capital intensive. For example, we expend significant manufacturing and production expense in connection with the development and production of our oxygen concentrator products and, in connection with our rental business, we incur expense in the deployment of rental products to our patients. Investments will continue to be required in order to grow our revenue.

Financing activities

Historically, we have funded our operations through our sales and rental revenue, the issuance of preferred and common stock, and the incurrence of indebtedness.

For the nine months ended September 30, 2016, net cash provided by financing activities consisted primarily of $5.7 million from the proceeds received from stock options that were exercised and purchases under our employee stock purchase program, partially offset by $0.2 million of payments on our contractual obligation.

For the nine months ended September 30, 2015, net cash provided by financing activities consisted primarily of $1.7 million from the proceeds of stock options that were exercised and purchases under our employee stock purchase. This was partially offset by $0.2 million of payments on our contractual obligations.

Non-GAAP financial measures

EBITDA, Adjusted EBITDA, and Adjusted net income, are financial measures that are not calculated in accordance with U.S. GAAP. We define EBITDA as net income excluding interest income, interest expense, taxes and depreciation and amortization. Adjusted EBITDA also excludes stock-based compensation. Adjusted net income excludes certain tax benefit adjustments. Below, we have provided a reconciliation of EBITDA, Adjusted EBITDA and Adjusted net income to our net income, the most directly comparable financial measure calculated and presented in accordance with U.S. GAAP. EBITDA, Adjusted EBITDA and Adjusted net income should not be considered alternatives to net income or any other measure of financial performance calculated and presented in accordance with U.S. GAAP. Our EBITDA, Adjusted EBITDA and Adjusted net income may not be comparable to similarly titled measures of other organizations because other organizations may not calculate EBITDA, Adjusted EBITDA and Adjusted net income in the same manner as we calculate these measures.

We include EBITDA, Adjusted EBITDA and Adjusted net income in this Quarterly Report on Form 10-Q because they are important measures upon which our management assesses our operating performance. We use EBITDA, Adjusted EBITDA and Adjusted net income as key performance measures because we believe they facilitate operating performance comparisons from period-to-period by excluding potential differences primarily caused by variations in capital structures, tax positions, the impact of depreciation and amortization expense on our fixed assets and the impact of stock-based compensation expense. Because EBITDA, Adjusted EBITDA and Adjusted net income

facilitate internal comparisons of our historical operating performance on a more consistent basis, we also use EBITDA, Adjusted EBITDA and Adjusted net income for business planning purposes, to incentivize and compensate our management personnel, and in evaluating acquisition opportunities. In addition, we believe EBITDA, Adjusted EBITDA and Adjusted net income and similar measures are widely used by investors, securities analysts, ratings agencies, and other parties in evaluating companies in our industry as a measure of financial performance and debt-service capabilities.

Our uses of EBITDA, Adjusted EBITDA and Adjusted net income have limitations as analytical tools, and you should not consider them in isolation or as a substitute for analysis of our results as reported under U.S. GAAP. Some of these limitations are:

- EBITDA and Adjusted EBITDA do not reflect our cash expenditures for capital equipment or other contractual commitments;
- although depreciation and amortization are non-cash charges, the assets being depreciated and amortized may have to be replaced in the future, and EBITDA and Adjusted EBITDA do not reflect capital expenditure requirements for such replacements;
- EBITDA and Adjusted EBITDA do not reflect changes in, or cash requirements for, our working capital needs;
- EBITDA and Adjusted EBITDA do not reflect the interest expense or the cash requirements necessary to service interest or principal payments on our indebtedness;
- Adjusted net income does not reflect the tax benefit adjustments recorded based on U.S. GAAP; and
- other companies, including companies in our industry, may calculate EBITDA, Adjusted EBITDA and Adjusted net income measures differently, which reduces their usefulness as a comparative measure.

In evaluating EBITDA, Adjusted EBITDA and Adjusted net income, you should be aware that in the future we will incur expenses within these categories similar to this presentation. Our presentation of EBITDA, Adjusted EBITDA and Adjusted net income should not be construed as an inference that our future results will be unaffected by certain expenses. When evaluating our performance, you should consider EBITDA, Adjusted EBITDA and Adjusted net income alongside other financial performance measures, including U.S. GAAP results.

The following table presents a reconciliation of EBITDA, Adjusted EBITDA and Adjusted net income to our net income, the most comparable U.S. GAAP measure, for each of the periods indicated:

(amounts in thousands)	Three months ended September 30,		Nine months ended September 30,	
Non-GAAP EBITDA and Adjusted EBITDA	2016	2015	2016	2015
Net income	$3,455	$2,696	$10,962	$7,727
Non-GAAP adjustments:				
Interest expense	1	5	6	18
Interest income	(61)	(28)	(126)	(66)
Provision for income taxes	1,994	982	5,929	3,683
Depreciation and amortization	3,416	3,560	10,290	10,468
EBITDA (Non-GAAP)	8,805	7,215	27,061	21,830
Stock-based compensation	1,953	1,016	5,404	2,343
Adjusted EBITDA (Non-GAAP)	$10,758	$8,231	$32,465	$24,173

(amounts in thousands)	Three months ended September 30,		Nine months ended September 30,	
Non-GAAP Adjusted net income	2016	2015	2016	2015
Net income	$3,455	$2,696	$10,962	$7,727
Non-GAAP adjustments:				

Tax benefit adjustments	—	(556)	—	(556)
Adjusted net income (non-GAAP)	$3,455	$2,140	$10,962	$7,171

Item 3. Quantitative and Qualitative Disclosures About Market Risk

We are exposed to various market risks, including fluctuation in interest rates, foreign currency, and exchange rates. Market risk is the potential loss arising from adverse changes in market rates and prices. We do not hold or issue financial instruments for trading purposes.

Interest rate fluctuation risk

The principal market risk we face is interest rate risk. We had cash and cash equivalents of $86.0 million as of September 30, 2016, which consisted of highly-liquid investments with a maturity of three months or less, and $22.3 million of marketable securities with maturity dates of greater than three months and less than twelve months. The primary goals of our investment policy are liquidity and capital preservation. We do not enter into investments for trading or speculative purposes. We believe that we do not have any material exposure to changes in the fair value of these assets as a result of changes in interest rates due to the short-term nature of our cash and cash equivalents. Declines in interest rates, however, would reduce future investment income. If overall interest rates had decreased by 10% during the periods presented, our interest income would not have been materially affected.

As of September 30, 2016, we did not have outstanding borrowings under our JPMorgan Chase Bank credit facility. If overall interest rates had increased by 10% during the periods presented, our interest expense would not have been affected.

Foreign currency exchange risk

Historically, the majority of our revenue has been denominated in U.S. dollars. In the fourth quarter of 2014, we began invoicing certain European sales in Euros. Our results of operations and cash flows are, therefore, subject to fluctuations due to changes in foreign currency exchange rates. The volatility of exchange rates depends on many factors that we cannot forecast with reliable accuracy. We have experienced and will continue to experience fluctuations in our net income or loss as a result of transaction gains or losses related to revaluing certain current asset and current liability balances that are denominated in currencies other than the functional currency in which they are recorded. The effect of a 10% adverse change in exchange rates on foreign denominated cash, receivables and payables as of September 30, 2016 would not have been material. As our operations in countries outside of the United States grow, our results of operations and cash flows will be subject to fluctuations due to changes in foreign currency exchange rates, which could harm our business in the future.

We began entering into foreign exchange forward contracts to protect our forecasted U.S. dollar-equivalent earnings from adverse change in foreign currency exchange rates in December 2015. These hedging contracts reduce, but will not entirely eliminate, the impact of adverse currency exchange rate movements. We performed a sensitivity analysis assuming a hypothetical 10% adverse movement in foreign exchange rates to the hedging contracts and the underlying exposures described above. As of September 30, 2016, the analysis indicated that these hypothetical market movements would not have a material effect on our financial position, results of operations or cash flows. We estimate prior to any hedging activity that a 10% adverse change in exchange rates on our foreign denominated sales would have resulted in a $2.6 million decline in revenue for the first nine months of 2016. We designate these forward contracts as cash flow hedges for accounting purposes. The fair value of the forward contract is separated into intrinsic and time values. The fair value of forward currency-exchange contracts is sensitive to changes in currency exchange rates. Changes in the time value are coded in other income (expense), net. Changes in the intrinsic value are recorded as a component of accumulated other comprehensive income and subsequently reclassified into revenue to offset the hedged exposures as they occur.

Inflation risk

We do not believe that inflation has had a material effect on our business, financial condition or results of operations. If our costs were to become subject to significant inflationary pressures, we might not be able to fully offset such higher costs through price increases. Our inability or failure to do so could harm our business, financial condition and results of operations.

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Item 4. Controls and Procedures

Evaluation of disclosure controls and procedures

Our management, with the participation of our Chief Executive Officer and our Chief Financial Officer, evaluated the effectiveness of our disclosure controls and procedures as of September 30, 2016. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the SEC’s rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company’s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of September 30, 2016, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in internal controls over financial reporting

There has been no change in our internal control over financial reporting during the three months ended September 30, 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

Limitations on effectiveness of controls

In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives. In addition, the design of disclosure controls and procedures must reflect the fact that there are resource constraints and that management is required to apply its judgment in evaluating the benefits of possible controls and procedures relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, have been detected. Because of the inherent limitations in any control system, misstatements due to error or fraud may occur and not be detected.

Part II. OTHER INFORMATION

Item 1. Legal Proceedings

Inova Labs lawsuit

On November 4, 2011, we filed a lawsuit in the United States District Court for the Central District of California against Inova Labs Inc., or Defendant, for infringement of two of our patents. The case, Inogen Inc. v. Inova Labs Inc., Case No. 8:11-cv-01692-JGB-AN, or the Inova Labs Lawsuit, involves U.S. Patent Nos. 7,841,343, entitled "Systems and Methods For Delivering Therapeutic Gas to Patients," or the '343 patent, and 6,605,136 entitled "Pressure Swing Adsorption Process Operation And Optimization," or the '136 patent. We alleged in the Inova Labs Lawsuit that certain of Defendant's oxygen concentrators infringe various claims of the '343 and '136 patents. The Inova Labs Lawsuit sought damages, injunctive relief, costs and attorneys' fees.

The Defendant answered the complaint, denying infringement and asserting various sets of defenses including non-infringement, invalidity and unenforceability, patent misuse, unclean hands, laches and estoppel. The Defendant also filed counterclaims against us alleging patent invalidity, non-infringement and inequitable conduct. We denied the allegations in the Defendant's counterclaims and filed a motion to dismiss Defendant's inequitable conduct counterclaim.

The Defendant filed requests with the U.S. Patent and Trademark Office seeking an inter partes reexamination of the '343 and '136 patents. The Defendant also filed a motion to stay the Inova Labs Lawsuit pending outcome of the reexamination. On March 20, 2012, the Court granted the Defendant's motion to stay the Inova Labs Lawsuit pending outcome of the reexamination and also granted our motion to dismiss the Defendant's inequitable conduct counterclaim. On December 7, 2015, the U.S. Patent and Trademark Office issued an inter partes Reexamination Certificate for the '343 patent. Reexamination proceedings for the '136 patent have not concluded.

On February 4, 2016, ResMed Inc. announced the completion of the acquisition of Inova Labs Inc. The parties reached a settlement in June 2016. On June 30, 2016, the parties filed a Stipulated Dismissal with Prejudice of all claims in this lawsuit and a Joint Motion to Dismiss the reexamination proceeding for the '136 patent. We recognized a gain of $1.0 million relating to the settlement during the three months ended June 30, 2016 classified within general and administrative expense and the receivable was recorded in prepaid expenses and other current assets as of June 30, 2016. In addition, the settlement included a gain contingency of $0.25 million for future services and licensing fees charged by the Defendant. We received $1.25 million on July 26, 2016 finalizing the payment of this settlement. We recorded a gain of $72 during the three months ended September 30, 2016 classified within general and administrative expense. The remaining deferred gain contingency of $0.18 million as of September 30, 2016 was recorded within accounts payable and accrued expenses and will be recognized when services are rendered or incurred. The parties are also collaborating on a study of the use of portable oxygen concentrators.

Separation Design Group lawsuit

On October 23, 2015, Separation Design Group IP Holdings, LLC (SDGIP) filed a lawsuit against Inogen in the United States District Court for the Central District of California. On December 7, 2015, the SDGIP filed a First Amended Complaint in the SDGIP Lawsuit.

SDGIP alleges that we willfully infringe U.S. Patent Nos. 8,894,751 and 9,199,055, both of which are titled “Ultra Rapid Cycle Portable Oxygen Concentrator.” SDGIP also alleges misappropriation of trade secrets and breach of contract stemming from a meeting in September 2010. We never received any communication from SDGIP related to patent infringement, misuse of trade secrets, or breach of the mutual non-disclosure agreement prior to SDGIP filing the lawsuit. SDGIP seeks to recover an unspecified amount of damages (including compensatory and treble damages), costs and expenses (including attorneys’ fees), pre-judgment and post-judgment interest, and other relief that the Court deems proper. SDGIP also seeks a permanent injunction against us.

We have and continue to vigorously contest SDGIP’s claims. We have answered SDGIP’s First Amended Complaint, denying SDGIP’s allegations of patent infringement, trade secret misappropriation, and breach of contract and asserting several affirmative defenses. We have also filed counterclaims against SDGIP alleging that the patents-in-suit are unenforceable due to inequitable conduct.

Labor law dispute

On April 13, 2016, Ryan Casper and Shane Hoefer (Plaintiffs) filed a lawsuit against Inogen on behalf of themselves and all other similarly situated employees in the Superior Court for Santa Barbara County, California. The complaint alleges failure to pay overtime wages, failure to allow and pay for meal periods, and other alleged violations of California wage and hour law. The Plaintiffs and class members are seeking compensatory damages in the amount of all wages, interest, and penalties allegedly due, as well as

liquidated damages, attorney's fees and other relief. The parties successfully mediated the claims and reached a settlement in April 2016. While we dispute the claims, we agreed to the settlement with no admission of liability to avoid the risks and costs associated with litigating the claims. As of June 30, 2016, we accrued approximately $1 million for the settlement costs. On August 2, 2016, the Court granted preliminary approval of the settlement. The parties anticipate final approval of the settlement in late November 2016, and distribution of the settlement funds in December 2016.

CAIRE Inc. lawsuit

On September 12, 2016, CAIRE Inc. (CAIRE) filed a lawsuit in the United States District Court for the Northern District of Georgia against Inogen. CAIRE alleges we infringe U.S. Patent No. 6,949,133, entitled "Portable Oxygen Concentrator." CAIRE alleges willful infringement and seeks damages, injunctive relief, pre-judgment and post-judgment interest, costs, and attorneys' fees. We deny CAIRE's allegations and plan to vigorously contest CAIRE's claims. Our response to CAIRE's complaint is due in early November 2016.

Other litigation

In the normal course of business, we are from time to time involved in various other legal proceedings or potential legal proceedings, including matters involving employment, intellectual property, or others. We carry insurance, subject to specified deductibles under our policies, to protect against losses from certain types of legal claims. At this time, we do not anticipate that any of these proceedings will have a material adverse effect on our business. Regardless of the outcome, litigation can have an adverse impact on us because of defense and settlement costs, diversion of management resources, and other factors.

Item 1A. Risk Factors

We operate in a rapidly changing environment that involves numerous uncertainties and risks. In addition to the other information included in this Quarterly Report on Form 10-Q, the following risks and uncertainties may have a material and adverse effect on our business, financial condition, results of operations, or stock price. You should consider these risks and uncertainties carefully, together with all of the other information included or incorporated by reference in this Quarterly Report on Form 10-Q. If any of the risks or uncertainties we face were to occur, the trading price of our securities could decline, and you may lose all or part of your investment. This Quarterly Report on Form 10-Q also contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those anticipated in the forward-looking statements as a result of factors that are described below and elsewhere in this report.

Risks related to our business and strategy

A significant majority of our customers have health coverage under the Medicare program, and recently enacted and future changes in the reimbursement rates or payment methodologies under Medicare and other government programs have affected and could continue to materially and adversely affect our business and operating results.

As a provider of oxygen product rentals, we depend heavily on Medicare reimbursement as a result of the higher proportion of elderly persons suffering from chronic respiratory conditions. Medicare Part B, or Supplementary Medical Insurance Benefits, provides coverage to eligible beneficiaries that include items of durable medical equipment for use in the home, such as oxygen equipment and other respiratory devices. We believe that more than 60% of oxygen therapy patients in the United States have primary coverage under Medicare Part B. For the three

months ended September 30, 2016 and September 30, 2015, we derived 9.5% and 21.5%, respectively, and for the nine months ended September 30, 2016 and September 30, 2015, we derived 12.4% and 21.1%, respectively, of our total revenue from Medicare's program or beneficiaries (including patient co-insurance obligations). There are increasing pressures on Medicare to control healthcare costs and to reduce or limit reimbursement rates for home medical products.

Legislation, including the Medicare Prescription Drug, Improvement, and Modernization Act of 2003, the Deficit Reduction Act of 2005, the Medicare Improvements for Patients and Providers Act of 2008, and the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act, contain provisions that directly impact reimbursement for the durable medical equipment products provided by us:

- The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 significantly reduced reimbursement for inhalation drug therapies beginning in 2005, reduced payment amounts for certain durable medical equipment, including oxygen, beginning in 2005, froze payment amounts for other covered home medical equipment items through 2008, established a competitive bidding program for home medical equipment and implemented quality standards and accreditation requirements for durable medical equipment suppliers.

- The Deficit Reduction Act of 2005 limited the total number of continuous rental months for which Medicare will pay for oxygen equipment to 36 months, after which time there is generally no additional reimbursement to the supplier (other than for periodic, in-home maintenance and servicing). The Deficit Reduction Act of 2005 also provided that title of the equipment would transfer to the beneficiary, which was later repealed by the Medicare Improvements for Patients and Providers Act of 2008. For purposes of the rental cap, the Deficit Reduction Act of 2005 provided for a new 36-month rental period that began January 1, 2006 for all oxygen equipment. After the 36th continuous month during which payment is made for the oxygen equipment, the supplier is generally required to continue to furnish the equipment during the period of medical need for the remainder of the useful lifetime of the equipment, provided there are no breaks in service due to medical necessity that exceed 60 days. The reasonable useful lifetime for portable oxygen equipment is 60 months. After 60 months, if the patient requests, and the patient meets Medicare coverage criteria, the rental cycle starts over and a new 36-month rental period begins. There are no limits on the number of 60-month cycles over which a Medicare patient may receive benefits and an oxygen therapy provider may receive reimbursement, so long as such equipment continues to be medically necessary for the patient. We anticipate that the Deficit Reduction Act of 2005 oxygen payment rules will continue to negatively affect our net revenue on an ongoing basis, as each month additional customers reach the capped rental period in month thirty-seven, resulting in potentially two or more years without rental income from these customers. Our capped patients as a percentage of total patients on service was approximately 16.0% as of September 30, 2016, which is slightly higher than the capped patients as a percentage of total patients on service of approximately 15.0% as of September 30, 2015. The percentage of capped patients may fluctuate over time as new patients come on service, patients come off of service before and during the capped rental period, and existing patients enter the capped rental period. We cannot predict the potential impact to rental revenues in future periods associated with patients in the capped rental period.
- The Medicare Improvements for Patients and Providers Act of 2008 retroactively delayed the implementation of competitive bidding for 18 months from previously established dates and decreased the 2009 fee schedule payment amounts by 9.5% for product categories included in competitive bidding. In addition to the 9.5% reduction under Medicare Improvements for Patients and Providers Act of 2008, the Centers for Medicare and Medicaid Services (CMS) implemented a reduction to the monthly payment amount for stationary oxygen equipment. The monthly payment rate for non-delivery ambulatory oxygen in the years beginning January 1, 2010 to January 1, 2015 was flat at $51.63. The table below summarizes the increases and decreases in the monthly payment amounts for stationary oxygen equipment. This does not apply for 2016 as the standard allowables were set based on regional averages of the competitive bidding prices as described in the “Business” section and below in this “Risk Factors” section.

	2010		2011		2012		2013		2014		2015	
Stationary oxygen percentage rate changes	-1.50	%	0.10	%	1.60	%	0.70	%	0.50	%	1.50	%
Stationary oxygen monthly payment amounts	$173.17		$173.31		$176.06		$177.36		$178.24		$180.92	

- The Patient Protection and Affordable Care Act, as amended by the Health Care and Education Reconciliation Act, includes, among other things, new face-to-face physician encounter requirements for certain durable medical equipment and home health services, and a requirement that by 2016, the competitive bidding process must be nationalized or prices in non-competitive bidding areas must be adjusted to match competitive bidding prices. As of July 1, 2016, CMS has decreased prices for durable medical equipment in non-competitive bidding areas to match competitive bidding prices.

These legislative provisions, as currently in effect and when fully implemented, have had and will continue to have a material and adverse effect on our business, financial condition and operating results.

In addition, the President’s proposed federal budget for fiscal year 2017 includes multiple provisions that could impact the Company if they were enacted. The budget proposed eliminating the 36-month cap for oxygen equipment, and reducing the monthly payment amount for oxygen and oxygen equipment by the necessary percentage to be budget

neutral. The Company's patient population may materially differ from the Medicare population, which could lead to either more or less revenue per patient on service if this is enacted. For example, the Company's patient population is more heavily weighted towards ambulatory patients versus stationary/nocturnal patients seen in the overall Medicare market. In addition, this would likely also impact the number of patients interested in a cash purchase and could increase rental patients and decrease out-of-pocket purchases. The proposed budget also proposes to extend the authority to require prior authorization to all Medicare fee-for-service items and services, particularly those that are at the highest risk for improper payment. The proposed budget also contains multiple provisions related to the Medicare appeals process including establishing a refundable filing fee (non-refundable if denied), providing the Office of Medicare Hearings and Appeals and Department Appeals Board Authority to use Recover Audit Contractor collections, and increase minimum amount in controversy for administrative law judge adjudication of claims to equal the amount required for judicial review. In addition, this proposal includes the ability to remand appeals to the redetermination level with the introduction of new evidence and the ability to sample and consolidate similar claims for administrative efficiency.

The Health and Human Services (HHS) Office of Inspector General (OIG) has recommended states to review Medicaid reimbursement for durable medical equipment (DME) and supplies. The OIG cites an earlier report estimating that four states (California, Minnesota, New York, and Ohio) could have saved more than $18.1 million on selected DME items if their Medicaid prices were comparable to those under round one of the Medicare competitive bidding program. Since issuing those reports, the OIG identified $12 million in additional savings that the four states could have obtained on the selected items by using pricing similar to the Medicare round two competitive bidding and national mail-order programs. In light of varying Medicaid provider rates for DME and the potential for lower spending, the OIG recommends that CMS (1) seek legislative authority to limit state Medicaid DME reimbursement rates to Medicare program rates, and (2) encourage further reduction of Medicaid reimbursement rates through competitive bidding or manufacturer rebates (the OIG did not determine the cost of implementing a rebate or competitive bidding program in each state). CMS concurred with the OIG's recommendations, observing that the President's fiscal year 2016 budget recommended limiting Medicaid reimbursement of DME to Medicare rates. In December 2015, the Omnibus bill passed that will require state Medicaid agencies to match Medicare fee schedule reimbursement rates (including single payment amounts in applicable areas) beginning January 1, 2019, including for oxygen. CMS also noted that it communicates frequently with states to inform them of available options for their DME purchasing programs, including manufacturer rebates and competitive bidding.

On January 28, 2016, the Department of Health and Human Services (DHHS) published a final rule to implement Medicare's face-to-face provisions for home health and DME under the Medicaid program, effective July 1, 2016. Medicaid programs are run by state agencies that must coordinate with state legislative bodies, therefore the state agencies have until July 1, 2017 or July 1, 2018 (depending on the timing of their legislative sessions) to allow state agencies to publish compliant initiatives on this rule. The Medicaid definition of medical supplies, equipment and appliances were aligned with the Medicare definitions. In addition, the DHHS is implementing the requirement for a face-to-face visit related to the beneficiary's primary need for medical equipment within 6 months prior to the start of certain durable medical equipment services, including oxygen. These legislative provisions, when enacted, could have an adverse impact on our business, financial conditions and operating results.

On June 28, 2016, the U.S. Department of Health and Human Services announced an appeals backlog plan that included the potential to allow certain decisions made by the Medicare Appeals Council to set precedent for lower levels of appeal, expand the pool of available adjudicators, and to increase decision-making consistency among the levels of appeal. In addition, it included provisions to improve the efficiency by streamlining the appeals process, allow attorneys to handle some procedural matters at the administrative law judge level, and proposed funding increases and legislative actions outlined in the President's budget for 2017. If enacted, they estimate this could eliminate the backlog in appeals by 2021. However, if not enacted or if enacted and not effective, the appeals backlog could increase, which could increase our collection times and decrease our cash flow, increase billing administrative costs, and/or increase the provision for rental revenue adjustments, which would adversely affect our business financial condition and results of operations.

Due to budgetary shortfalls, many states are considering, or have enacted, cuts to their Medicaid programs. These cuts have included, or may include, elimination or reduction of coverage for our products, amounts eligible for payment under co-insurance arrangements, or payment rates for covered items. Continued state budgetary pressures could lead to further reductions in funding for the reimbursement for our products which, in turn, would adversely affect our business, financial condition and results of operations.

The competitive bidding process under Medicare could negatively affect our business and financial condition.

The Medicare Prescription Drug, Improvement, and Modernization Act of 2003 requires the Secretary of Health and Human Services to establish and implement programs under which competitive acquisition areas are established throughout the United States for purposes of awarding contracts for the furnishing of competitively priced items of

durable medical equipment, including oxygen equipment.

As of January 1, 2011, Medicare phased in the competitive bidding program. The competitive bidding program impacts the amount Medicare reimburses suppliers of durable medical equipment rentals, including portable oxygen concentrators. The program is defined geographically, with suppliers submitting bids to provide medical equipment for specific product categories within a specified geographic region called competitive bidding areas, or CBAs. Once bids have been placed, an individual company's bids within a product category are aggregated and weighted by each product's market share in the category. The weighted-average price is then indexed against all bidding suppliers. Medicare determines a "clearing price" out of these weighted-average prices, at which a sufficient number of suppliers have indicated they will support patients in the category. This threshold is typically designed to generate theoretical supply that is twice the expected demand. Bids for each modality among the suppliers that made the cut are then arrayed to determine what Medicare will reimburse for each product category and geographic area. The program has strict anti-collusion guidelines to ensure bidding is truly competitive. A competitive bidding contract lasts up to three years, once implemented, after which the contract is subject to a new round of bidding. Discounts off the standard Medicare allowable occur in CBAs where contracts have been awarded as well as in cases where private payors pay less than this allowable. Competitive bidding rates are based on the zip code where the patient resides. Rental revenue includes payments for product, disposables, and customer service/support.

As of January 1, 2016, all areas previously not subject to the competitive bidding program (non-competitive bidding areas or “non-CBAs”) have experienced reductions in the Medicare fee schedule for DMEPOS. The fee schedules in the non-CBAs were adjusted based on regional averages of the single payment amounts that apply to the competitive bidding program (Adjusted Fee Schedule). The regional prices are limited by a national ceiling (110% of the average of the regional prices) and a national floor (90% of the average regional prices). From January 1, 2016 to June 30, 2016, the reimbursement rates for these non-CBAs (with dates of service from January 1, 2016 to June 30, 2016) were 50% of the un-adjusted fee schedule amount plus 50% of the Adjusted Fee Schedule amount. As of July 1, 2016, Medicare reimbursed DMEPOS at 100% of the Adjusted Fee Schedule amount.

The regions are defined as follows:

Region Name	States Covered
Far West	CA, NV, OR, WA
Great Lakes	IL, IN, MI, OH, WI
Mideast	DC, DE, MD, NJ, NY, PA
New England	CT, MA, NH, RI
Plains	IA, KS, MN, MO, NE
Rocky Mountain	CO, ID, UT
Southeast	AL, AR, FL, GA, KY, LA, NC, SC, TN, VA
Southwest	AZ, NM, OK, TX

In addition to regional pricing, CMS imposed different pricing on “frontier states” and rural areas. CMS defines frontier states as states where more than 50% of the counties in the state have a population density of 6 people or less per square mile and rural states are defined as states where more than 50% of the population lives in rural areas per census data. Current frontier states include MT, ND, SD and WY; rural states include ME, MS, VT and WV; and non-contiguous United States areas include AK, HI, Guam and Puerto Rico. For frontier and rural states, and frontier and rural zip codes in non-frontier/rural states, the single payment amount will be the national ceiling (110% of the average of the regional prices) to account for higher servicing costs in these areas. For non-contiguous United States areas, single payment amounts will be the higher of the national ceiling, or the average of competitive bidding pricing from these areas, if the areas had been bid through competitive bidding. We estimate that less than 10% of our patients would be eligible to receive the 110% of the regional prices for rural and frontier areas based on the geographic locations of our current patient population.

A ruling from CMS has outlined the expansion of competitive bidding to certain previously unbid areas by applying regional pricing averages to unbid areas with 110% of regional prices to be paid for defined rural and frontier areas. Medicare was 21.0% of our total revenue in the year ended December 31, 2015, and we estimate that 41% of the Medicare markets will be subject to the reimbursement reduction. We also estimate that on average the rates will be reduced to the average of the regional prices under round one re-compete and round two re-compete. We estimate that less than 10% of our patients would be eligible to receive the 110% of the regional prices for rural and frontier areas based on the geographic locations of our current patient population. CMS has also collected bids and issued (or will issue) contracts for the round two re-compete from July 1, 2016 through December 31, 2018 and the round one re-compete 2017 from January 1, 2017 through December 31, 2018.

With regard to round two re-compete, which began on July 1, 2016, CMS updated the product categories and the competitive bidding areas. Respiratory equipment includes oxygen, oxygen equipment, continuous positive airway pressure devices, respiratory assist devices and related supplies and accessories. Nebulizers are now a separate product category from respiratory equipment. Round two re-compete is in the same geographic areas that were included in the original round two. However, as a result of the Office of Management and Budget’s updates to the original 91 round

two metropolitan statistical areas, there are now 90 metropolitan statistical areas for round two re-compete and 117 CBAs. Any CBA that was previously located in multi-state metropolitan statistical areas was redefined so that no CBA is included in more than one state. The round two re-compete CBAs have nearly the same zip codes as the round two CBAs; the associated changes in the zip codes since competitive bidding was implemented are reflective in this round two re-compete. Pricing was announced in March 2016 and impacts both the zip codes covered under round two and also the rates for the non-CBAs effective July 1, 2016.

In round one re-compete 2017, there are 9 metropolitan statistical areas and 13 CBAs to make sure each CBA does not cross state boundaries. We estimate approximately 9% of the Medicare market will be impacted by these contracts set to begin January 1, 2017 and continue through December 31, 2018. Pricing was announced in September 2016, and impacts both the zip codes covered under round one and also the rates for the non-CBAs effective January 1, 2017. To the extent that we are not successful in future competitive bidding rounds, we may lose access to patients in CBAs in which we are not awarded contracts, which would adversely affect our business, financial condition and results of operation. Moreover, any items and services provided by the Company to Medicare patients that reside in non-CBAs will be affected by the reimbursement reductions aimed at bringing national reimbursement in line with the competitive bidding program single payment amounts.

On April 16, 2015, the Medicare Access and CHIP Reauthorization Act of 2015 was signed into law which requires Medicare suppliers that bid under the DMEPOS competitive bidding program to obtain a $0.05 million to $0.1 million bid surety bond for each CBA. The provision is intended to prevent suppliers from submitting not-binding, “low-ball” bids that artificially drive down prices and jeopardize beneficiary access to equipment. If the supplier bids at or lower than the median composite bid rate and does not accept a contract offered for a CBA, the bid bond would be forfeited. The Act also codifies that competitive bidding contracts can only be awarded to suppliers that meet applicable state licensure requirements. We will incur additional expense to obtain the appropriate surety bonds in the CBAs where we win contracts in future competitive bidding rounds. As of January 1, 2017, there are 13 CBAs under contract in round one re-compete 2017 and 117 CBAs under contract in round two re-compete. CBAs are defined by Medicare and are subject to change at each new bidding period.

On October 28, 2016, CMS released a final rule which will be published in the Federal Register on November 4, 2016. The final rule imposes additional regulations on the competitive bidding process. The final rule requires bidders choosing to participate in the competitive bidding program to obtain a $0.05 million surety bond for each CBA in which they bid. If a bidder does not accept a contract offer when its composite bid is at or below the median composite bid rate for suppliers used in the calculation of the single payment amount, the bid surety bond for the applicable CBA will be forfeited to CMS. In instances where the bidder does not meet the forfeiture conditions specified in the final rule, the bid surety bond liability will be returned to the bidder within 90 days of the public announcement of the contract suppliers for the CBA. Currently, there are 130 CBAs, which would mean a bidding supplier could incur a surety bond obligation with forfeiture conditions of up to $6.5 million. The final rule also changes the bid limits for individual items for future rounds of competitive bidding to reflect the 2015 unadjusted fee schedule to avoid a downward trend in bid pricing, to ensure the long-term viability of the competitive bidding program, and to allow suppliers to take into account both decreases and increases in costs in determining their bids. The rule also finalizes an appeals process for all breach of contract actions that CMS may take under the competitive bidding program. Lastly, the final rule sets forth a provision for lead item bidding for certain product categories in future bidding rounds to prevent the creation of price inversions, which occurred in round two of competitive bidding. Lead item bidding means that all HCPCS codes for similar items will be grouped together and priced relative to the bid for the “lead item,” as calculated by CMS.

Although we continue to monitor developments regarding the implementation of the competitive bidding program, we cannot predict the outcome of the competitive bidding program on our business when fully implemented, nor the Medicare payment rates that will be in effect in future years for the items subject to competitive bidding, including our products. We expect that the stationary oxygen and non-delivery ambulatory oxygen payment rates will continue to fluctuate and a large negative payment adjustment would adversely affect our business, financial conditions and results of operations.

The implementation of prior authorization rules for DMEPOS under Medicare could negatively affect our business and financial condition.

CMS has issued a final rule to require Medicare prior authorization (PA) for certain durable medical equipment, prosthetics, orthotics, and supplies (DMEPOS) that the agency characterizes as frequently subject to unnecessary utilization. The final rule was published on December 30, 2015 and specifies a master list of 135 items that could potentially be subject to PA, including stationary oxygen rentals (E1390). The master list will be updated annually and published in the Federal Register. The presence of an item on the master list does not automatically mean that a PA is required. CMS will select a subset of these master list items for its “Required Prior Authorization List”, which has not yet been published in the Federal Register. There will be a notice period of at least 60 days prior to implementation. The ruling does not create any new clinical documentation requirements; instead the same information necessary to support Medicare payment will be required prior to the item being furnished to the beneficiary. CMS has proposed that reasonable efforts are made to provide a PA decision within 10 days of receipt of all applicable information,

unless this timeline could seriously jeopardize the life or health of the beneficiary or the beneficiary's ability to regain maximum function, in which case the proposed PA decision would be 2 business days. CMS will issue additional sub-regulatory guidance on these timelines in the future. CMS has announced that two power mobility codes (HCPCS K0856 and K0861) will be considered for PA as CMS moves forward with the implementation of this final rule. No other codes have been publicly discussed. If our products are subject to prior authorization, it could reduce the number of patients qualified to come on service using their Medicare benefits, it could delay the start of those patients while we wait for the prior authorization to be received, and/or it could decrease sales productivity. As a result, this could adversely affect our business, financial conditions and results of operations.

The Medicare Fee-For-Service (FFS) sequestration reduction has and may continue to negatively impact our revenue and profits.

Medicare FFS claims with dates of service on or after April 1, 2013 are subject to a 2% reduction in Medicare payment, including claims for DMEPOS, including in competitive bidding areas. The claims payment adjustment is applied to all claims after determining coinsurance, any applicable deductible, and any applicable Medicare secondary payment adjustments. These reductions are included in rental revenue adjustments. This sequestration reduction will continue until further notice. As a result, this could adversely affect our financial conditions and results of operations.

We face intense international, national, regional and local competition and if we are unable to compete successfully, it could have an adverse effect on our revenue, revenue growth rate, if any, and market share.

The oxygen therapy market is a highly competitive industry. We compete with a number of manufacturers and distributors of portable oxygen concentrators, as well as providers of other oxygen therapy solutions such as home delivery of oxygen tanks or cylinders.

Our significant manufacturing competitors are Invacare Corporation, Respironics (a subsidiary of Koninklijke Philips N.V.), AirSep Corporation and SeQual Technologies (subsidiaries of Chart Industries, Inc.), Inova Labs, Inc. (a subsidiary of ResMed), DeVilbiss Healthcare (a subsidiary of Drive Medical), O2 Concepts, and Gas Control Equipment. Given the relatively straightforward regulatory path in the oxygen therapy device manufacturing market, we expect that the industry will become increasingly competitive in the future. Manufacturing companies compete for sales to providers primarily on the basis of product features, service and price.

For many years, Lincare, Inc. (a subsidiary of the Linde Group), Apria Healthcare, Inc., Rotech Healthcare, Inc. and American HomePatient, Inc. (now a subsidiary of Lincare, Inc.) have been among the market leaders in providing oxygen therapy, while the remaining oxygen therapy market is serviced by local providers. Because many oxygen therapy providers were either excluded from contracts in the Medicare competitive bidding process, or will have difficulty providing service at the prevailing Medicare reimbursement rates, we expect more industry consolidation. Oxygen therapy providers compete primarily on the basis of product features and service, rather than price, since reimbursement levels are established by Medicare and Medicaid, or by the individual determinations of private payors.

Some of our competitors are large, well-capitalized companies with greater resources than we have. As a consequence, they are able to spend more aggressively on product development, marketing, sales and other product initiatives than we can. Some of these competitors have:

- significantly greater name recognition;
- established relationships with healthcare professionals, customers and third-party payors;
- established distribution networks;
- additional lines of products, and the ability to offer rebates or bundle products to offer higher discounts or other incentives to gain a competitive advantage;
- greater history in conducting research and development, manufacturing, marketing and obtaining regulatory approval for oxygen device products; and
- greater financial and human resources for product development, sales and marketing, patent litigation and customer financing.

As a result, our competitors may be able to respond more quickly and effectively than we can due to new or changing opportunities, technologies, standard regulatory and reimbursement development and customer requirements. In light of these advantages that our competitors maintain, even if our technology and direct-to-consumer distribution strategy is more effective than the technology and distribution strategy of our competitors, current or potential customers might accept competitor products and services in lieu of purchasing our products. We anticipate that we will face increased competition in the future as existing companies and competitors develop new or improved products and distribution strategies and as new companies enter the market with new technologies and distribution strategies. We may not be able to compete effectively against these organizations. Our ability to compete successfully and to increase our market share is dependent upon our reputation for providing responsive, professional and high-quality products and services and achieving strong customer satisfaction. Increased competition in the future could adversely affect our revenue, revenue growth rate, margins and market share.

Healthcare reform measures may have a material adverse effect on our business and results of operations.

In the United States, the legislative landscape, particularly as it relates to healthcare regulation and reimbursement coverage, continues to evolve. In March 2010, the Patient Protection and Affordable Care Act was passed, which has the potential to substantially change healthcare financing by both governmental and private insurers, and significantly impact the U.S. medical device industry. In addition, as discussed above, the Patient Protection and Affordable Care Act also expands round two of the competitive bidding program to a total of 117 CBAs, and in 2016 prices in non-CBAs were adjusted to match competitive bidding prices.

In addition, other legislative changes have been proposed and adopted in the United States since the Patient Protection and Affordable Care Act was enacted. On August 2, 2011, the Budget Control Act of 2011 created, among other things, measures for spending reductions by Congress. A Joint Select Committee on Deficit Reduction, tasked with recommending a targeted deficit

reduction of at least $1.2 trillion for the years 2013 through 2021, was unable to reach required goals, thereby triggering the legislation's automatic reduction to several government programs. This includes aggregate reductions of Medicare payments to providers up to 2% per fiscal year, which went into effect on April 1, 2013, and will remain in effect through 2024 unless additional Congressional action is taken. On January 2, 2013, President Obama signed into law the American Taxpayer Relief Act of 2012 which, among other things, further reduced Medicare payments to certain providers, including physicians, hospitals, imaging centers and cancer treatment centers, and increased the statute of limitations period for the government to recover overpayments to providers from three to five years. We expect that additional state and federal healthcare reform measures will be adopted in the future, any of which could limit the amounts that federal and state governments will pay for healthcare products and services, which could result in reduced demand for our products or additional pricing pressures.

In addition to the legislative changes discussed above, the Patient Protection and Affordable Care Act also requires healthcare providers to voluntarily report and return an identified overpayment within 60 days after identifying the overpayment. Failure to repay the overpayment within 60 days will result in the claim being considered a "false claim" and the healthcare provider will be subject to False Claims Act liability.

State legislative bodies also have the right to enact legislation that would impact requirements of home medical equipment providers, including oxygen therapy providers. Some states have already enacted legislation that would require in-state facilities. Additional states such as Arizona and New York are considering such legislation. Arizona is currently considering HB 2266, which would place additional requirements on durable medical equipment suppliers that service Medicare beneficiaries that reside in Arizona. HB2266 would require any durable medical equipment supplier to have at least one accredited physical facility that is either located in Arizona or is within 100 miles of any Arizona resident who is a Medicare beneficiary being served by the supplier. Further, the location must be staffed for reasonable business hours and maintain inventory at the physical location. New York is considering state assembly Bill A05074 which would require durable medical equipment suppliers enrolled in the Medicare program to have at least one storefront location in New York. We do not have facilities in these states but we do currently service Medicare beneficiaries in both Arizona and New York. As such, if these bills passed as drafted, we would be required to incur costs to comply with these requirements. We are monitoring all state requirements to maintain compliance with state-specific legislation and access to service patients in these states. To the extent such legislation is enacted, it could result in increased administrative costs or otherwise exclude us from doing business in a particular state, which would adversely impact our business, financial condition and operating results.

If we are unable to continue to enhance our existing products and develop and market new products that respond to customer needs and preferences and achieve market acceptance, we may experience a decrease in demand for our products and our business could suffer.

We may not be able to compete as effectively with our competitors, and ultimately satisfy the needs and preferences of our customers, unless we can continue to enhance existing products and develop new innovative products. Product development requires significant financial, technological and other resources. While we expended $1.4 million and $1.1 million for the three months ended September 30, 2016 and September 30, 2015, respectively, and $3.9 million and $3.0 million for the nine months ended September 30, 2016 and September 30, 2015, respectively, for research and development efforts, we cannot assure that this level of investment in research and development will be sufficient to maintain a competitive advantage in product innovation, which could cause our business to suffer. Product improvements and new product introductions also require significant planning, design, development, and testing at the technological, product, and manufacturing process levels and we may not be able to timely develop product improvements or new products, or obtain necessary regulatory clearances or approvals for such product improvements or new products in a timely manner, or at all. Our competitors' new products may enter the market before our new products reach market, be more effective with more features, obtain better market acceptance, or render our products obsolete. Any new products that we develop may not receive market acceptance or otherwise generate any meaningful

sales or profits for us relative to our expectations based on, among other things, existing and anticipated investments in manufacturing capacity and commitments to fund advertising, marketing, promotional programs and research and development.

We depend upon reimbursement from Medicare, private payors, Medicaid and patients for a significant portion of our revenue, and if we fail to manage the complex and lengthy reimbursement process, our business and operating results could suffer.

A significant portion of our revenue is derived from reimbursement by third-party payors. We accept assignment of insurance benefits from customers and, in a majority of cases, invoice and collect payments directly from Medicare, private payors and Medicaid, as well as direct from patients under co-insurance provisions. For the three months ended September 30, 2016 and September 30, 2015, approximately 13.3% and 28.3%, respectively, and for the nine months ended September 30, 2016 and September 30, 2015, approximately 17.4% and 28.6%, respectively, of our total revenue was derived from Medicare, private payors, Medicaid, and individual patients who directly receive reimbursement from third-party payors.

Our financial condition and results of operations may be affected by the healthcare industry's reimbursement process, which is complex and can involve lengthy delays between the time that a product is delivered to the consumer and the time that the reimbursement amounts are settled. Depending on the payor, we may be required to obtain certain payor-specific documentation from physicians and other healthcare providers before submitting claims for reimbursement. Certain payors have filing deadlines and they will not pay claims submitted after such time. We are also subject to extensive pre-payment and post-payment audits by governmental and private payors that could result in material delays, refunds of monies received or denials of claims submitted for payment under such third-party payor programs and contracts. We cannot ensure that we will be able to continue to effectively manage the reimbursement process and collect payments for our products promptly. If we fail to manage the complex and lengthy reimbursement process, it would adversely affect our business, financial conditions and results of operations.

Failure to obtain private payor contracts and future reductions in reimbursement rates from private payors could have a material adverse effect on our financial condition and operating results.

A portion of our revenue is derived from private payors. Based on our patient population, we estimate at least 30% of potential customers have non-Medicare insurance coverage, and we believe these patients represent a younger and more active patient population that will be drawn to the quality-of-life benefits of our solution. Failing to maintain and obtain private payor contracts from private insurance companies and employers and secure in-network provider status could have a material adverse effect on our financial condition and operating results. In addition, private payors are under pressure to increase profitability and reduce costs. In response, certain private payors are limiting coverage or reducing reimbursement rates for the products we provide. We believe that private payor reimbursement levels will generally be reset in accordance with the Medicare payment amounts determined by competitive bidding. We cannot predict the extent to which reimbursement for our products will be affected by competitive bidding or by initiatives to reduce costs for private payors. Failure to obtain or maintain private payor contracts or the unavailability of third-party coverage or inadequacy of reimbursement for our products would adversely affect our business, financial conditions and results of operations.

We obtain some of the components, subassemblies and completed products included in our Inogen One systems and our Inogen At Home from a single source or a limited group of manufacturers or suppliers, and the partial or complete loss of one of these manufacturers or suppliers could cause significant production delays, an inability to meet customer demand and a substantial loss in revenue.

We utilize single-source suppliers for some of the components and subassemblies we use in our Inogen One systems and our Inogen At Home system. We have qualified alternate sources of supply sufficient to support future needs and we have taken other mitigating steps to reduce the impact of a change in supplier; however, there may be delays in switching to these alternative suppliers if our primary source is terminated without notice. Our dependence on single-source suppliers of components may expose us to several risks, including, among other things:

- our suppliers may encounter financial hardships as a result of unfavorable economic and market conditions unrelated to our demand for components, which could inhibit their ability to fulfill our orders and meet our requirements;
- suppliers may fail to comply with regulatory requirements, be subject to lengthy compliance, validation or qualification periods, or make errors in manufacturing components that could negatively affect the performance or safety of our products or cause delays in supplying of our products to our customers;
- newly identified suppliers may not qualify under the stringent quality regulatory standards to which our business is subject;
- we or our suppliers may not be able to respond to unanticipated changes in customer orders, and if orders do not match forecasts, we or our suppliers may have excess or inadequate inventory of materials and components;
- we may be subject to price fluctuations due to a lack of long-term supply arrangements for key components;

- we may experience delays in delivery by our suppliers due to changes in demand from us or their other customers;
- we or our suppliers may lose access to critical services and components, resulting in an interruption in the manufacture, assembly and shipment of our systems;
- our suppliers may be subject to allegations by other parties of misappropriation of proprietary information in connection with their supply of products to us, which could inhibit their ability to fulfill our orders and meet our requirements;
- fluctuations in demand for products that our suppliers manufacture for others may affect their ability or willingness to deliver components to us in a timely manner;

- our suppliers may wish to discontinue supplying components or services to us; and
- we may not be able to find new or alternative components or reconfigure our system and manufacturing processes in a timely manner if the necessary components become unavailable.

In addition, we may be deemed to manufacture or contract to manufacture products that contain certain minerals that have been designated as "conflict minerals" under the Dodd-Frank Wall Street Reform and Consumer Protection Act. As a result, in future periods, we may be required to perform due diligence to determine the origin of such minerals, and disclose and report whether or not such minerals originated in the Democratic Republic of the Congo or adjoining countries. The implementation of these new requirements could adversely affect the sourcing, availability, and pricing of minerals used in the manufacture of our products. In addition, we may incur additional costs to comply with the disclosure requirements, including costs related to determining the source of any of the relevant minerals and metals used in our products. If any of these risks materialize, costs could significantly increase and our ability to meet demand for our products could be impacted. If we are unable to satisfy commercial demand for our Inogen One systems and Inogen At Home systems in a timely manner, our ability to generate revenue would be impaired, market acceptance of our products could be adversely affected, and customers may instead purchase or use alternative products. In addition, we could be forced to secure new or alternative components and subassemblies through a replacement supplier. Finding alternative sources for these components and subassemblies could be difficult in certain cases and may entail a significant amount of time and disruption. In some cases, we would need to change the components or subassemblies if we sourced them from an alternative supplier. This, in turn, could require a redesign of our Inogen One systems and Inogen At Home systems and, potentially, require additional Food and Drug Administration (FDA) clearance or approval before we could use any redesigned product with new components or subassemblies, thereby causing further costs and delays that could adversely affect our business, financial condition and operating results.

We do not have long-term supply contracts with many of our third-party suppliers.

We purchase components and subassemblies from third-party suppliers, including some of our single-source suppliers, through purchase orders and do not have long-term supply contracts with many of these third-party suppliers. Many of our third-party suppliers, therefore, are not obligated to perform services or supply products to us for any specific period, in any specific quantity or at any specific price, except as may be provided in a particular purchase order. We do not maintain large volumes of inventory from most of these suppliers. If we inaccurately forecast demand for components or subassemblies, our ability to manufacture and commercialize our Inogen One systems and Inogen At Home systems could be delayed and our competitive position and reputation could be harmed. In addition, if we fail to effectively manage our relationships with these suppliers, we may be required to change suppliers which would be time consuming and disruptive and could adversely affect our business, financial condition and operating results.

If our manufacturing facilities become unavailable or inoperable, we will be unable to continue manufacturing our Inogen One systems and Inogen At Home systems and, as a result, our business, financial condition, and operating results will be harmed until we are able to secure a new facility.

We assemble our Inogen One concentrators and Inogen At Home concentrators at our facility in Richardson, Texas and assemble compressors as well as load and assemble sieve beds (columns) at our facility in Goleta, California. No other manufacturing facilities are currently available to us, particularly facilities of the size and scope of our Texas facility. Our facilities and the equipment we use to manufacture our Inogen One systems and Inogen At Home systems would be costly to replace and could require substantial lead time to repair or replace. Our facilities may be harmed or rendered inoperable by natural or man-made disasters, including fire, flood, earthquakes and power outages, which may render it difficult or impossible for us to manufacture our products for some period of time. If any of our facilities become unavailable to us, we cannot provide assurances that we will be able to secure a new manufacturing facility on acceptable terms, in a timely manner. The inability to manufacture our products, combined with delays in replacing parts inventory and manufacturing supplies and equipment, may result in the loss of customers and/or harm our

reputation, and we may be unable to reestablish relationships with those customers in the future. Although we have insurance coverage for certain types of disasters which may help us recover some of the costs of damage to our property and lost income from the disruption of our business, this insurance is limited and may not be sufficient to cover any or all of our potential losses and may not continue to be available to us on acceptable terms, or at all. If our manufacturing capabilities are impaired, we may not be able to manufacture, store, and ship our products in a cost effective or timely manner, which would adversely impact our business, financial condition, and operating results.

If we are unable to manage our anticipated growth effectively, our business could be harmed.

The rapid growth of our business has placed a significant strain on our managerial and operational resources and systems. To execute our anticipated growth successfully, we must continue to attract and retain qualified personnel and manage and train them effectively. We must also upgrade our internal business processes and capabilities to create the scalability that a growing business demands.

We believe our facilities located in Richardson, Texas, and Goleta, California, are sufficient to meet our manufacturing needs. However, our anticipated growth will place additional strain on our suppliers and manufacturing facilities, resulting in an increased need for us to carefully monitor quality assurance. Any failure by us to manage our growth effectively could have an adverse effect on our ability to achieve our development and commercialization goals.

We may experience manufacturing problems or delays that could limit our growth or adversely affect our operating results.

Our Inogen One systems and Inogen At Home systems are manufactured using complex processes, sophisticated equipment and strict adherence to specifications and quality standards. Any unforeseen manufacturing problems, such as contamination of our facility, equipment malfunction, regulatory findings, or failure to strictly follow procedures or meet specifications, could result in delays or shortfalls in production of our products. Identifying and resolving the cause of any such manufacturing issues could require substantial time and resources. If we are unable to keep up with demand for our products by successfully manufacturing and shipping our products in a timely and quality manner, our operating results could be impaired, market acceptance for our products could be adversely affected and our customers might instead purchase our competitors' products.

In addition, the introduction of new products may require the development of new manufacturing processes and procedures. While all of our products are assembled using the same basic processes, significant changes in technology, programming, and other variations may be required to meet product specifications. Developing new processes can be very time consuming and affect quality, as such any unexpected difficulty in doing so could delay the introduction of a new product and our ability to produce sufficient quantities of existing products.

We are exposed to the credit and non-payment risk of our HME providers, distributors, private label partners and resellers, especially during times of economic uncertainty and tight credit markets, which could result in material losses.

We make sales to certain HME providers, distributors, private label partners and resellers on unsecured credit, with terms that vary depending upon the customer's credit history, solvency, credit limits and sales history, as well as prevailing terms with similarly situated customers and whether sufficient credit insurance can be obtained. Challenging economic conditions may impair the ability of our customers to pay for products they have purchased, and as a result, our reserves for doubtful accounts and write-off of accounts receivable could increase and, even if increased, may turn out to be insufficient. Moreover, even in cases where we have insolvency risk insurance to protect against a customer's bankruptcy, insolvency or liquidation, this insurance typically contains a significant deductible and co-payment obligation, and does not cover all instances of non-payment. Our exposure to credit risks of our business partners may increase if our business partners and their end customers are adversely affected by global or regional economic conditions. One or more of these business partners could delay payments or default on credit extended to them, either of which could adversely impact our business, financial condition, and operating results.

We generate a substantial portion of our revenue internationally and are subject to various risks relating to such international activities, which could adversely affect our operating results. In addition, any disruption or delay in the

shipping of our products, whether domestically or internationally, may have an adverse effect on our financial condition and results of operations.

During the nine months ended September 30, 2016 and September 30, 2015, approximately 25.0% and 22.6%, respectively, of our total revenue was generated from customers located outside of the United States. We believe that a significant percentage of our future revenue will come from international sources as we expand our international operations and develop opportunities in other countries. Engaging in international business inherently involves a number of difficulties and risks, including:

- required compliance with anti-bribery laws, such as the U.S. Foreign Corrupt Practices Act and U.K. Bribery Act, data privacy requirements, labor laws, and anti-competition regulations;
- export or import restrictions;
- laws and business practices favoring local companies;
- difficulties in enforcing agreements and collecting receivables through certain foreign legal systems;
- unstable economic, political, and regulatory conditions;

- potentially adverse tax consequences, tariffs, customs charges, bureaucratic requirements, and other trade barriers; and
- difficulties protecting or procuring intellectual property rights.

If one or more of these risks occurs, it could require us to dedicate significant resources to remedy, and if we are unsuccessful in finding a solution, our financial results will suffer.

In addition, on June 23, 2016, the United Kingdom (U.K.) held a referendum in which voters approved an exit from the European Union, commonly referred to as "Brexit." As a result of the referendum, it is expected that the British government will begin negotiating the terms of the U.K.'s withdrawal from the European Union and the U.K.'s future relationships with European Union member states. Adverse consequences concerning Brexit or the future of the European Union could include deterioration in global economic conditions, instability in global financial markets, political uncertainty, volatility in currency exchange rates or adverse changes in the cross-border agreements currently in place, any of which could have an adverse impact on our financial results in the future.

A majority of our product sales are currently denominated in U.S. dollars and fluctuations in the value of the U.S. dollar relative to foreign currencies could decrease demand for our products and adversely impact our financial performance. For example, if the value of the U.S. dollar increases relative to foreign currencies, our products could become more costly to the international consumer and therefore less competitive in international markets. Our results of operations and cash flows are, therefore, subject to fluctuations due to changes in foreign currency exchange rates. The volatility of exchange rates depends on many factors that we cannot forecast with reliable accuracy. We have experienced and will continue to experience fluctuations in our net income or loss as a result of transaction gains or losses related to revaluing certain current asset and current liability balances that are denominated in currencies other than the functional currency of the entities in which they are recorded. For example, for the nine months ended September 30, 2016, we experienced a net foreign currency gain of $0.1 million and for the year ended December 31, 2015, we experienced a net foreign currency loss of $0.4 million. Fluctuations in currency exchange rates could have an adverse impact on our financial results in the future.

We rely on shipping providers to deliver products to our customers globally. Labor, tariff, or World Trade Organization-related disputes, piracy, physical damage to shipping facilities or equipment caused by severe weather or terrorist incidents, congestion at shipping facilities, inadequate equipment to load, dock, and offload our products, energy-related tie-ups, or other factors could disrupt or delay shipping or off-loading of our products domestically and internationally. Such disruptions or delays may have an adverse effect on our financial condition and results of operations.

Failure to comply with anti-bribery, anti-corruption, and anti-money laundering laws, including the U.S. Foreign Corrupt Practices Act of 1977, as amended, or the FCPA, and similar laws associated with our activities outside of the United States could subject us to penalties and other adverse consequences.

We are subject to the FCPA, the U.S. domestic bribery statute contained in 18 U.S.C. § 201, the U.S. Travel Act, the USA PATRIOT Act, the United Kingdom Bribery Act of 2010 and possibly other anti-corruption, anti-bribery and anti-money laundering laws in the more than forty countries around the world where we conduct activities and sell our products. We face significant risks and liability if we fail to comply with the FCPA and other anti-corruption and anti-bribery laws that prohibit companies and their employees and third-party business partners, such as distributors or resellers, from authorizing, offering or providing, directly or indirectly, improper payments or benefits to foreign government officials, political parties or candidates, employees of public international organizations including healthcare professionals, or private-sector recipients for the corrupt purpose of obtaining or retaining business, directing business to any person, or securing any advantage.

We leverage various third parties to sell our products and conduct our business abroad. We, our distributors and channel partners, and our other third-party intermediaries may have direct or indirect interactions with officials and employees of government agencies or state-owned or affiliated entities (such as in the context of obtaining government approvals, registrations, or licenses) and may be held liable for the corrupt or other illegal activities of these third-party business partners and intermediaries, our employees, representatives, contractors, partners, and agents, even if we do not explicitly authorize such activities. In many foreign countries, particularly in countries with developing economies, it may be a local custom that businesses engage in practices that are prohibited by the FCPA or other applicable laws and regulations. As such, we intend to continue to implement an FCPA/anti-corruption compliance program to ensure compliance with such laws but cannot assure you that all of our employees and agents, as well as those companies to which we outsource certain of our business operations, will not take actions in violation of our policies and applicable law, for which we may be ultimately held responsible.

Any violation of the FCPA, other applicable anti-bribery, anti-corruption laws, and anti-money laundering laws could result in whistleblower complaints, adverse media coverage, investigations, loss of export privileges, severe criminal or civil sanctions and, in the case of the FCPA, suspension or debarment from U.S. government contracts, which could have a material and adverse effect on our reputation, business, operating results and prospects. In addition, responding to any enforcement action or related investigation may result in a materially significant diversion of management's attention and resources and significant defense costs and other professional fees.

If we fail to comply with U.S. export control and economic sanctions or fail to expand and maintain an effective sales force or successfully develop our international distribution network, our business, financial condition and operating results may be adversely affected.

We currently derive the majority of our revenue from rentals or sales generated from our own direct sales force. Failure to maintain or expand our direct sales force could adversely impact our financial and operating performance. Additionally, we use international distributors to augment our sales efforts, certain of which are exclusive distributors in certain foreign countries. We cannot assure you that we will be able to successfully develop our relationships with third-party distributors internationally. In addition, we are subject to United States export control and economic sanctions laws relating to the sale of our products, the violation of which could result in substantial penalties being imposed against us. In particular, we have secured annual export licenses from the U.S. Treasury Department's Office of Foreign Assets Control to sell our products to a distributor and hospital and clinic end-users in Iran. The use of this license requires us to observe strict conditions with respect to products sold, end-user limitations and payment requirements. Although we believe we have maintained compliance with license requirements, there can be no assurance that the license will not be revoked, be renewed in the future or that we will remain in compliance. More broadly, if we fail to comply with export control laws or successfully develop our relationship with international distributors, our sales could fail to grow or could decline, and our ability to grow our business could be adversely affected. Distributors that are in the business of selling other medical products may not devote a sufficient level of resources and support required to generate awareness of our products and grow or maintain product sales. If our distributors are unwilling or unable to market and sell our products, or if they do not perform to our expectations, we could experience delayed or reduced market acceptance and sales of our products.

We may be subject to substantial warranty or product liability claims or other litigation in the ordinary course of business that may adversely affect our business, financial condition and operating results.

As manufacturers of medical devices, we may be subject to substantial warranty or product liability claims or other litigation in the ordinary course of business that may require us to make significant expenditures to defend these claims or pay damage awards. For example, our Inogen One systems contain lithium ion batteries, which, under certain circumstances, can be a fire hazard. We, as well as our key suppliers, maintain product liability insurance, but this insurance is limited in amount and subject to significant deductibles. There is no guarantee that insurance will be available or adequate to protect against all claims. Our insurance policies are subject to annual renewal and we may not be able to obtain liability insurance in the future on acceptable terms or at all. In addition, our insurance premiums could be subject to increases in the future, which may be material. If the coverage limits are inadequate to cover our liabilities or our insurance costs continue to increase as a result of warranty or product liability claims or other litigation, then our business, financial condition and operating results may be adversely affected.

We may also be subject to other types of claims arising from our normal business activities. These may include claims, suits, and proceedings involving labor and employment, wage and hour, commercial, alleged securities laws violations or other investor claims and other matters. The outcome of any litigation, regardless of its merits, is inherently uncertain. Any claims and lawsuits, and the disposition of such claims and lawsuits, could be time-consuming and expensive to resolve, divert management attention and resources, and lead to attempts on the part of other parties to pursue similar claims. Any adverse determination related to litigation could require us to change our

technology or our business practices, pay monetary damages or enter into royalty or licensing arrangements, which could adversely impact our business, financial condition, and operating results.

Increases in our operating costs could have a material adverse effect on our business, financial condition and operating results.

Reimbursement rates are established by fee schedules mandated by Medicare, private payors and Medicaid, and are likely to remain constant or decrease due, in part, to federal and state government budgetary constraints. As a result, with respect to Medicare and Medicaid related revenue, we are not able to offset the effects of general inflation on our operating costs through increases in prices for our products. In particular, labor and related costs account for a significant portion of our operating costs and we compete with other healthcare providers to attract and retain qualified or skilled personnel and with various industries for administrative and service employees. This competitive environment could result in increased labor costs. As such, we must control our operating costs, particularly labor and related costs and failing to do so could adversely affect our financial conditions and results of operations.

We depend on the services of our senior executives and other key technical personnel, the loss of whom could negatively affect our business.

Our success depends upon the skills, experience and efforts of our senior executives and other key technical personnel, including certain members of our engineering staff and our sales and marketing executives. Much of our corporate expertise is concentrated in relatively few employees, the loss of which for any reason could negatively affect our business. Competition for our highly skilled employees is intense and we cannot prevent the resignation of any employee. We do not maintain “key man” life insurance on any of our senior executives. None of our senior executive team is bound by written employment contracts to remain with us for a specified period. In addition, we have not entered into non-compete agreements with members of our senior management team. The loss of any member of our senior management team could harm our ability to implement our business strategy and respond to the market conditions in which we operate.

We rely on information technology, and if we are unable to protect against service interruptions, data corruption, cyber-based attacks or network security breaches, our operations could be disrupted and our business could be negatively affected.

We rely on information technology networks and systems to process, transmit and store electronic and financial information; to coordinate our business; and to communicate within our company and with customers, suppliers, partners and other third-parties. These information technology systems may be susceptible to damage, disruptions or shutdowns, hardware or software failures, power outages, computer viruses, cyber-attacks, telecommunication failures, user errors or catastrophic events. If our information technology systems suffer severe damage, disruption or shutdown, and our business continuity plans do not effectively resolve the issues in a timely manner, our operations could be disrupted and our business could be negatively affected. In addition, cyber-attacks could lead to potential unauthorized access and disclosure of confidential information (including patient-identifiable health information), and data loss and corruption. There is no assurance that we will not experience these service interruptions or cyber-attacks in the future.

We incurred losses from inception until fiscal year 2012, and we have only recently achieved profitability.

We incurred significant net losses in each fiscal year until fiscal year 2012, when we achieved positive net income. As of September 30, 2016, we had an accumulated deficit of $34.1 million. These net losses have resulted principally from costs incurred from our selling, general and administrative expenses and to a lesser extent in our research and development programs. We expect to incur significant expansion of our sales and marketing expenses and increases in expenses for research and development to a lesser extent. Additionally, since completing our initial public offering, we expect that our general and administrative expenses will increase due to the additional operational and reporting costs associated with being a public company. Because of the numerous risks and uncertainties associated with our commercialization efforts and future product development, we are unable to predict if we will maintain or increase our net income.

Our financial results may vary significantly from quarter-to-quarter due to a number of factors, which may lead to volatility in our stock price.

Our quarterly revenue and results of operations have varied in the past and may continue to vary significantly from quarter-to-quarter. This variability may lead to volatility in our stock price as research analysts and investors respond to these quarterly fluctuations. These fluctuations are due to numerous factors, including: fluctuations in consumer demand for our products; seasonal cycles in consumer spending; our ability to design, manufacture and deliver products to our consumers in a timely and cost-effective manner; quality control problems in our manufacturing operations; our ability to timely obtain adequate quantities of the components used in our products; new product

introductions and enhancements by us and our competitors; unanticipated increases in costs or expenses; and fluctuations in foreign currency exchange rates. For example, we typically experience higher total sales in the second and third quarter, as a result of consumers traveling and vacationing during warmer weather in the spring and summer months, but this may vary year-over-year in certain domestic and international locations in our business-to-business channels. In particular, we have previously seen lower international revenue in the third quarter due to reduced economic activity in Europe in the summer months, but this trend did not continue in 2016. The foregoing factors are difficult to forecast, and these, as well as other factors, could materially and adversely affect our quarterly and annual results of operations. We have experienced significant revenue growth in the past, but we may not achieve similar growth rates in future periods. You should not rely on our operating results for any prior quarterly or annual period as an indication of our future operating performance. If we are unable to maintain adequate revenue growth, our operating results could suffer and our stock price could decline. In addition, a significant amount of our operating expenses are relatively fixed due to our manufacturing, research and development and sales and general administrative efforts. Any failure to adjust spending quickly enough to compensate for a revenue shortfall could magnify the adverse impact of such revenue shortfall on our results of operations. Our results of operations may not meet the expectations of research analysts or investors, in which case the price of our common stock could decrease significantly.

If the market opportunities for our products are smaller than we believe they are, our revenues may be adversely affected and our business may suffer.

Our projections regarding (i) the size of the oxygen therapy market, both in the United States and internationally, (ii) the size and percentage of the oxygen therapy market that is subject to competitive bidding in the United States, (iii) the number of oxygen therapy patients, (iv) the number of patients requiring ambulatory and stationary oxygen, (v) the number of patients who rely on the delivery model, and (vi) the share of portable oxygen concentrators as a percentage of the total oxygen therapy spend are based on estimates that we believe are reliable. These estimates may prove to be incorrect, new data or studies may change the estimated incidence or prevalence of patients requiring oxygen therapy, or the type of oxygen therapy patients. The number of patients in the United States and internationally may turn out to be lower than expected, patients may not be otherwise amenable to treatment with our products, or new patients may become increasingly difficult to identify or gain access to, all of which would adversely affect our results of operations and our business.

The terms of our revolving credit agreement may restrict our current and future operations, and could affect our ability to respond to changes in our business and to manage our operations.

On November 7, 2014, we entered into a revolving credit agreement with JPMorgan Chase Bank, which we refer to as our revolving credit agreement. The agreement provides for a revolving credit facility in an aggregate principal amount of $15.0 million with a sublimit of $1.0 million for the issuance of letters of credit on our behalf. The agreement is secured by all or substantially all of our assets.

Pursuant to the revolving credit agreement, we are subject to certain financial covenants relating to our net worth and EBITDA. Tangible net worth under the revolving credit agreement is calculated by subtracting the sum of intangible assets and total liabilities from total assets. EBITDA is defined in the revolving credit agreement as our net income plus interest expense, plus depreciation expense, plus amortization expense, plus income tax expense, plus non-cash expense, plus extraordinary losses, minus non-cash income, and minus extraordinary gains, as computed during certain test periods provided in the revolving credit agreement. We are required to maintain at all times a tangible net worth of $90.0 million and EBITDA (i) of $10.0 million for any period of four consecutive quarters commencing with the four-quarter test period ended September 30, 2014 through the four-quarter test period ended March 31, 2016 and (ii) of $12.5 million for any four-quarter test period commencing with the four-quarter test period ended June 30, 2016 and continuing thereafter.

The agreement contains events of default customary for transactions of this type, including non-payment, misrepresentation, breach of covenants, and bankruptcy. In the event we fail to satisfy our covenants, or otherwise go into default, JPMorgan Chase Bank, has a number of remedies, including sale of our assets and acceleration of all outstanding indebtedness. Certain of these remedies would likely have a material adverse effect on our business. As of September 30, 2016, in order to be in compliance with the EBITDA and tangible net worth requirements, we were required to maintain $12.5 million in EBITDA for the preceding test period, and we had $40.8 million in EBITDA for that period. As of September 30, 2016, we were also required to maintain a tangible net worth of $90.0 million, and we had a tangible net worth of $155.8 million.

An adverse outcome of a sales and use tax audit could have a material adverse effect on our results of operations and financial condition.

The California State Board of Equalization conducted a sales and use tax audit of our operations in California in 2008. As a result of the audit, the California State Board of Equalization confirmed that our sales are not subject to California sales and use tax. We believe that our sales in other states should not be subject to sales and use tax. There can be no assurance, however, that other states may agree with our position and we may be subject to an audit that

may not be resolved in our favor. Such an audit could be expensive and time-consuming and result in substantial management distraction. If the matter were to be resolved in a manner adverse to us, it could have a material adverse effect on our results of operations and financial position.

Changes in accounting principles, or interpretations thereof, could have a significant impact on our financial position and results of operations.

We prepare our financial statements in accordance with accounting principles generally accepted in the United States of America, referred to as U.S. GAAP. These principles are subject to interpretation by the Securities and Exchange Commission (SEC) and various bodies formed to interpret and create appropriate accounting principles. A change in these principles can have a significant effect on our reported results and may even retroactively affect previously reported transactions. Additionally, the adoption of new or revised accounting principles may require that we make significant changes to our systems, processes and controls.

For example, the U.S.-based Financial Accounting Standards Board, referred to as FASB, is currently working together with the International Accounting Standards Board, referred to as IASB, on several projects to further align accounting principles and facilitate more comparable financial reporting between companies who are required to follow U.S. GAAP under SEC regulations and those who are required to follow International Financial Reporting Standards outside of the United States. These efforts by the FASB and IASB may result in different accounting principles under U.S. GAAP that may result in materially different financial results for us in areas including, but not limited to, principles for recognizing revenue and lease accounting. Additionally, significant changes to U.S. GAAP resulting from the FASB's and IASB's efforts may require that we change how we process, analyze and report financial information and that we change financial reporting controls.

It is not clear if or when these potential changes in accounting principles may become effective, whether we have the proper systems and controls in place to accommodate such changes and the impact that any such changes may have on our financial position and results of operations.

Our ability to use net operating losses to offset future taxable income may be subject to certain limitations.

Our existing net operating losses (NOLs) are subject to limitations arising from ownership changes subject to the provisions of Section 382 of the Internal Revenue Code of 1986, as amended. If we undergo one or more future ownership changes our ability to utilize NOLs could be further limited.

Risks related to the regulatory environment

We are subject to extensive federal and state regulation, and if we fail to comply with applicable regulations, we could suffer severe criminal or civil sanctions and be required to make significant changes to our operations that could adversely affect our business, financial condition and operating results.

The federal government and all states in which we currently operate regulate various aspects of our business. In particular, our operations are subject to state laws governing, among other things, distribution of medical equipment and certain types of home health activities, and we are required to obtain and maintain licenses in each state to act as a durable medical equipment supplier. Certain of our employees are subject to state laws and regulations governing the professional practices of respiratory therapy.

As a healthcare provider participating in governmental healthcare programs, we are subject to laws directed at preventing fraud and abuse, which subject our marketing, billing, documentation and other practices to strict government scrutiny. To ensure compliance with Medicare, Medicaid and other regulations, government agencies or their contractors often conduct routine audits and request customer records and other documents to support our claims submitted for payment of services rendered. Government agencies or their contractors also periodically open investigations and obtain information from healthcare providers. Violations of federal and state regulations can result in severe criminal, civil and administrative penalties and sanctions, including debarment, suspension or exclusion from Medicare, Medicaid and other government reimbursement programs, any of which would have a material adverse effect on our business.

Changes in healthcare laws and regulations and new interpretations of existing laws and regulations may affect permissible activities, the relative costs associated with doing business, and reimbursement amounts paid by federal, state and other third-party payors. There have been and will continue to be regulatory initiatives affecting our business and we cannot predict the extent to which future legislation and regulatory changes could have a material adverse effect on our business.

We are subject to burdensome and complex billing and record-keeping requirements in order to substantiate our claims for payment under federal, state and commercial healthcare reimbursement programs, and our failure to comply with existing requirements, or changes in those requirements or interpretations thereof, could adversely affect our business, financial condition and operating results.

We are subject to burdensome and complex billing and record-keeping requirements in order to substantiate our claims for payment under federal, state and commercial healthcare reimbursement programs. Our records also are subject to routine and other reviews by third-party payors, which can result in delays in payments or refunds of paid claims. For example, we have experienced a significant increase in pre-payment reviews of our claims by the Durable Medical Equipment Medicare Administrative Contractors, which has caused substantial delays in the collection of our Medicare accounts receivable as well as related amounts due under supplemental insurance plans.

Current law provides for a significant expansion of the government's auditing and oversight of suppliers who care for patients covered by various government healthcare programs. Examples of this expansion include audit programs being implemented by the Durable Medical Equipment Medicare Administrative Contractors, the Zone Program Integrity Contractors, the Recovery Audit Contractors, and the Comprehensive Error Rate Testing contractors, operating under the direction of the Centers for Medicare and Medicaid Services, and the various state Medicaid Fraud Control Units.

We have been informed by these auditors that healthcare providers and suppliers of certain durable medical equipment product categories are expected to experience further increased scrutiny from these audit programs. When a government auditor ascribes a high billing error rate to one or more of our locations, it generally results in protracted pre-payment claims review, payment delays, refunds and other payments to the government and/or our need to request more documentation from providers than has historically been required. It may also result in additional audit activity in other company locations in that state or Durable Medical Equipment Medicare Administrative Contractors jurisdiction. We cannot currently predict the adverse impact that these audits, methodologies and interpretations might have on our business, financial condition or operating results, but such impact could be material.

We are subject to significant regulation by numerous government agencies, including the U.S. Food and Drug Administration, or FDA. We cannot market or commercially distribute our products without obtaining and maintaining necessary regulatory clearances or approvals.

Our Inogen concentrators are medical devices subject to extensive regulation in the United States and in the foreign markets where we distribute our products. The FDA and other U.S. and foreign governmental agencies regulate, among other things, with respect to medical devices:

- design, development and manufacturing;
- testing, labeling, content and language of instructions for use and storage;
- clinical trials;
- product safety;
- marketing, sales and distribution;
- pre-market clearance and approval;
- record keeping;
- advertising and promotion;
- recalls and field safety corrective actions;
- post-market surveillance, including reporting of deaths or serious injuries and malfunctions that, if they were to recur, could lead to death or serious injury;
- post-market approval studies; and
- product import and export.

Before we can market or sell a medical device in the United States, we must obtain either clearance from the FDA under Section 510(k) of the Federal Food, Drug, and Cosmetic Act, or the FDCA, or approval of a pre-market approval application from the FDA, unless an exemption applies. In the 510(k) clearance process, the FDA must determine that a proposed device is "substantially equivalent" to a device legally on the market, known as a "predicate" device, with respect to intended use, technology and safety and effectiveness, in order to clear the proposed device for marketing.

All of our commercial products have received 510(k) clearance by the FDA. If the FDA requires us to go through a lengthier, more rigorous examination for future products or modifications to existing products than we had expected, our product introductions or modifications could be delayed or canceled, which could cause our sales to decline. In addition, the FDA may determine that future products will require the more costly, lengthy and uncertain pre-market approval process. Although we do not currently market any devices under a pre-market approval, the FDA may

demand that we obtain a pre-market approval prior to marketing certain of our future products. In addition, if the FDA disagrees with our determination that a product we currently market is subject to an exemption from pre-market review, the FDA may require us to submit a 510(k) or pre-market approval application in order to continue marketing the product. Further, even with respect to those future products where a pre-market approval is not required, we cannot assure you that we will be able to obtain the 510(k) clearances with respect to those products, or do so in a timely fashion.

The FDA can delay, limit or deny clearance or approval of a device for many reasons, including:

- we may not be able to demonstrate to the FDA's satisfaction that our products are safe and effective for their intended users;
- the data from our pre-clinical studies and clinical trials may be insufficient to support clearance or approval, where required; and
- the manufacturing process or facilities we use may not meet applicable Quality System requirements.

Medical devices may only be promoted and sold for the indications for which they are approved or cleared. In addition, even if the FDA has approved or cleared a product, it can take action affecting such product approvals or clearances if serious safety or other problems develop in the marketplace. Delays in obtaining clearances or approvals could adversely affect our ability to introduce new products or modifications to our existing products in a timely manner, which would delay or prevent commercial sales of our products. Additionally, the FDA and other regulatory authorities have broad enforcement powers. Regulatory enforcement or inquiries, or other increased scrutiny on us, could affect the perceived safety and performance of our products and dissuade our customers from using our products.

If we modify our FDA cleared devices, we may need to seek additional clearances or approvals, which, if not granted, would prevent us from selling our modified products.

Any modification we make to our Inogen One systems and Inogen At Home system that could significantly affect its safety or performance, or would constitute a major change in its intended use, manufacture, design, components, or technology requires the submission and clearance of a new 510(k) pre-market notification or, possibly, pre-market approval. The FDA requires every manufacturer to make this determination in the first instance, but the FDA may review and disagree with any manufacturer's decision. The FDA may not agree with our decisions regarding whether new clearances or approvals are necessary. We have modified some of our 510(k) cleared products, and have determined that in certain instances new 510(k) clearances or pre-market approval are not required. If the FDA disagrees with our determination and requires us to submit new 510(k) notifications or pre-market approval for modifications to our previously cleared products for which we have concluded that new clearances or approvals are unnecessary, we may be required to cease marketing or to recall the modified product until we obtain clearance or approval, and we may be subject to significant regulatory fines or penalties.