

LIGAND PHARMACEUTICALS INC

Form 10-Q

November 09, 2015

Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934

For the quarterly period ended September 30, 2015

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: 001-33093

LIGAND PHARMACEUTICALS INCORPORATED

(Exact name of registrant as specified in its charter)

Delaware

(State or other jurisdiction of
incorporation or organization)

77-0160744

(I.R.S. Employer
Identification No.)

11119 North Torrey Pines Road, Suite 200

La Jolla, CA

(Address of principal executive offices)

(858) 550-7500

(Registrant's Telephone Number, Including Area Code)

92037

(Zip Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes 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 definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act. (Check one)

Large Accelerated Filer

Accelerated Filer

Non-Accelerated Filer (Do not check if a smaller reporting company)

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 November 7, 2015, the registrant had 19,925,754 shares of common stock outstanding.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
QUARTERLY REPORT

FORM 10-Q

TABLE OF CONTENTS

PART I. FINANCIAL INFORMATION

<u>ITEM 1. Financial Statements</u>	<u>3</u>
<u>Condensed Consolidated Balance Sheets as of September 30, 2015 and December 31, 2014 (Unaudited)</u>	<u>3</u>
<u>Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2015 and 2014 (Unaudited)</u>	<u>4</u>
<u>Condensed Consolidated Statements of Comprehensive Income (Loss) for the three and nine months ended September 30, 2015 and 2014 (Unaudited)</u>	<u>5</u>
<u>Condensed Consolidated Statements of Cash Flows for the three and nine months ended September 30, 2015 and 2014 (Unaudited)</u>	<u>6</u>
<u>Notes to Condensed Consolidated Financial Statements (Unaudited)</u>	<u>8</u>
<u>ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	<u>26</u>
<u>ITEM 3. Quantitative and Qualitative Disclosures about Market Risk</u>	<u>32</u>
<u>ITEM 4. Controls and Procedures</u>	<u>34</u>

PART II. OTHER INFORMATION

<u>ITEM 1. Legal Proceedings</u>	<u>35</u>
<u>ITEM 1A. Risk Factors</u>	<u>36</u>
<u>ITEM 2. Unregistered Sales of Equity Securities and Use of Proceeds</u>	<u>45</u>
<u>ITEM 6. Exhibits</u>	<u>45</u>
<u>SIGNATURE</u>	<u>46</u>

Table of Contents

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

LIGAND PHARMACEUTICALS INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited, in thousands, except share data)

	September 30, 2015	December 31, 2014
ASSETS		
Current assets:		
Cash and cash equivalents	\$93,770	\$160,203
Short-term investments	93,528	7,133
Accounts receivable	5,517	12,634
Deferred income taxes	7,517	—
Note receivable from Viking Therapeutics	5,547	—
Inventory	1,221	269
Capitalized expenses (Viking IPO)	—	2,268
Current debt issuance costs	847	809
Restricted investments	600	1,261
Other current assets	1,777	1,842
Total current assets	210,324	186,419
Deferred income taxes	206,423	—
Investment in Viking Therapeutics	31,826	—
Intangible assets, net	48,941	50,723
Goodwill	12,238	12,238
Commercial license rights	8,598	4,568
Long-term debt issuance costs	2,747	3,388
Property and equipment, net	355	486
Other assets	248	207
Total assets	\$521,700	\$258,029
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	\$3,143	\$7,698
Accrued liabilities	4,156	4,866
Current contingent liabilities	7,620	6,796
Current lease exit obligations	1,300	2,356
Other current liabilities	34	1,063
Total current liabilities	16,253	22,779
Long-term debt, net	202,951	195,908
Long-term contingent liabilities	7,589	8,353
Long-term lease exit obligations	—	934
Deferred income taxes	—	2,792
Long-term deferred revenue, net	2,083	2,085
Other long-term liabilities	643	770
Total liabilities	229,519	233,621
Commitments and Contingencies		
Stockholders' equity:		
Common stock, \$0.001 par value; 33,333,333 shares authorized; 19,918,334 and 19,575,150 shares issued and outstanding at September 30, 2015 and December 31, 2014, respectively	20	20

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Additional paid-in capital	697,061	680,660	
Accumulated other comprehensive income	5,558	4,953	
Accumulated deficit	(410,458	) (659,315)
Total stockholders' equity attributable to Ligand Pharmaceuticals	292,181	26,318	
Noncontrolling interests	—	(1,910)
Total liabilities and stockholders' equity	\$521,700	\$258,029	
See accompanying notes.			

3

Table of ContentsLIGAND PHARMACEUTICALS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(in thousands, except share data)

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Revenues:				
Royalties	\$9,755	\$7,482	\$26,648	\$20,573
Material sales	6,046	6,334	20,456	15,525
Collaborative research and development and other revenues	1,900	1,157	3,618	5,441
Total revenues	17,701	14,973	50,722	41,539
Operating costs and expenses:				
Cost of goods	1,250	1,496	4,923	5,133
Research and development	2,538	3,021	10,510	8,842
General and administrative	4,971	6,742	18,190	17,053
Lease exit and termination costs	345	182	786	522
Total operating costs and expenses	9,104	11,441	34,409	31,550
Income from operations	8,597	3,532	16,313	9,989
Other (expense) income:				
Interest expense, net	(2,930	) (1,516	) (8,875	) (1,946
Decrease (increase) in contingent liabilities	2,301	(1,620	) (4,976	) (4,880
Gain on deconsolidation of Viking Therapeutics	—	—	28,190	—
Equity in net losses from Viking Therapeutics	(2,169	) —	(3,040) —
Other, net	1,485	505	1,889	1,128
Total other (expense) income, net	(1,313	) (2,631	) 13,188	(5,698
Income before income taxes	7,284	901	29,501	4,291
Income tax benefit (expense)	217,255	(124	) 216,976	(131
Net income including noncontrolling interests:	224,539	777	246,477	4,160
Less: Net loss attributable to noncontrolling interests	—	(503	) (2,380	) (809
Net income	\$224,539	\$1,280	\$248,857	\$4,969
Per share amounts attributable to Ligand common shareholders:				
Basic net income per share	\$11.29	\$0.06	\$12.61	\$0.24
Diluted net income per share	\$10.46	\$0.06	\$11.78	\$0.23
Weighted-average number of common shares-basic	19,886,877	20,417,187	19,741,081	20,584,469
Weighted-average number of common shares-diluted	21,459,648	21,345,311	21,121,972	21,632,521

See accompanying notes.

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
 CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
 (Unaudited)
 (in thousands)

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Net income:	\$224,539	\$1,280	\$248,857	\$4,969
Unrealized net (loss) gain on available-for-sale securities, net of tax	(3,059	) (1,224	) 1,978	1,870
Less: Reclassification of net realized (gains) losses included in net income, net of tax	(606	) (274	) (1,591	) 1,241
Comprehensive income (loss)	\$220,874	\$(218	) \$249,244	\$8,080

See accompanying notes.

Table of Contents

LIGAND PHARMACEUTICAL INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited)
(in thousands)

	Nine months ended September 30,	
	2015	2014
Operating activities		
Net income including noncontrolling interests	\$246,477	\$4,160
Adjustments to reconcile net income including noncontrolling interests to net cash provided by operating activities:		
Non-cash change in estimated fair value of contingent liabilities	4,976	4,880
Realized gain on sale of short-term investment	(1,988	) (1,241
Gain on write-off of assets	—	(16
Depreciation and amortization	1,940	1,998
Amortization of discount on investments, net	73	—
Amortization of debt discount and issuance fees	7,646	1,223
Stock-based compensation	9,511	8,795
Non-cash upfront fee	—	(1,211
Deferred income taxes	(216,989	) 116
Accretion of note payable	16	225
Gain on deconsolidation of Viking Therapeutics, Inc.	(28,190) —
Loss on equity investment in Viking Therapeutics, Inc.	3,040	—
Changes in operating assets and liabilities:		
Accounts receivable	7,142	(3,590
Inventory	(158	) 321
Other current assets	(438	) (615
Other long-term assets	(546	) (1,245
Accounts payable and accrued liabilities	(4,993	) (3,478
Restricted investments	661	—
Deferred revenue	(118	) (2
Net cash provided by operating activities	28,062	10,320
Investing activities		
Purchase of commercial license rights	(4,030) —
Payments to CVR holders and other contingency payments	(4,941	) (1,936
Purchases of property and equipment	(27) —
Purchase of short-term investments	(111,788) —
Purchase of Viking common stock	(9,000) —
Proceeds from sale of property and equipment	1	124
Reduction of cash due to deconsolidation of Viking Therapeutics, Inc.	(247) —
Proceeds from sale of short-term investments	5,680	1,496
Proceeds from maturity of short-term investments	22,967	—
Net cash used in investing activities	(101,385	) (316
Financing activities		
Repayment of debt	—	(9,364
Gross proceeds from issuance of 2019 Convertible Senior Notes	—	245,000
Payment of debt issuance costs	—	(5,711
Proceeds from issuance of warrants	—	11,637

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Purchase of convertible bond hedge	—	(48,143)
Net proceeds from stock option exercises and ESPP	7,379	4,124	
Share repurchase	(489	) (38,523)
Net cash provided by financing activities	6,890	159,020	
Net (decrease) increase in cash and cash equivalents	(66,433	) 169,024	
Cash and cash equivalents at beginning of period	160,203	11,639	
Cash and cash equivalents at end of period	\$93,770	\$180,663	

6

Table of Contents

Supplemental disclosure of cash flow information

Interest paid	\$1,822	\$494
Taxes paid	\$19	\$3
Supplemental schedule of non-cash activity		
Unrealized gain on AFS investments	\$3,082	\$1,870

See accompanying notes

7

Table of Contents

LIGAND PHARMACEUTICALS INCORPORATED
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Basis of Presentation

Business

Ligand Pharmaceuticals Incorporated (including its subsidiaries, referred to as the "Company" or "Ligand") is a biopharmaceutical company with a business model based on developing or acquiring assets which generate royalty, milestone, or other passive revenue for Ligand and using a lean corporate cost structure. The Company operates in the United States in two business segments: biopharmaceutical asset development and licensing, and manufacturing and licensing Captisol, a formulation technology platform.

Principles of Consolidation

The accompanying consolidated financial statements include Ligand and its wholly owned subsidiaries. All significant intercompany accounts and transactions have been eliminated in consolidation.

Basis of Presentation

The Company's accompanying unaudited condensed consolidated financial statements as of September 30, 2015 and for the three and nine months ended September 30, 2015 and 2014 have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information. In the opinion of management, all adjustments (consisting of normal recurring adjustments) considered necessary for a fair presentation of the financial position and results of operations of the Company and its subsidiaries, have been included. Operating results for the three and nine months ended September 30, 2015 are not necessarily indicative of the results that may be expected for the year ending December 31, 2015. These financial statements should be read in conjunction with the consolidated financial statements and notes therein included in the Company's annual report on Form 10-K for the year ended December 31, 2014.

Use of Estimates

The preparation of condensed consolidated financial statements in conformity with U.S. GAAP requires the use of estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and the accompanying notes. Actual results may differ from those estimates.

Revision of Immaterial Error

During the three and nine months ended September 30, 2015, a clerical error was identified in the calculation of the projections used in the June 30, 2015 and September 30, 2015 valuation of contingent liabilities related to Cydex contingent value right holders. The error in the June 30, 2015 projection resulted in an understatement of short-term contingent liabilities of \$0.6 million as of June 30, 2015, and an overstatement of net income of \$0.6 million, or \$0.03 per share for the three and six months ended June 30, 2015, respectively. No other error was identified in the other interim period(s) in 2015 or 2014 based on the Company's review in those periods. The impact of correcting the error resulted in an understatement of net income of \$0.6 million, or \$0.03 per share for the three months ended September 30, 2015. Based on a qualitative and quantitative analysis of the error, the Company concluded that it is immaterial to the interim condensed consolidated financial statements for the three and six months ended June 30, 2015 and had no effect on the trend of financial results. As such, the Company has corrected the error in the condensed consolidated financial statements for the period ended September 30, 2015.

Income Per Share

Basic income per share is calculated by dividing net income by the weighted-average number of common shares outstanding during the period. Diluted income per share is computed by dividing net income by the weighted-average number of common shares and common stock equivalents of all dilutive securities calculated using the treasury stock method and the if-converted method. The total number of potentially dilutive securities including stock options and warrants excluded from the computation of diluted income per share because their inclusion would have been anti-dilutive was 3.3 million and 5.0 million, as of September 30, 2015 and 2014, respectively.

Table of Contents

The following table presents the computation of basic and diluted net income per share for the periods indicated (in thousands, except per share amounts):

	Three months ended		Nine months ended	
	September 30,		September 30,	
	2015	2014	2015	2014
Net income	\$224,539	\$1,280	\$248,857	\$4,969
Shares used to compute basic income per share	19,886,877	20,417,187	19,741,081	20,584,469
Dilutive potential common shares:				
Restricted stock	63,324	22,531	55,899	37,387
Stock options	763,856	905,593	922,051	1,010,665
0.75% Convertible Senior Notes, Due 2019	745,591	—	402,941	—
Shares used to compute diluted income per share	21,459,648	21,345,311	21,121,972	21,632,521
Basic net income per share	\$11.29	\$0.06	\$12.61	\$0.24
Diluted net income per share	\$10.46	\$0.06	\$11.78	\$0.23

Cash Equivalents

Cash equivalents consist of all investments with maturities of three months or less from the date of acquisition.

Short-term Investments

Short-term investments primarily consist of investments in debt securities that have effective maturities greater than three months and less than twelve months from the date of acquisition. The Company classifies its short-term investments as "available-for-sale". Such investments are carried at fair value, with unrealized gains and losses included in the statement of comprehensive income (loss). The Company determines the cost of investments based on the specific identification method.

Table of Contents

Restricted Investments

Restricted investments consist of certificates of deposit held with a financial institution as collateral under a facility lease and third-party service provider arrangements.

The following table summarizes the various investment categories at September 30, 2015 and December 31, 2014 (in thousands):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
September 30, 2015				
Short-term investments				
Bank deposits	\$38,712	\$4	\$(1	) \$38,715
Corporate bonds	29,347	2	(5	) 29,344
Commercial paper	2,000	—	—	2,000
Asset backed securities	15,995	—	(4	) 15,991
Corporate equity securities	1,917	5,561	—	7,478
Restricted investments	600	—	—	600
	\$88,571	\$5,567	\$(10	) \$94,128
December 31, 2014				
Short-term investments				
Corporate equity securities	\$2,179	\$4,954	\$—	\$7,133
Restricted investments	1,261	—	—	1,261
	\$3,440	\$4,954	\$—	\$8,394

Inventory

Inventory, which consists of finished goods, is stated at the lower of cost or market value. The Company determines cost using the first-in, first-out method. Inventory levels are analyzed periodically and written down to its net realizable value if it has become obsolete, has a cost basis in excess of its expected net realizable value or is in excess of expected requirements. There were no write downs related to obsolete inventory recorded for the three and nine months ended September 30, 2015 and 2014.

Goodwill and Other Identifiable Intangible Assets

Goodwill and other identifiable intangible assets consist of the following (in thousands):

	September 30, 2015	December 31, 2014
Indefinite lived intangible assets		
Acquired in-process research and development ("IPR&D")	\$12,556	\$12,556
Goodwill	12,238	12,238
Definite lived intangible assets		
Complete technology	15,267	15,267
Less: Accumulated amortization	(3,571	) (2,999
Trade name	2,642	2,642
Less: Accumulated amortization	(619	) (519
Customer relationships	29,600	29,600
Less: Accumulated amortization	(6,934	) (5,824

Total goodwill and other identifiable intangible assets, net	\$61,179	\$62,961
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10

Table of Contents

Amortization of definite-lived intangible assets is computed using the straight-line method over the estimated useful life of the asset of 20 years. Amortization expense of \$0.6 million and \$1.8 million was recognized for each of the three and nine months ended September 30, 2015 and 2014, respectively. Estimated amortization expense for the years ending December 31, 2015 through 2019 is \$2.4 million per year. For each of the three and nine months ended September 30, 2015 and 2014, there was no impairment of IPR&D or goodwill.

Commercial License Rights

Commercial license rights represent a portfolio of future milestone and royalty payment rights acquired from Selexis SA ("Selexis") in April 2013 and April 2015. Individual commercial license rights acquired under the agreement are carried at allocated cost and approximate fair value. The carrying value of the license rights will be reduced on a pro-rata basis as revenue is realized over the term of the agreement. Declines in the fair value of individual license rights below their carrying value that are deemed to be other than temporary are reflected in earnings in the period such determination is made. As of September 30, 2015, management does not believe there have been any events or circumstances indicating that the carrying amount of its commercial license rights may not be recoverable.

Property and Equipment

Property and equipment is stated at cost and consists of the following (in thousands):

	September 30, 2015	December 31, 2014
Lab and office equipment	\$2,182	\$2,232
Leasehold improvements	273	273
Computer equipment and software	632	624
	3,087	3,129
Less accumulated depreciation and amortization	(2,732	) (2,643
Total property and equipment, net	\$355	\$486

Depreciation of equipment is computed using the straight-line method over the estimated useful lives of the assets, which range from three to ten years. Leasehold improvements are amortized using the straight-line method over the shorter of the estimated useful lives or the related lease term. Depreciation expense of \$0.1 million and \$0.2 million was recognized for each of the three and nine months ended September 30, 2015 and 2014, respectively, which is included in operating expenses.

Other Current Assets

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

	September 30, 2015	December 31, 2014
Prepaid expenses	\$1,494	\$835
Other receivables	283	685
Co-promote receivable	—	322
Total other current assets	\$1,777	\$1,842

Table of Contents

Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	September 30, 2015	December 31, 2014
Compensation	\$1,485	\$1,708
Professional fees	443	459
Amounts owed to former licensees	956	925
Royalties owed to third parties	798	705
Other	474	1,069
Total accrued liabilities	\$4,156	\$4,866

Other Long-Term Liabilities

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

	September 30, 2015	December 31, 2014
Deposits	\$319	\$411
Deferred rent	291	327
Other	33	32
Total other long-term liabilities	\$643	\$770

Contingent Liabilities

In connection with the Company's acquisition of CyDex in January 2011, the Company recorded a contingent liability, for amounts potentially due to holders of the CyDex contingent value rights ("CVRs") and former license holders. The liability is periodically assessed based on events and circumstances related to the underlying milestones, royalties and material sales. Any change in fair value is recorded in the Company's consolidated statement of operations. The carrying amount of the liability may fluctuate significantly and actual amounts paid under the CVR agreements may be materially different than the carrying amount of the liability. The fair value of the liability at September 30, 2015 and December 31, 2014 was \$10.5 million and \$11.5 million, respectively. The Company recorded a fair-value adjustment to increase the liability by \$0.9 million and \$3.1 million for the three and nine months ended September 30, 2015, respectively. There was a revenue-sharing payment of \$0.8 million and \$3.9 million to CyDex CVR holders during the three and nine months ended September 30, 2015, respectively. For the three and nine months ended September 30, 2014, the Company recorded a fair-value adjustment to increase the liability by \$2.8 million and \$5.6 million, respectively. There was no revenue sharing payment made for the three months ended September 30, 2014 and a revenue-sharing payment of \$1.6 million was made during the nine months ended September 30, 2014.

In connection with the Company's acquisition of Metabasis Therapeutics, Inc. ("Metabasis") in January 2010, the Company issued to Metabasis stockholders four tradable CVRs, one CVR from each of four respective series of CVR, for each Metabasis share. The CVRs will entitle Metabasis stockholders to cash payments as frequently as every six months as cash is received by the Company from proceeds from the sale or partnering of any of the Metabasis drug development programs, among other triggering events. The fair values of the CVRs are remeasured at each reporting date through the term of the related agreement. Any change in fair value is recorded in the Company's consolidated statement of operations. The carrying amount of the liability may fluctuate significantly based upon quoted market prices and actual amounts paid under the agreements may be materially different than the carrying amount of the liability. The fair value of the liability was estimated to be \$4.7 million and \$3.7 million as of September 30, 2015 and December 31, 2014, respectively. The Company recorded a decrease in the liability for Metabasis-related CVRs of

\$3.2 million and an increase of \$1.9 million for the three and nine months ended September 30, 2015, respectively. The Company recorded a decrease in the liability for Metabasis-related CVRs of \$1.2 million and an increase in the liability of \$0.7 million for the three and nine months ended September 30, 2014, respectively. The Company paid Metabasis CVR holders \$0.5 million and \$0.8 million for the three and nine months ended September 30, 2015, respectively.

Table of Contents

Revenue Recognition

Royalties on sales of products commercialized by the Company's partners are recognized in the quarter reported to Ligand by the respective partner. Generally, the Company receives royalty reports from its licensees approximately one quarter in arrears due to the fact that its agreements require partners to report product sales between 30 and 60 days after the end of the quarter. The Company recognizes royalty revenues when it can reliably estimate such amounts and collectability is reasonably assured. Under this accounting policy, the royalty revenues reported are not based upon estimates and such royalty revenues are typically reported to the Company by its partners in the same period in which payment is received.

Revenue from material sales of Captisol is recognized upon transfer of title, which normally passes upon shipment to the customer, provided all other revenue recognition criteria have been met. All product returns are subject to the Company's credit and exchange policy, approval by the Company and a 20% restocking fee. To date, product returns by customers have not been material to net material sales in any related period. The Company records revenue net of product returns, if any, and sales tax collected and remitted to government authorities during the period.

The Company analyzes its revenue arrangements and other agreements to determine whether there are multiple elements that should be separated and accounted for individually or as a single unit of accounting. For multiple element contracts, arrangement consideration is allocated at the inception of the arrangement to all deliverables on the basis of relative selling price, using a hierarchy to determine selling price. Management first considers vendor-specific objective evidence ("VSOE"), then third-party evidence ("TPE") and if neither VSOE nor TPE exist, the Company uses its best estimate of selling price.

Many of the Company's revenue arrangements for Captisol involve a license agreement with the supply of manufactured Captisol product. Licenses may be granted to pharmaceutical companies for the use of Captisol product in the development of pharmaceutical compounds. The supply of the Captisol product may be for all phases of clinical trials and through commercial availability of the host drug or may be limited to certain phases of the clinical trial process. Management believes that the Company's licenses have stand-alone value at the outset of an arrangement because the customer obtains the right to use Captisol in its formulations without any additional input by the Company.

Other nonrefundable, upfront license fees are recognized as revenue upon delivery of the license, if the license is determined to have stand-alone value that is not dependent on any future performance by the Company under the applicable collaboration agreement. Nonrefundable contingent event-based payments are recognized as revenue when the contingent event is met, which is usually the earlier of when payments are received or collections are assured, provided that it does not require future performance by the Company. The Company occasionally has sub-license obligations related to arrangements for which it receives license fees, milestones and royalties. The Company evaluates the determination of gross versus net reporting based on each individual agreement.

Sales-based contingent payments from partners are accounted for similarly to royalties, with revenue recognized upon achievement of the sales targets assuming all other revenue recognition criteria for milestones are met. Revenue from development and regulatory milestones is recognized when earned, as evidenced by written acknowledgement from the collaborator, provided that (1) the milestone event is substantive, its achievability was not reasonably assured at the inception of the agreement, and the Company has no further performance obligations relating to that event, and (2) collectability is reasonably assured. If these criteria are not met, the milestone payment is recognized over the remaining period of the Company's performance obligations under the arrangement.

Revenue from research funding under our collaboration agreements is earned and recognized on a percentage-of completion basis as research hours are incurred in accordance with the provisions of each agreement.

In May 2014, the Company entered into a licensing agreement and research collaboration with Omthera Pharmaceuticals, a wholly-owned subsidiary of AstraZeneca. The research collaboration targets the development of novel products that utilize the proprietary Ligand developed LTP TECHNOLOGY™ to improve lipid-lowering activity

of certain omega-3 fatty acids. The Company is eligible to receive compensation and reimbursement from Omthera for internal research efforts and external costs incurred, as well as development and regulatory event-based payments. The completion of a proof of concept under the development program would trigger a \$1.0 million payment which is determined to be a milestone under the milestone method of accounting as (1) it is an event that can only be achieved in part on the Company's past performance, (2) there was substantive uncertainty at the date the arrangement was entered into that the event would be achieved and (3) it results in additional payment being due to the Company. None of the other event-based payments represents a milestone under the milestone method of accounting. The Company received \$0.5 million from Omthera in 2014 under the agreement and

Table of Contents

recognized \$0.4 million as collaborative revenue based on the percentage of completion of the research program at December 31, 2014. No milestone payment or contingent payment was received in 2014 or in the nine months ended September 30, 2015.

Stock-Based Compensation

Stock-based compensation expense for awards to employees and non-employee directors is recognized on a straight-line basis over the vesting period until the last tranche vests. The following table summarizes stock-based compensation expense recorded as components of research and development expenses and general and administrative expenses for the periods indicated (in thousands):

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Stock-based compensation expense as a component of:				
Research and development expenses	\$957	\$1,169	\$3,131	\$2,814
General and administrative expenses	1,879	2,533	6,380	5,981
	\$2,836	\$3,702	\$9,511	\$8,795

The fair-value for options that were awarded to employees and directors was estimated at the date of grant using the Black-Scholes option valuation model with the following weighted-average assumptions:

	Three months ended September 30,		Nine months ended September 30,	
	2015	2014	2015	2014
Risk-free interest rate	2.0%	1.9%	1.7%-2.0%	1.9%
Dividend yield	—	—	—	—
Expected volatility	50%	67%	50%-58%	68%
Expected term	6.5	6.4	6.6	6.4
Forfeiture rate	8.5%	8.6%	8.5%	8.6%-9.7%

Income Taxes

Income taxes are accounted for under the liability method. This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of differences between the tax basis of assets or liabilities and their carrying amounts in the consolidated financial statements. The Company provides a valuation allowance for deferred tax assets if it is more likely than not that these items will expire before we are able to realize their benefit. The Company calculates the valuation allowance in accordance with the authoritative guidance relating to income taxes under ASC 740, Income Taxes, which requires an assessment of both positive and negative evidence that is available regarding the reliability of these deferred tax assets, when measuring the need for a valuation allowance. Developing the provision for income taxes requires significant judgment and expertise in federal and state income tax laws, regulations and strategies, including the determination of deferred tax assets and liabilities and, if necessary, any valuation allowances that may be required for deferred tax assets. The Company's judgments and tax strategies are subject to audit by various taxing authorities. While management believes the Company has provided adequately for its income tax liabilities in its consolidated financial statements, adverse determinations by these taxing authorities could have a material adverse effect on the Company's consolidated financial condition and results of operations.

Table of Contents

Segment Reporting

Under ASC 280, Segment Reporting, operating segments are defined as components of an enterprise about which separate financial information is available that is regularly evaluated by the entity's chief operating decision maker, in deciding how to allocate resources and in assessing performance. The Company has evaluated this codification and has identified two reportable segments: the development and commercialization of drugs using Captisol technology and the biopharmaceutical company with a business model based on developing or acquiring royalty revenue generating assets and coupling them with a lean corporate cost structure.

Variable Interest Entities

The Company identifies an entity as a variable interest entity ("VIE") if either: (1) the entity does not have sufficient equity investment at risk to permit the entity to finance its activities without additional subordinated financial support, or (2) the entity's equity investors lack the essential characteristics of a controlling financial interest. The Company performs ongoing qualitative assessments of its VIEs to determine whether the Company has a controlling financial interest in any VIE and therefore is the primary beneficiary. If the Company is the primary beneficiary of a VIE, it consolidates the VIE under applicable accounting guidance. If the Company is no longer the primary of a VIE or the entity is no longer considered as a VIE as facts and circumstances changed, it deconsolidates the entity under the applicable accounting guidance. Beginning May 2015, the Company deconsolidated Viking Therapeutics ("Viking") a previously reported VIE, and elected to record its investment in Viking under the equity method of accounting as Viking is no longer considered a VIE and the Company does not have voting control or other elements of control that would require consolidation. The investment is subsequently adjusted for the Company's share of Viking's operating results, and if applicable, cash contributions and distributions, which is reported on a separate line in our condensed consolidated statement of operations called "Equity in net losses of Viking Therapeutics". On the condensed consolidated balance sheet, the Company reports its investment in Viking on a separate line in the non-current assets section called "Investment in Viking Therapeutics". See Note 3, Investment in Viking Therapeutics, Inc., for additional details.

Convertible Debt

In August 2014, the Company completed a \$245.0 million offering of convertible senior notes, which mature in 2019 and bear interest at 0.75% (the "2019 Convertible Senior Notes"). The Company accounts for the 2019 Convertible Senior Notes by separating the liability and equity components of the instrument in a manner that reflects the Company's nonconvertible debt borrowing rate. As a result, the Company assigned a value to the debt component of the 2019 Convertible Senior Notes equal to the estimated fair value of similar debt instruments without the conversion feature, which resulted in the Company recording the debt instrument at a discount. The Company is amortizing the debt discount over the life of the 2019 Convertible Senior Notes as additional non-cash interest expense utilizing the effective interest method.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers. ASU 2014-09 is effective for annual periods beginning after December 15, 2016 and interim periods within those annual periods. The revenue standard's core principle is built on the contract between a vendor and a customer for the provision of goods and services. It attempts to depict the exchange of rights and obligations between the parties in the pattern of revenue recognition based on the consideration to which the vendor is entitled. To accomplish this objective, the standard requires five basic steps: (1) identify the

contract with the customer, (2) identify the performance obligations in the contract, (3) determine the transaction price, (4) allocate the transaction price to the performance obligations in the contract, (5) recognize revenue when (or as) the entity satisfies a performance obligation. Management is currently evaluating the effect the adoption of this standard will have on the Company's financial statements.

In February 2015, FASB issued ASU 2015-02 Consolidation (Topic 810): Amendments to the Consolidation Analysis. ASU 2015-02 changes the analysis that a reporting entity must perform to determine whether it should consolidate certain types of legal entities. It is effective for annual reporting periods, and interim periods within those years, beginning after December 15, 2015. Early adoption is permitted, including adoption in an interim period. Management is currently evaluating the impact of the adoption of ASU 2015-02 on our consolidated financial statements.

Table of Contents

In April 2015, FASB issued ASU 2015-03, Interest—Imputation of Interest: Simplifying the Presentation of Debt Issuance Costs. This update was issued to simplify the presentation for debt issuance costs. Upon adoption, such costs shall be presented on our consolidated balance sheets as a direct deduction from the carrying amount of the related debt liability and not as a deferred charge presented in Other assets on our consolidated balance sheets. This amendment will be effective for interim and annual periods beginning on January 1, 2016, and is required to be retrospectively adopted. Management expects to change the presentation on our consolidated balance sheets accordingly for all periods impacted upon the required adoption date.

2. Fair Value Measurements

The Company measures certain financial assets and liabilities at fair value on a recurring basis. Fair value is a market-based measurement that should be determined using assumptions that market participants would use in pricing an asset or liability. The Company establishes a three-level hierarchy to prioritize the inputs used in measuring fair value. The levels are described below with level 1 having the highest level input that is significant to the measurement and level 3 having the lowest:

Level 1 - Quoted prices in active markets;

Level 2 - Inputs other than the quoted prices in active markets that are observable either directly or indirectly; and

Level 3 - Unobservable inputs in which there is little or no market data, which require the Company to develop its own assumptions.

The following table provides a summary of the carrying value of assets and liabilities that are measured at fair value on a recurring basis as of September 30, 2015 (in thousands), and there were no transfers between Level 1 and Level 2 securities during the three and nine months ended September 30, 2015:

Fair Value Measurements at Reporting Date Using

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents ⁽¹⁾	\$62,637	\$—	\$62,637	\$—
Short-term investments ⁽²⁾	95,587	7,543	88,044	—
Note receivable Viking Therapeutics, Inc. ⁽³⁾	5,547	—	—	5,547
Total assets	\$163,771	\$7,543	\$150,681	\$5,547
Liabilities:				
Current contingent liabilities-CyDex ⁽⁴⁾	\$5,018	\$—	\$—	\$5,018
Current contingent liabilities-Metabasis ⁽⁵⁾	2,602	—	2,602	—
Long-term contingent liabilities-CyDex ⁽⁴⁾	5,469	—	—	5,469
Long-term contingent liabilities-Metabasis ⁽⁵⁾	2,120	—	2,120	—
Liability for amounts owed to former licensees ⁽⁶⁾	1,577	1,577	—	—
Total liabilities	\$16,786	\$1,577	\$4,722	\$10,487

Table of Contents

The following table provides a summary of the assets and liabilities that are measured at fair value on a recurring basis as of December 31, 2014 (in thousands):

Fair Value Measurements at Reporting Date Using

	Total	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs * (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash equivalents ⁽¹⁾	\$69,261	\$—	\$69,261	\$—
Current co-promote termination payments receivable ⁽⁷⁾	322	—	—	322
Short-term investments ⁽²⁾	7,133	7,133	—	—
Total assets	\$76,716	\$7,133	\$69,261	\$ 322
Liabilities:				
Current contingent liabilities-CyDex ⁽⁴⁾	\$6,796	\$—	\$—	\$ 6,796
Current co-promote termination liability ⁽⁷⁾	322	—	—	322
Long-term contingent liabilities-Metabasis ⁽⁵⁾	3,652	—	3,652	—
Long-term contingent liabilities-CyDex ⁽⁴⁾	4,701	—	—	4,701
Liability for amounts owed to former licensees ⁽⁶⁾	773	773	—	—
Total liabilities	\$16,244	\$773	\$3,652	\$ 11,819

*Adjusted to correct an error in disclosure that was deemed immaterial to the financial statements taken as a whole.

Contingent liabilities related to Metabasis were reclassified from Level 1 to Level 2 as market is deemed inactive.

Additionally, certain certificates of deposit with maturities less than 90 days were not previously disclosed in the table above.

(1) Highly liquid investments with maturities less than 90 days from the purchase date are recorded as cash equivalents that are classified as Level 2 of the fair value hierarchy, as these investment securities are valued based upon quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

(2) Investments in equity securities, which the Company received as a result of event-based and upfront payments from licensees, are classified as level 1 as the fair value is determined using quoted market prices in active markets for the same securities. Short-term investments in marketable securities with maturities greater than 90 days are classified as level 2 of the fair value hierarchy, as these investment securities are valued based upon quoted prices for identical or similar instruments in markets that are not active, and model-based valuation techniques for which all significant assumptions are observable in the market.

(3) The fair value of the convertible note receivable from Viking was determined using a probability weighted option pricing model using a lattice methodology. The fair value is subjective and is affected by certain significant input to the valuation model such as the estimated volatility of the common stock, which was estimated to be 50% at September 30, 2015. Changes in these assumptions may materially affect the fair value estimate.

(4) The fair value of the liabilities for CyDex contingent liabilities were determined based on the income approach using a Monte Carlo analysis. The fair value is subjective and is affected by changes in inputs to the valuation model including management's assumptions regarding revenue volatility, probability of commercialization of products, estimates of timing and probability of achievement of certain revenue thresholds and developmental and regulatory milestones which may be achieved and affect amounts owed to former license holders and CVR holders. Changes in these assumptions can materially affect the fair value estimate.

- (5) The liability for CVRs for Metabasis are determined using quoted market prices in an inactive market for the underlying CVR.
- (6) The liability for amounts owed to former licensees are determined using quoted market prices in active markets for the underlying investment received from a partner, a portion of which is owed to former licensees.
The co-promote termination payments receivable represents a receivable for future payments to be made by Pfizer
- (7) related to product sales and is recorded at its fair value. The receivable and liability will remain equal. The fair value is determined based on a valuation model using an income approach.

Table of Contents

The following table represents significant unobservable inputs used in determining the fair value of contingent liabilities assumed in the acquisition of CyDex:

	September 30, 2015	December 31, 2014
Range of annual revenue subject to revenue sharing (1)	\$20.7 million-\$24.6 million	\$17.2 million-\$17.3 million
Revenue volatility	25%	25%
Average probability of commercialization	88%	81%
Sales beta	0.50	0.60
Credit rating	B	B
Equity risk premium	6%	6%

Revenue subject to revenue sharing represent management's estimate of the range of total annual revenue subject to (1) revenue sharing (i.e. annual revenues in excess of \$15 million) through December 31, 2016, which is the term of the CVR agreement.

A reconciliation of the level 3 financial instruments as of September 30, 2015 is as follows (in thousands):

Assets:

Fair value of level 3 financial instrument assets as of December 31, 2014	\$322	
Assumed payments made by Pfizer or assignee	(390)
Fair value adjustments to co-promote termination liability	68	
Viking note receivable	5,547	
Fair value of level 3 financial instrument assets as of September 30, 2015	\$5,547	

Liabilities:

Fair value of level 3 financial instrument liabilities as of December 31, 2014	\$11,819	
Assumed payments made by Pfizer or assignee	(390)
Payments to CVR and other former license holders	(4,074)
Fair value adjustments to contingent liabilities	3,064	
Fair value adjustments to co-promote termination liability	68	
Fair value of level 3 financial instrument liabilities as of September 30, 2015	\$10,487	

Other Fair Value Measurements

2019 Convertible Senior Notes

In August 2014, the Company issued \$245.0 million aggregate principal amount of its 2019 Convertible Senior Notes. The Company uses a quoted market rate in an inactive market, which is classified as a Level 2 input, to estimate the current fair value of its 2019 Convertible Senior Notes. The estimated fair value of the 2019 Senior Convertible Notes was \$318.6 million as of September 30, 2015. The carrying value of the notes does not reflect the market rate. See Note 7 Financing Arrangements for additional information.

Viking Therapeutics, Inc.

The Company records its investment in Viking under the equity method of accounting. The investment is subsequently adjusted for the Company's share of Viking's operating results, and if applicable, cash contributions and distributions. See Note 3 Investment in Viking Therapeutics, Inc. for additional information. The market value of the

Company's investment in Viking was \$28.0 million as of September 30, 2015. The carrying value of the investment in Viking does not reflect the market value.

Table of Contents

3. Investment in Viking Therapeutics, Inc.

Transaction History

In May 2014, the Company entered into a Master License Agreement ("MLA") to license rights to five programs to Viking, an unrelated clinical-stage biopharmaceutical company. Upon the consummation of Viking's initial public offering (the "Viking IPO"), Viking agreed to issue to the Company shares of Viking common stock having an aggregate value of approximately \$29.2 million. In addition, Viking agreed to pay the Company royalties and milestone payments based on the progression and eventual sale of any products developed under the rights and licenses granted under the MLA. As part of this transaction, the Company extended a \$2.5 million loan to Viking under a Loan and Security Agreement ("LSA"). The loan accrues interest at a fixed rate equal to 5%.

In April 2015, the Company entered into an amendment to the MLA with Viking (the "MLA Amendment") which among other things, capped the Company's aggregate ownership of Viking common stock to 49.9% of the Viking capital stock outstanding following the closing of the Viking IPO. Additionally, the Company and Viking entered into an amendment to the LSA (the "LSA Amendment"), pursuant to which, the loans were no longer due and payable upon completion of the Viking IPO, but were extended to become due upon the earlier of: (i) a certain private qualified financing transaction with aggregate net proceeds to Viking of at least \$20.0 million or (ii) a public offering subsequent to the Viking IPO with aggregate net proceeds to Viking of at least \$20.0 million or (iii) one year after the closing of the Viking IPO. The Company may elect to receive equity of Viking common stock or cash equal to 200% of the principal amount plus accrued and unpaid interest. As of September 30, 2015, the aggregate fair market value of the note receivable was \$5.5 million.

In May 2015, Viking completed the Viking IPO selling 3.5 million shares of its common stock at an initial offering price of \$8.00 per share for an aggregate offering price of \$27.6 million before underwriting discounts and commissions. In connection with the Viking IPO, the Company purchased 1.1 million shares of Viking common stock for an aggregate price of \$9.0 million at the initial public offering price. In addition, pursuant to the amended MLA Amendment, the Company received approximately 3.7 million shares of Viking common stock having an aggregate value of approximately \$29.2 million based on the initial public offering price of \$8.00 per share. As a result, the Company including its related parties owned an aggregate of 48.8% of the outstanding common stock of Viking, based on the shares of outstanding Viking common stock at September 30, 2015. As of September 30, 2015, the carrying value of the Company's investment in Viking was \$31.8 million.

Accounting Consideration

In May 2014, the Company determined it held a variable interest in Viking. The Company's variable interests in Viking included the convertible note issued pursuant to the LSA and the Company's potential upfront payment of equity pursuant to the MLA. The Company considered certain criteria, including risk and reward sharing, experience and financial condition of its partner, voting rights, involvement in day-to-day operating decisions, the Company's representation on Viking's executive committee, and level of economics between the Company and Viking. Based on these criteria, and using its judgment, the Company determined that it was the primary beneficiary of Viking and, as a result, the Company consolidated Viking on its financial statements. From May 21, 2014 through May 4, 2015, the date of Viking's initial public offering (the "Viking IPO"), the Company recorded 100% of the losses incurred as net loss attributable to noncontrolling interest because it was a primary beneficiary with no equity interest in the VIE. The loans issued pursuant to the LSA were included as notes payable by Viking and were eliminated as long as the Company consolidated Viking on its financial statements.

Upon completion of the Viking IPO in May 2015, the Company determined that Viking was no longer a VIE. The Company also determined that it does not have voting control or other elements of control that would require

consolidation of Viking. As a result of this assessment, the Company deconsolidated Viking on May 4, 2015 by derecognizing its assets, liabilities, and noncontrolling interest from the Company's consolidated financial statements. Applying deconsolidation accounting guidance, the Company determined, based on an independent valuation, the fair value of its equity investment in Viking upon deconsolidation was approximately \$34.9 million after applying a discount on the Viking IPO price due to applicable transfer restrictions applicable to the Company as an affiliate of Viking pursuant to Rule 144 under the Securities Act of 1933. Based on a separate independent valuation, the Company determined that the fair value of the convertible notes receivable was approximately \$5.5 million upon deconsolidation. The Company recorded a \$28.2 million gain on deconsolidation of Viking in its consolidated statement of operations for the nine month period ending September 30, 2015.

Following the deconsolidation, the Company accounts for its equity investment in Viking under the equity method. For each of the three and nine months ended September 30, 2015, the Company reported approximately \$2.2 million and \$3.0 million, respectively, as equity in net losses from Viking. The Company has opted to account for the Viking convertible notes

Table of Contents

receivable at fair value. For each of the three and nine months ended September 30, 2015, the Company recorded no change in the fair value of the Viking convertible notes since the deconsolidation date. See Note 2, Fair Value Measurements for additional details.

Viking's Assets and Liabilities

As of September 30, 2015, Viking's total assets were \$19.0 million, total liabilities were \$5.7 million and net losses for the three and nine months ended September 30, 2015 were \$4.7 million and \$18.3 million, respectively. As of December 31, 2014 Viking's assets and liabilities which were consolidated for the period shown were as follows (in thousands):

	December 31, 2014
Cash and cash equivalents	\$756
Other current assets	18
Capitalized IPO expenses	2,268
Total current assets	\$3,042
Other assets	\$ 1
Total assets	\$3,043
Accounts payable	\$2,211
Accrued liabilities	77
Current portion of notes payable	334
Total current liabilities	\$2,622
Long-term portion of notes payable	2,331
Total liabilities	\$4,953

Metabasis CVR payouts

In connection with the shares of Viking common stock received pursuant to the MLA, the Company will make a cash payment to the holders of certain Metabasis CVRs. The Company made a cash payment to certain holders of Metabasis CVRs of \$0.5 million and \$0.8 million during the three and nine months ended September 30, 2015, respectively. The Company estimates that the remaining cash payment, expected to be made in January 2016, will be approximately \$2.6 million. See Note 1. Basis of Presentation-Contingent Liabilities for additional information on the Metabasis CVRs.

Table of Contents

4. Lease Obligations

The Company leases office and laboratory facilities in California, Kansas and New Jersey. These leases expire between 2016 and 2019, some of which are subject to annual rent increases which range from 3.0% to 3.5%. The Company currently subleases office and laboratory space in California and New Jersey. The following table provides a summary of operating lease obligations and payments expected to be received from sublease agreements as of September 30, 2015 (in thousands):

Operating lease obligations:	Lease Termination Date	Less than 1 year	1 year	2 years	3 years	4 years	Total
Corporate headquarters- San Diego, CA	June 2019	\$695	\$713	\$732	\$560	\$—	\$2,700
Bioscience and Technology Business Center- Lawrence, KS	December 2017	54	54	14	—	—	122
Vacated office and research facility- Cranbury, NJ	August 2016	2,397	—	—	—	—	2,397
Total operating lease obligations		\$3,146	\$767	\$746	\$560	\$—	\$5,219
Sublease payments expected to be received:							
Corporate headquarters- San Diego, CA	June 2019	\$438	\$449	\$460	\$351	\$—	\$1,698
Office and research facility- Cranbury, NJ	August 2016	194	—	—	—	—	194
Net operating lease obligations		\$2,514	\$318	\$286	\$209	\$—	\$3,327

As of September 30, 2015 and December 31, 2014, the Company had lease exit obligations of \$1.3 million and \$3.3 million, respectively. For the three and nine months ended September 30, 2015, the Company made cash payments, net of sublease payments received of \$0.8 million and \$2.7 million, respectively. The Company recognized adjustments for accretion and changes in leasing assumptions of \$0.3 million and \$0.8 million for the three and nine months ended September 30, 2015, respectively. For the three and nine months ended September 30, 2014, the Company made cash payments, net of sublease payments received of \$0.8 million and \$2.6 million, respectively. The Company recognized adjustments for accretion and changes in leasing assumptions of \$0.2 million and \$0.4 million for the three and nine months ended September 30, 2014, respectively.

Table of Contents

6. Financing Arrangements

0.75% Convertible Senior Notes Due 2019

In August 2014, the Company issued \$245.0 million aggregate principal amount of its 2019 Convertible Senior Notes, resulting in net proceeds of \$239.3 million. The 2019 Convertible Senior Notes are convertible into common stock at an initial conversion rate of 13.3251 shares per \$1,000 principal amount of convertible notes, subject to adjustment upon certain events, which is equivalent to an initial conversion price of approximately \$75.05 per share of common stock. The notes bear cash interest at a rate of 0.75% per year, payable semi-annually.

Holders of the 2019 Convertible Senior Notes may convert the notes at any time prior to the close of business on the business day immediately preceding May 15, 2019, under any of the following circumstances:

- (1) during any fiscal quarter (and only during such fiscal quarter) commencing after December 31, 2014, if, for at least 20 trading days (whether or not consecutive) during the 30 consecutive trading day period ending on the last trading day of the immediately preceding fiscal quarter, the last reported sale price of the Company's common stock on such trading day is greater than 130% of the conversion price on such trading day;
- (2) during the five business day period immediately following any ten consecutive trading day period, in which the trading price per \$1,000 principal amount of notes was less than 98% of the product of the last reported sale price of the Company's common stock on such trading day and the conversion rate on each such trading day; or
- (3) upon the occurrence of certain specified corporate events as specified in the indenture governing the notes.

On or after May 15, 2019 until the close of business on the second scheduled trading day immediately preceding August 15, 2019, holders of the notes may convert all or a portion of their notes at any time, regardless of the foregoing circumstances. Upon conversion, Ligand must deliver cash to settle the principal and may deliver cash or shares of common stock, at the option of the Company, to settle any premium due upon conversion.

In accordance with accounting guidance for debt related to conversion and other options, the Company separately accounted for the debt and equity components of the 2019 Convertible Senior Notes by allocating the \$245.0 million total proceeds between the debt component and the embedded conversion option, or equity component, due to Ligand's ability to settle the 2019 Convertible Senior Notes in cash for the principal portion and to settle any premium in cash or common stock, at the Company's election. The debt allocation was performed in a manner that reflected the Company's non-convertible borrowing rate for similar debt of 5.83% derived from independent valuation analysis. The initial debt value of \$192.5 million accretes at 5.83% to reach \$245.0 million at the maturity date. The equity component of the 2019 Convertible Senior Notes was recognized as a debt discount and represents the difference between the \$245.0 million proceeds at issuance of the 2019 Convertible Senior Notes and the fair value of the debt allocation on their respective issuance dates. The debt discount is amortized to interest expense using the effective interest method over the expected life of a similar liability without an equity component. The notes will have a dilutive effect to the extent the average market price per share of common stock for a given reporting period exceeds the conversion price of \$75.05. As of September 30, 2015, the "if-converted value" exceeded the principal amount of the 2019 Convertible Senior Notes by \$29.0 million.

In connection with the issuance of the 2019 Convertible Senior Notes, the Company incurred \$5.7 million of issuance costs, which primarily consisted of underwriting, legal and other professional fees. The portions of these costs allocated to the equity components totaling \$1.2 million were recorded as a reduction to additional paid-in capital. The portions of these costs allocated to the liability components totaling \$4.5 million were recorded as assets on the

balance sheet. The portions allocated to the liability components are amortized to interest expense using the effective interest method over the expected life of the 2019 Convertible Senior Notes.

The Company determined the expected life of the debt discount for the 2019 Convertible Senior Notes to be equal to the original five-year term of the notes. The carrying value of the equity component related to the 2019 Convertible Senior Notes as of September 30, 2015 and December 31, 2014, net of issuance costs, was \$51.3 million.

Table of Contents

Convertible Bond Hedge and Warrant Transactions

In August 2014, in connection with the issuance of the 2019 Convertible Senior Notes, to minimize the impact of potential dilution to the Company's common stock upon conversion of such notes, the Company entered into convertible bond hedges and sold warrants covering approximately 3,264,643 shares of its common stock. The convertible bond hedges have an exercise price of \$75.05 per share and are exercisable when and if the 2019 Convertible Senior Notes are converted. If upon conversion of the 2019 Convertible Senior Notes, the price of the Company's common stock is above the exercise price of the convertible bond hedges, the counterparties will deliver shares of common stock and/or cash with an aggregate value approximately equal to the difference between the price of common stock at the conversion date and the exercise price, multiplied by the number of shares of common stock related to the convertible bond hedge transaction being exercised. The convertible bond hedges and warrants described below are separate transactions entered into by the Company and are not part of the terms of the 2019 Convertible Senior Notes. Holders of the 2019 Convertible Senior Notes and warrants will not have any rights with respect to the convertible bond hedges. The Company paid \$48.1 million for these convertible bond hedges and recorded the amount as a reduction to additional paid-in capital.

Concurrently with the convertible bond hedge transactions, the Company entered into warrant transactions whereby it sold warrants to acquire, approximately 3,264,643 shares of common stock with an exercise price of approximately \$125.08 per share, subject to certain adjustments. The warrants have various expiration dates ranging from November 13, 2019 to April 22, 2020. The warrants will have a dilutive effect to the extent the market price per share of common stock exceeds the applicable exercise price of the warrants, as measured under the terms of the warrant transactions. The Company received \$11.6 million for these warrants and recorded this amount to additional paid-in capital. The common stock issuable upon exercise of the warrants will be in unregistered shares, and the Company does not have the obligation and does not intend to file any registration statement with the Securities and Exchange Commission (the "SEC") registering the issuance of the shares under the warrants.

The carrying values and the fixed contractual coupon rates of the Company's financing arrangements as of September 30, 2015 and December 31, 2014 were as follows (in thousands):

	September 30, 2015	December 31, 2014
2019 Convertible Senior Notes		
Principal amount outstanding	\$245,000	\$245,000
Unamortized discount	(42,049	) (49,092
Net carrying amount	202,951	195,908
Convertible notes payable, Viking Therapeutics, Inc.	—	334
Total notes payable	\$202,951	\$196,242

7. Income Tax

As of December 31, 2014, due to a history of operating losses and other key operating factors, the Company concluded that a full valuation allowance was necessary to offset its deferred tax assets. As of September 30, 2015, the Company concluded that it was more likely than not that a substantial portion of its deferred tax assets would be realized through future taxable income. The Company's income tax provision of \$217.3 million, or \$10.12 per diluted share, and \$217.0 million, or \$10.27 per diluted share for the three and nine months ended September 30, 2015, respectively, included income tax expense and a discrete income tax benefit related to the release of a majority of the Company's valuation allowance and various adjustments to its deferred tax assets, including studies validating the Company's tax attributes and adjustments resulting from the tax return filings during the quarter.

The Company estimates its annual effective income tax rate for continuing operations to be approximately (596)% for 2015, compared to the 3% effective income tax rate for 2014. The primary difference relates to the release of the Company's valuation allowance.

The Company's effective tax rate for the three and nine months ended September 30, 2015 was (2,983)% and 681% compared to 9% and 3% for the same periods in 2014. For the period ended on September 30, 2015, the primary driver of the effective tax rate for both the three and nine month periods was the valuation allowance release. Aside from significant one-time items such as the valuation allowance release, the effective rate fluctuates primarily due to the significant permanent book-

Table of Contents

to-tax differences. These permanent differences include non-taxable contingent consideration income (expense) recorded related to the change in market value of CVRs. Any significant contingent consideration expense or income will result in a significantly higher or lower effective tax rate because contingent consideration expense is largely not deductible for tax purposes and contingent consideration income is not taxable. Other permanent differences between financial statement income and taxable income relate to items such as stock compensation, meals and entertainment charges, and compensation of officers.

The Company maintains a valuation allowance in the amount of \$9.1 million against certain U.S. state NOLs, federal NOLs arising from Pre-ASC 718 excess stock compensation benefits and federal research and development tax credits. Each reporting period, the Company evaluates the need for a valuation allowance on our deferred tax assets by jurisdiction and adjusts our estimates as more information becomes available. The Company will reassess the ability to realize the deferred tax assets on a quarterly basis. If it is more likely than not that it will not realize the recognized deferred tax assets, then all or a portion of the valuation allowance may need to be re-established, which would result in a charge to tax expense. Conversely if new events indicate that it is more likely than not that we will realize additional deferred tax assets, then all or a portion of the remaining valuation allowance may be released, which would result in a tax benefit.

As of September 30, 2015, the Company had unrecognized tax benefits of approximately \$8.3 million related to uncertain tax positions that, if recognized, would result in adjustments to the related deferred tax assets and reduce our annual effective tax rate, subject to the remaining valuation allowance.

The Company files income tax returns in the U.S. and in various state jurisdictions with varying statutes of limitations. The Company is no longer subject to income tax examination by tax authorities for years prior to 2010; however, its net operating loss and research credit carry-forwards arising prior to that year are subject to adjustment. It is the Company's policy to recognize interest expense and penalties related to income tax matters as a component of income tax expense. As of September 30, 2015, there was no material accrued interest related to uncertain tax positions.

8. Stockholders' Equity

The Company grants options and awards to employees and non-employee directors pursuant to a stockholder approved stock incentive plan, which is described in further detail in Note 10, Stockholders' Equity, of Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

The following is a summary of the Company's stock option and restricted stock activity and related information:

	Stock Options		Restricted Stock Award	
	Shares	Weighted-Average Exercise Price	Shares	Weighted-Average Grant Date Fair Value
Balance as of December 31, 2014	1,800,697	\$28.78	82,673	\$45.76
Granted	287,747	\$62.82	112,954	\$63.5
Exercised	(297,040)	) \$24.43	(48,066)	) \$44.78
Forfeited	(78,685)	) \$45.75	(15,512)	) \$54.91
Balance as of September 30, 2015	1,712,719	\$34.47	132,049	\$60.22

Net cash received from options exercised during the nine months ended September 30, 2015 and 2014 was approximately \$7.3 million and \$4.1 million, respectively. Tax deductions for stock options and restricted stock which

have exceeded stock based compensation expense in previous years have not been recognized by the Company. The Company will monitor the utilization of the net operating losses and recognize the excess tax deduction when that deduction reduces taxes payable.

As of September 30, 2015, 0.8 million shares were available for future option grants or direct issuance under the Company's 2002 Stock Incentive Plan, as amended.

Employee Stock Purchase Plan

25

Table of Contents

The Company's Employee Stock Purchase Plan, as amended and restated (the "Amended ESPP") allows participating employees to purchase up to 1,250 shares of Ligand common stock during each offering period, but in no event may a participant purchase more than 1,250 shares of common stock during any calendar year. The length of each offering period is six months, and employees are eligible to participate in the first offering period beginning after their hire date. This plan is described in further detail in Note 10, Stockholders' Equity, of Notes to Consolidated Financial Statements in our Annual Report on Form 10-K for the fiscal year ended December 31, 2014.

There were 2,654 and 2,230 shares of common stock issued under the amended ESPP during the nine months ended September 30, 2015 and 2014, respectively. As of September 30, 2015, 73,087 shares were available for future purchases under the Amended ESPP.

Corporate Share Repurchases

In September 2015, the Company's Board of Directors authorized the Company to repurchase up to \$200 million of its common stock for a period of up to three years. During the three and nine months ended September 30, 2015, the Company repurchased 6,120 common shares pursuant to the repurchase program for an aggregate purchase price of approximately \$0.5 million. During the three and nine months ended September 30, 2014, the Company repurchased 692,800 common shares pursuant to its repurchase plan effective in August 2014 for aggregate purchase price of approximately \$38.5 million.

9. Litigation

The Company records an estimate of a loss when the loss is considered probable and estimable. Where a liability is probable and there is a range of estimated loss and no amount in the range is more likely than any other number in the range, the Company records the minimum estimated liability related to the claim in accordance with ASC Topic 450-Contingencies. As additional information becomes available, the Company assesses the potential liability related to its pending litigation and revises its estimates. Revisions in the Company's estimates of potential liability could materially impact its results of operations.

Securities Litigation

On June 8, 2012, a federal securities class action and shareholder derivative lawsuit was filed in the Eastern District of Pennsylvania alleging that the Company and its CEO assisted various breaches of fiduciary duties based on the Company's purchase of a licensing interest in a development-stage pharmaceutical program from the Genaera Liquidating Trust in May 2010 and the Company's subsequent sale of half of its interest in the transaction to Biotechnology Value Fund, Inc. Plaintiff filed a second amended complaint in February 2015, which the Company moved to dismiss on March 20, 2015. The court heard oral arguments on September 30, 2015. The Company intends to continue to vigorously defend against the claims against the Company and its CEO. Due to the complex nature of the legal and factual issues involved, however, the outcome of the matter is not presently determinable.

10. Subsequent event

In November, 2015, the Company entered into a lease termination agreement with its current lessor for the corporate headquarters facility located in La Jolla, California. The termination agreement accelerated the expiration date of the lease to April 30, 2016, through which date, the Company is obligated to pay all base rent, operating expenses and other obligations due under the current lease. In addition, contingent upon the Company's surrender of the leased space in compliance with the termination agreement on or before April 30, 2016, the Company is entitled to receive

from the lessor a one-time lease buy-out payment equal to the base rent and the operating expenses paid for last six months of the revised lease term.

In conjunction with the execution of the termination agreement, the Company entered into a new lease agreement with a different lessor for its corporate headquarters located in San Diego, California. The new lease has an initial term of approximately 7 years and is expected to commence in May 2016. The base rent under the new facility lease agreement is approximately \$125,000 per year for the first year, escalating 3.0% annually thereafter over the initial term. The Company has an option to extend the term of the lease for an additional five years. The lease is subject to additional charges for property management, common area maintenance and other costs.

ITEM 2. Management's Discussion and Analysis of Financial Condition and Results of Operations

Table of Contents

Caution: This discussion and analysis may contain predictions, estimates and other forward-looking statements that involve a number of risks and uncertainties, including those discussed in Part II, Item 1A: "Risk Factors." This outlook represents our current judgment on the future direction of our business. These statements include those related to our Captisol-related revenues, our Promacta, Kyprolis, and other product royalty revenues, product returns, and product development. Actual events or results may differ materially from our expectations. For example, there can be no assurance that our revenues or expenses will meet any expectations or follow any trend(s), that we will be able to retain our key employees or that we will be able to enter into any strategic partnerships or other transactions. We cannot assure you that we will receive expected Promacta, Kyprolis, Captisol and other product revenues to support our ongoing business or that our internal or partnered pipeline products will progress in their development, gain marketing approval or achieve success in the market. In addition, ongoing or future arbitration, or litigation or disputes with third parties may have a material adverse effect on us. Such risks and uncertainties, and others, could cause actual results to differ materially from any future performance suggested. We undertake no obligation to make any revisions to these forward-looking statements to reflect events or circumstances arising after the date of this quarterly report. This caution is made under the safe harbor provisions of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act.

Our trademarks, trade names and service marks referenced herein include Ligand. Each other trademark, trade name or service mark appearing in this quarterly report belongs to its owner.

References to "Ligand Pharmaceuticals Incorporated," "Ligand," the "Company," "we" or "our" include Ligand Pharmaceuticals Incorporated and our wholly owned subsidiaries.

Overview

We are a biotechnology company with a business model based on developing or acquiring assets which generate royalty, milestone or other passive revenue for Ligand and using a lean corporate cost structure. By diversifying our portfolio of assets across numerous technology types, therapeutic areas, drug targets, and industry partners, we offer investors an opportunity for broad exposure to multiple pharmaceutical and biotechnology assets without the risk associated with developing only one or a limited number of drugs. These therapies address the unmet medical needs of patients for a broad spectrum of diseases including thrombocytopenia, multiple myeloma, hepatitis, ventricular fibrillation, muscle wasting, Alzheimer's disease, dyslipidemia, diabetes, anemia, asthma, focal segmental glomerulosclerosis ("FSGS"), menopausal symptoms and osteoporosis. Our partners include several of the world's leading pharmaceutical companies such as Novartis, Amgen, Merck, Pfizer, Baxter International, and Eli Lilly.

Results of Operations

Three and nine months ended September 30, 2015 and 2014

Total revenues for the three and nine months ended September 30, 2015 were \$17.7 million and \$50.7 million, respectively, compared to \$15.0 million and \$41.5 million, respectively, for the same periods in 2014. We reported net income attributable to common stock holders of \$224.5 million and \$248.9 million for the three and nine months ended September 30, 2015, respectively, compared to \$1.3 million and \$5.0 million, respectively, for the same periods in 2014.

Royalty Revenue

Royalty revenues were \$9.8 million and \$26.6 million for the three and nine months ended September 30, 2015, respectively, compared to \$7.5 million and \$20.6 million, respectively, for the same periods in 2014. The increase in royalty revenue is primarily due to an increase in Promacta and Kyprolis royalties.

Material Sales

We recorded material sales of \$6.0 million and \$20.5 million for the three and nine months ended September 30, 2015, respectively, compared to \$6.3 million and \$15.5 million, respectively, for the same periods in 2014. The increase in material sales of \$5.0 million for nine months ended September 30, 2015, is due to an increase in Captisol purchases for use in clinical trials and in commercialized products.

27

Table of Contents**Collaborative Research and Development and Other Revenue**

We recorded collaborative research and development and other revenue of \$1.9 million and \$3.6 million for the three and nine months ended September 30, 2015, respectively, compared to \$1.2 million and \$5.4 million, respectively, for the same periods in 2014. The increase of \$0.7 million and the decrease of \$1.8 million for the three and nine months ended September 30, 2015, respectively, is primarily due to timing of significant milestones and upfront fees earned.

Cost of Sales

Cost of sales were \$1.3 million and \$4.9 million for the three and nine months ended September 30, 2015, respectively, compared to \$1.5 million and \$5.1 million, respectively, for the same periods in 2014. The decrease of \$0.2 million for the three and nine months ended September 30, 2015, respectively, is primarily due to lower pricing tiers from our contract manufacturer due to higher quantities of Captisol material ordered.

Research and Development Expenses

Research and development expenses were \$2.5 million and \$10.5 million for the three and nine months ended September 30, 2015, respectively, compared to \$3.0 million and \$8.8 million, respectively, for the same periods in 2014. The decrease of \$0.5 million and the increase of \$1.7 million for the three and nine months ended September 30, 2015, respectively, is primarily due to timing of costs associated with internal programs.

As summarized in the table below, we are developing several proprietary products for a variety of indications. Our programs are not limited to the following, but are representative of a range of future licensing opportunities to expand our partnered asset portfolio.

Program	Disease/Indication	Development Phase
Glucagon Receptor Antagonist	Diabetes	Preparing for Phase 2
Oral Human Granulocyte Colony Stimulating Factor	Neutropenia	Preclinical
LTP Platform	Metabolic and Cardiovascular	Preclinical
Kinase Inhibitors	Multiple	Preclinical
HepDirect	Liver	Preclinical

We do not provide forward-looking estimates of costs and time to complete our ongoing research and development projects as such estimates would involve a high degree of uncertainty. Uncertainties include our inability to predict the outcome of complex research, our inability to predict the results of clinical studies, regulatory requirements placed upon us by regulatory authorities such as the FDA and EMA, our inability to predict the decisions of our collaborative partners, our ability to fund research and development programs, competition from other entities of which we may become aware in future periods, predictions of market potential from products that may be derived from our research and development efforts, and our ability to recruit and retain personnel or third-party research organizations with the necessary knowledge and skills to perform certain research. Refer to “Item 1A. Risk Factors” for additional discussion of the uncertainties surrounding our research and development initiatives.

General and Administrative Expenses

General and administrative expenses were \$5.0 million and \$18.2 million for the three and nine months ended September 30, 2015, respectively, compared to \$6.7 million and \$17.1 million, respectively, for the same periods in 2014. The decrease of \$1.7 million for the three months ended September 30, 2015 is primarily due to a decrease in stock-based compensation expense and in legal expenses. The increase of \$1.1 million for the nine months ended September 30, 2015 is primarily due to an increase in stock-based compensation expense and costs associated with

business development activities.

28

Table of Contents

Lease Exit and Termination Costs

In September 2010, we ceased use of our facility located in Cranbury, New Jersey. As a result, during the three months ended September 30, 2010, we recorded lease exit costs of \$9.7 million for costs related to the difference between the remaining lease obligations of the abandoned operating leases, which run through August 2016, and management's estimate of potential future sublease income, discounted to present value. Actual future sublease income may differ materially from our estimate, which would result in us recording additional expense or reductions in expense. In addition, we wrote-off approximately \$5.4 million of property and equipment related to the facility closure and recorded approximately \$1.8 million of severance related costs. Lease exit and termination costs were \$0.3 million and \$0.8 million for each of the three and nine months ended September 30, 2015, respectively, compared to \$0.2 million and \$0.5 million, respectively, for the same periods in 2014.

Interest Expense, net

Interest expense, net was \$2.9 million and \$8.9 million for the three and nine months ended September 30, 2015, respectively, compared to \$1.5 million and \$1.9 million, respectively, for the same periods in 2014. The increase in interest expense of \$1.4 million and \$7.0 million for the three and nine months ended September 30, 2015, respectively, is due to cash interest expense and non-cash debt related costs related to our \$245.0 million aggregate principal amount of 0.75% Convertible Senior Notes due 2019, or the 2019 Convertible Senior Notes, which was issued in August 2014.

(Increase) decrease in Contingent Liabilities

We recorded a decrease in contingent liabilities of \$2.3 million and an increase of \$5.0 million for the three and nine months ended September 30, 2015, respectively, compared to an increase of \$1.6 million and \$4.9 million, respectively, for the same periods in 2014. The decrease for the three months ended September 30, 2015 primarily relates to a decrease of \$3.2 million in the liability for amounts potentially due to holders of CVRs associated with our Metabasis acquisition and is partially offset by an increase of \$0.9 million in the liability for amounts potentially due to holders of CVRs related to our CyDex acquisition. The increase for the nine months ended September 30, 2015 primarily relates to an increase in the liability for amounts potentially due to holders of CVRs related to our CyDex acquisition of \$3.1 million and an increase of \$1.9 million in the liability for amounts potentially due to holders of CVRs associated with our Metabasis acquisition. The increase for the three months ended September, 2014 primarily relates to an increase in the liability for amounts potentially due to holders of CVRs related to our CyDex acquisition of \$2.8 million and is partially offset by a decrease of \$1.2 million in the liability for amounts potentially due to holders of CVRs associated with our Metabasis acquisition. The increase for the nine months ended September 30, 2014 primarily relates to an increase of \$5.6 million in the liability for amounts potentially due to holders of CVRs related to our CyDex acquisition and is partially offset by a decrease of \$0.7 million in the liability for amounts potentially due to holders of CVRs associated with our Metabasis acquisition.

Income Tax Benefit (Expense)

We recorded an income tax benefit of \$217.3 million and \$217.0 million for the three and nine months ended September 30, 2015, respectively, compared to income tax expense of \$0.1 million for each of the same periods in 2014. The income tax benefit for the three and nine months ended September 30, 2015 is primarily the result of releasing a valuation allowance against a significant portion of our deferred tax assets. The tax benefit is primarily comprised of U.S. federal and state net operating loss carryforwards, tax credits, and other temporary differences.

Liquidity and Capital Resources

We have financed our operations through offerings of our equity securities, borrowings from long-term debt, issuance of convertible notes, product sales and the subsequent sales of our commercial assets, royalties, collaborative research and development and other revenue, and capital and operating lease transactions.

We had net income of \$224.5 million for the quarter ended September 30, 2015. As of September 30, 2015, our cash, cash equivalents and marketable securities totaled \$187.3 million, and we had working capital of \$194.1 million with net long-term convertible debt of \$203.0 million. We believe that our currently available funds, cash generated from operations as well as existing sources of and access to financing will be sufficient to fund our anticipated operating, capital requirements and debt service requirement. We expect to build cash in future months as we continue to generate significant cash flow from royalty, license and milestone revenue and Captisol material sales primarily driven by continued increases in Promacta and Kyprolis sales, recent product approvals and regulatory developments, as well as revenue from anticipated new licenses and milestones. In addition, we anticipate that our liquidity needs can be met through other sources, including sales of marketable securities,

Table of Contents

borrowings through commercial paper and/or syndicated credit facilities and access to other domestic and foreign debt markets and equity markets.

While we believe in the viability of our strategy to generate sufficient operating cash flow and in our ability to raise additional funds, there can be no assurances to that effect. See our Annual Report on Form 10-K for the year ended December 31, 2014, Item 1A. Risk Factors - If our business does not perform according to our expectations, we may not have sufficient resources to operate our business as currently contemplated.

Investments

We invest our excess cash principally in U.S. government debt securities, investment-grade corporate debt securities and certificates of deposit. We have established guidelines relative to diversification and maturities that maintain safety and liquidity. These guidelines are periodically reviewed and modified to take advantage of trends in yields and interest rates. Additionally, we own certain equity securities, which are classified as short-term investments, as a result of an event-based payment and an upfront license payment received from licensees in December 2012 and June 2014, respectively.

Borrowings and Other Liabilities

Term Loan Facility

In January 2011, we entered into a \$20.0 million secured term loan credit facility with Oxford Financial Group. The loan was amended in January 2012 to increase the secured credit facility to \$27.5 million. The maturity date of the term loan was August 1, 2014, and we fully repaid the loan as of July 31, 2014.

0.75% Convertible Senior Notes Due 2019

We have convertible debt outstanding as of September 30, 2015 related to our 2019 Convertible Senior Notes. In August 2014, we issued \$245.0 million aggregate principal amount of convertible senior unsecured notes. The Notes are convertible into common stock upon satisfaction of certain conditions. Interest of 0.75% per year is payable semi-annually on August 15th and February 15th through the maturity of the notes in August 2019.

Repurchases of Common Stock

In September 2015, our Board of Directors authorized us to repurchase up to \$200.0 million of our common stock from time to time over a period of up to three years. During the three and nine months ended September 30, 2015 we repurchased 6,120 common shares pursuant to the repurchase program.

Contingent Liabilities

CyDex

In connection with the acquisition of CyDex in January 2011, we issued a series of CVRs and also assumed certain contingent liabilities. We may be required to make additional payments upon achievement of certain clinical and regulatory milestones to the CyDex shareholders and former license holders. In addition, we will pay CyDex shareholders, for each respective year from 2014 through 2016, 20% of all CyDex-related revenue, but only to the extent that, and beginning only when, CyDex-related revenue for such year exceeds \$15.0 million; plus an additional 10% of all CyDex-related revenue recognized during such year, but only to the extent that, and beginning only when aggregate CyDex-related revenue for such year exceeds \$35.0 million. We have paid \$8.3 million to the CyDex

shareholders for revenue sharing payments under the terms of the CVR agreement. The estimated fair value of the contingent liabilities recorded as part of the CyDex acquisition at September 30, 2015 was \$10.5 million.

Metabasis

In connection with the acquisition of Metabasis in January 2010, we entered into four CVR agreements with Metabasis shareholders. The CVRs entitle the holders to cash payments upon the sale or licensing of certain assets and upon the

30

Table of Contents

achievement of specified milestones. The fair value of the liability at September 30, 2015 was \$4.7 million, and as of December 31, 2014 was \$3.7 million.

Leases and Off-Balance Sheet Arrangements

We lease our office and research facilities under operating lease arrangements with varying terms through November 2019. The agreements provide for increases in annual rents based on changes in the Consumer Price Index or fixed percentage increases ranging from 3.0% to 3.5%. We also sublease a portion of our facilities through leases which expire between 2015 and 2016. The sublease agreements provide for a 3% increase in annual rents. We had no off-balance sheet arrangements at September 30, 2015 and December 31, 2014.

Cash Flows

Operating Activities

Operating activities generated cash of \$28.1 million for the nine months ended September 30, 2015, compared to \$10.3 million for the same period in 2014.

The cash generated for the nine months ended September 30, 2015 reflects net income of \$246.5 million, adjusted by \$220.0 million of non-cash items to reconcile net income to net cash generated from operations. These reconciling items primarily reflect stock-based compensation of \$9.5 million, amortization of debt discount and issuance fees of \$7.6 million, depreciation and amortization of \$1.9 million, gain on deconsolidation of Viking of \$28.2 million, loss on equity investment in Viking of \$3.0 million, realized gain on investments of \$2.0 million, \$5.0 million increase in the estimated fair value of contingent liabilities and deferred income taxes of \$217.0 million. The cash generated during the nine months ended September 30, 2015 is further impacted by changes in operating assets and liabilities due primarily to a decrease in accounts receivable of \$7.1 million and a decrease in restricted cash of \$0.7 million. Partially offsetting, cash generated for the period was impacted by an increase in other current assets of \$0.4 million, a decrease in accounts payable and accrued liabilities of \$5.0 million, an increase in other long-term assets of \$0.5 million, and an increase in inventory of \$0.2 million.

The cash generated for the nine months ended September 30, 2014 reflects net income of \$4.2 million, adjusted by \$14.8 million of non-cash items to reconcile net income to net cash generated from operations. These reconciling items primarily reflect an increase in the estimated fair value of contingent liabilities of \$4.9 million, depreciation and amortization of \$2.0 million, stock-based compensation of \$8.8 million, amortization of debt discount and issuance fees of \$1.2 million, deferred income taxes of \$0.1 million and accretion of notes payable of \$0.2 million, partially offset by a non-cash upfront fee received of \$1.2 million and a realized gain on investments of \$1.2 million. The cash generated during the nine months ended September 30, 2014 is further impacted by changes in operating assets and liabilities due primarily to an increase in accounts receivable of \$3.6 million, an increase in other current assets of \$0.6 million, an increase in other long-term assets of \$1.2 million and an increase in accounts payable and accrued liabilities of \$3.5 million, partially offset by a decrease in inventory of \$0.3 million.

Investing Activities

Investing activities used cash of \$101.4 million for the nine months ended September 30, 2015, compared to \$0.3 million for the same period in 2014.

Cash used by investing activities during the nine months ended September 30, 2015 primarily reflects the purchase of short-term investments of \$111.8 million, investment in Viking of \$9.0 million, purchase of commercial license rights of \$4.0 million, payments to CVR holders and other contingency payments of \$4.9 million, and reduction in cash from deconsolidation of Viking of \$0.2 million partially offset by proceeds from sales and maturity of short-term

investments of \$5.7 million and \$23.0 million respectively.

Cash used by investing activities during the nine months ended September 30, 2014 primarily reflects payments to CVR holders of \$1.9 million, partially offset by proceeds from short-term investments of \$1.5 million and proceeds from the sale of equipment of \$0.1 million.

31

Table of Contents

Financing Activities

Financing activities provided cash of \$6.9 million for the nine months ended September 30, 2015 and \$159.0 million for the same period in 2014.

Cash provided by financing activities for the nine months ended September 30, 2015 reflects \$7.4 million of proceeds received from stock option exercises and our employee stock purchase plan, which is partially offset by \$0.5 million repurchase of our common stock.

Cash provided by financing activities for the nine months ended September 30, 2014 primarily reflects gross proceeds received from the issuance of the 2019 Convertible Senior Notes of \$245.0 million, proceeds from issuance of warrants of \$11.6 million, and \$4.1 million of proceeds received from stock option exercises and our employee stock purchase plan, partially offset by repayment of debt of \$9.4 million, purchase of convertible bond hedge of \$48.1 million, payment for share repurchases of \$38.5 million and payment of debt issuance costs of \$5.7 million.

Critical Accounting Policies

Certain of our policies require the application of management judgment in making estimates and assumptions that affect the amounts reported in our consolidated financial statements and the disclosures made in the accompanying notes. Those estimates and assumptions are based on historical experience and various other factors deemed applicable and reasonable under the circumstances. The use of judgment in determining such estimates and assumptions is by nature, subject to a degree of uncertainty. Accordingly, actual results could differ materially from the estimates made. Except for the accounting for our investment in Viking Therapeutics, Inc., and the release of the valuation allowance for our tax provision, there have been no material changes in our accounting policies as disclosed in our annual report on Form 10-K for the year ended December 31, 2014.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

We are exposed to market risk from interest rates and equity prices which could affect our results of operations, financial condition and cash flows. We manage our exposure to these market risks through our regular operating and financing activities.

Investment Portfolio Risk

At September 30, 2015, our investment portfolio included investments in available-for-sale equity securities of \$93.5 million. These securities are subject to market risk and may decline in value based on market conditions.

Equity Price Risk

Our 2019 Convertible Senior Notes include conversion and settlement provisions that are based on the price of our common stock at conversion or maturity of the notes, as applicable. The minimum amount of cash we may be required to pay is \$245.0 million, but will ultimately be determined by the price of our common stock. The fair values of our 2019 Convertible Senior Notes are dependent on the price and volatility of our common stock and will generally increase or decrease as the market price of our common stock changes. In order to minimize the impact of potential dilution to our common stock upon the conversion of the 2019 Convertible Senior Notes, we entered into convertible bond hedges covering 3,264,643 shares of our common stock. Concurrently with entering into the convertible bond hedge transactions, we entered into warrant transactions whereby we sold warrants with an exercise price of approximately \$125.08 per share, subject to adjustment. Throughout the term of the 2019 Convertible Senior Notes, the notes may have a dilutive effect on our earnings per share to the extent the stock price exceeds the conversion

price of the notes. Additionally, the warrants may have a dilutive effect on our earnings per share to the extent the stock price exceeds the strike price of the warrants.

Foreign currency risk

Through our licensing and business operations, we are exposed to foreign currency risk. Foreign currency exposures arise from transactions denominated in a currency other than the functional currency and from foreign denominated revenues and profit translated into U.S. dollars. Our collaborative partners sell our products worldwide in currencies other than the U.S. dollar. Because of this, our revenues from royalty payments are subject to risk from changes in exchange rates.

Table of Contents

We purchase Captisol from Hovione, located in Lisbon, Portugal. Payments to Hovione are denominated and paid in U.S. dollars, however the unit price of Captisol contains an adjustment factor which is based on the sharing of foreign currency risk between the two parties. The effect of an immediate 10% change in foreign exchange rates would not have a material impact on our financial condition, results of operations or cash flows. We do not currently hedge our exposures to foreign currency fluctuations.

Interest rate risk

We are exposed to market risk involving rising interest rates. To the extent interest rates rise, our interest costs could increase. An increase in interest costs of 10% would not have a material impact on our financial condition, results of operations or cash flows.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

Table of Contents

Under the supervision and with the participation of our management, including our principal executive officer and principal financial officer, we conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934, as amended, or the Exchange Act, as of the end of the period covered by this report, September 30, 2015, which we refer to as the Evaluation Date. Based upon and as of the Evaluation Date, our Chief Executive Officer and Chief Financial Officer concluded that our disclosure controls and procedures were not effective at a reasonable assurance level as of the end of such period. This conclusion was based on the material weakness identified in our internal control over financial reporting, as described below.

During the review of the three and nine month periods ended September 30, 2015, an error was identified by the Company's independent registered public accounting firm in the calculation of certain projections used for the valuation of certain contingent liabilities. Based on the potential exposure of the error, we have identified a material weakness in our internal controls related to management's review of the calculation of certain projections used in the valuation of certain contingent liabilities, specifically, the review lacks sufficient precision to confirm the related calculation.

A material weakness is defined as a deficiency, or combination of deficiencies, in internal control over financial reporting, such that there is a reasonable possibility that a material misstatement of our annual or interim financial statements will not be prevented or detected on a timely basis.

We are currently in the process of developing and implementing new and revised control procedures over financial reporting related to the material weakness identified above, including but not limited to, adding a new analytical review procedure focused on the projections and related contingent liabilities calculation as well as revising the review of the calculations to increase the precision of certain formulas critical to the calculation. The Company will continue to review the updated control structure to ensure management's plan is effective in remediating the material weakness identified.

Except as described above, there have been no changes in our internal controls over financial reporting that occurred during the quarter ended September 30, 2015 that have materially affected, or are reasonably likely to materially affect, our internal controls over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1. Legal Proceedings

From time to time we are subject to various lawsuits and claims with respect to matters arising out of the normal course of our business. Due to the uncertainty of the ultimate outcome of these matters, the impact on future financial results is not subject to reasonable estimates.

Securities Litigation

On June 8, 2012, a federal securities class action and shareholder derivative lawsuit was filed in the Eastern District of Pennsylvania alleging that we and our CEO assisted various breaches of fiduciary duties based on our purchase of a licensing interest in a development-stage pharmaceutical program from the Genaera Liquidating Trust in May 2010 and the subsequent sale of half of our interest in the transaction to Biotechnology Value Fund, Inc. Plaintiff filed a second amended complaint in February 2015, which we moved to dismiss on March 20, 2015. The court heard oral argument held on September 30, 2015. We intend to continue to vigorously defend against the claims against us and our CEO. Due to the complex nature of the legal and factual issues involved, however, the outcome of the matter is not presently determinable.

Table of Contents

ITEM 1A. RISK FACTORS

The following is a summary description of some of the many risks we face in our business. You should carefully review these risks in evaluating our business, including the businesses of our subsidiaries. You should also consider the other information described in this report. The risk factors set forth below with an asterisk (*) next to the title are new risk factors or risk factors containing material changes from the risk factors previously disclosed in Item 1A of our Annual Report on Form 10-K for the year ended December 31, 2014, as filed with the SEC on February 23, 2015:

Revenues based on Promacta and Kyprolis represent a substantial portion of our overall current and/or expected future revenues.

Novartis is obligated to pay us royalties on its sales of Promacta and we receive revenue from Amgen based on both sales of Kyprolis and purchases of Captisol material for clinical and commercial uses. These payments are expected to be a substantial portion of our ongoing revenues for some time. As a result, any setback that may occur with respect to Promacta or Kyprolis could significantly impair our operating results and/or reduce the market price of our stock. Setbacks for Promacta and Kyprolis could include problems with shipping, distribution, manufacturing, product safety, marketing, government regulation or reimbursement, licenses and approvals, intellectual property rights, competition with existing or new products and physician or patient acceptance of the product, as well as higher than expected total rebates, returns, discounts, or unfavorable exchange rates.

Revenue from sales of Captisol material to our collaborative partners represents a significant portion of our current revenue and our continued development and supply of Captisol is subject to a number of risks.

Any setback that may occur with respect to Captisol could significantly impair our operating results and/or reduce the market price of our stock. Setbacks for Captisol could include problems with shipping, distribution, manufacturing, product safety, marketing, government regulation or reimbursement, licenses and approvals, intellectual property rights, competition with existing or new products and physician or patient acceptance of the products using Captisol, as well as higher than expected total rebates, returns or discounts for such products.

If products or product candidates incorporating Captisol technology were to cause any unexpected adverse events, the perception of Captisol safety could be seriously harmed. If this were to occur, we may not be able to market Captisol products unless and until we are able to demonstrate that the adverse event was unrelated to Captisol, which we may not be able to do. Further, whether or not the adverse event was a result of Captisol, we could be required by the FDA to submit to additional regulatory reviews or approvals, including extensive safety testing or clinical testing of products using Captisol, which would be expensive and, even if we were to demonstrate that the adverse event was unrelated to Captisol, would delay our marketing of Captisol-enabled products and receipt of revenue related to those products, which could significantly impair our operating results and/or reduce the market price of our stock.

We obtain Captisol from a sole source supplier, and if this supplier were to cease to be able, for any reason, to supply Captisol to us in the amounts we require, or decline to supply Captisol to us, we would be required to seek an alternative source, which could potentially take a considerable length of time and impact our revenue and customer relationships.

We currently depend on our arrangements with our outlicensees to sell products using our Captisol technology. These agreements generally provide that outlicensees may terminate the agreements at will. If our outlicensees discontinue sales of products using our Captisol technology, fail to obtain regulatory approval for products using our Captisol technology, fail to satisfy their obligations under their agreements with us, or choose to utilize a generic form of Captisol should it become available, or if we are unable to establish new licensing and marketing relationships, our

financial results and growth prospects would be materially affected. We maintain inventory of Captisol, which has a five year shelf life, at three geographically spread storage locations in the United States and Europe. If we were to encounter problems maintaining our inventory, such as natural disasters, at one or all three of these locations, it could lead to supply interruptions. Further, under most of our Captisol outlicenses, the amount of royalties we receive will be reduced or will cease when the relevant patent expires. Our high purity patents and foreign equivalents, are not expected to expire until 2029 and our morphology patents and foreign equivalents, are not expected to expire until 2025, but the initially filed patents relating to Captisol expired starting in 2010 in the United States and will expire by 2016 in most countries outside the United States. If our other intellectual property rights are not sufficient to prevent a generic form of Captisol from coming to market and if in such case our outlicensees choose to terminate their agreements with us, our Captisol revenue may decrease significantly.

Table of Contents

Furthermore, we maintain significant accounts receivable balances with certain customers purchasing Captisol materials, which may result in the concentration of credit risk. We generally do not require any collateral from our customers to secure payment of these accounts receivable. If any of our major customers were to default in the payment of their obligations to us, our business, financial condition, operating results and cash flows could be adversely affected.

The product candidates of our partners and us face significant development and regulatory hurdles prior to partnering and/or marketing which could delay or prevent licensing, sales and/or milestone revenue.

Before we or our partners obtain the approvals necessary to sell any of our unpartnered assets or partnered programs, we must show through preclinical studies and human testing that each potential product is safe and effective. We and/or our partners have a number of partnered programs and unpartnered assets moving toward or currently awaiting regulatory action. Failure to show any product's safety and effectiveness could delay or prevent regulatory approval of a product and could adversely affect our business. The drug development and clinical trials process is complex and uncertain. For example, the results of preclinical studies and initial clinical trials may not necessarily predict the results from later large-scale clinical trials. In addition, clinical trials may not demonstrate a product's safety and effectiveness to the satisfaction of the regulatory authorities. A number of companies have suffered significant setbacks in advanced clinical trials or in seeking regulatory approvals, despite promising results in earlier trials. The FDA may also require additional clinical trials after regulatory approvals are received. Such additional trials may be expensive and time-consuming, and failure to successfully conduct those trials could jeopardize continued commercialization of a product.

The rates at which we complete our scientific studies and clinical trials depends on many factors, including, but are not limited to, our ability to obtain adequate supplies of the products to be tested and patient enrollment. Patient enrollment is a function of many factors, including the size of the patient population, the proximity of patients to clinical sites, the eligibility criteria for the trial and other potential drug candidates being studied. Delays in patient enrollment for our trials may result in increased costs and longer development times. In addition, our collaborative partners have rights to control product development and clinical programs for products developed under our collaborations. As a result, these collaborative partners may conduct these programs more slowly or in a different manner than expected. Moreover, even if clinical trials are completed, we or our collaborative partners still may not apply for FDA approval in a timely manner or the FDA still may not grant approval.

Table of Contents

We rely heavily on collaborative relationships, and any disputes or litigation with our collaborative partners or termination or breach of any of the related agreements could reduce the financial resources available to us, including milestone payments and future royalty revenues.

Our strategy for developing and commercializing many of our potential products, including products aimed at larger markets, includes entering into collaboration agreements with corporate partners and others. These agreements give our collaborative partners significant discretion when deciding whether or not to pursue any development program. Our existing collaborations may not continue or be successful, and we may be unable to enter into future collaborative arrangements to develop and commercialize our unpartnered assets.

For instance, our collaboration with Viking includes a \$2.5 million loan that we made to Viking to be repaid one year after Vikings initial public offering or upon certain other financing events. Viking recently completed its initial public offering and while we expect that Viking will be able to repay the loan in April 2016, there is no guaranty that they will have the resources to do so at that time. Despite our expectations, if Viking is unable to repay the loan at that time, we may decide to extend the term of our loan to Viking, invest additional capital, or terminate our agreements with Viking. We cannot make any assurances on the collectibility of our loan to Viking.

In addition, our collaborators may develop drugs, either alone or with others that compete with the types of drugs they are developing with us (or that we are developing on our own). This would result in increased competition for our or our partners' programs. If products are approved for marketing under our collaborative programs, revenues we receive will depend on the manufacturing, marketing and sales efforts of our collaborative partners, who generally retain commercialization rights under the collaborative agreements. Generally, our current collaborative partners also have the right to terminate their collaborations at will or under specified circumstances. If any of our collaborative partners breach or terminate their agreements with us or otherwise fail to conduct their collaborative activities successfully (for example, by not making required payments when due, or at all), our product development under these agreements will be delayed or terminated. Disputes or litigation may also arise with our collaborators (with us and/or with one or more third parties), including those over ownership rights to intellectual property, know-how or technologies developed with our collaborators. Such disputes or litigation could adversely affect our rights to one or more of our product candidates. Any such dispute or litigation could delay, interrupt or terminate the collaborative research, development and commercialization of certain potential products, create uncertainty as to ownership rights of intellectual property, or could result in litigation or arbitration. The occurrence of any of these problems could be time-consuming and expensive and could adversely affect our business.

Expirations of, challenges to or failure to secure patents and other proprietary rights may significantly hurt our business.

Any conflicts resulting from the patent rights of others could significantly reduce the coverage of our patents and limit our ability to obtain meaningful patent protection. We have had and will continue to have discussions with our current and potential collaborative partners regarding the scope and validity of our patents and other proprietary rights. If a collaborative partner or other party successfully establishes that our patent rights are invalid, we may not be able to continue our existing collaborations beyond their expiration. Any determination that our patent rights are invalid also could encourage our collaborative partners to seek early termination of our agreements. Such invalidation could adversely affect our ability to enter into new collaborations.

We may also need to initiate litigation, which could be time-consuming and expensive, to enforce our proprietary rights or to determine the scope and validity of others' rights. If this occurs, a court may find our patents or those of our licensors invalid or may find that we have infringed on a competitor's rights. In addition, if any of our competitors have filed patent applications in the United States which claim technology we also have invented, the United States Patent and Trademark Office may require us to participate in expensive interference proceedings to determine who has

the right to a patent for the technology.

We also rely on unpatented trade secrets and know-how to protect and maintain our competitive position. We require our employees, consultants, collaborative partners and others to sign confidentiality agreements when they begin their relationship with us. These agreements may be breached, and we may not have adequate remedies for any breach. In addition, our competitors may independently discover our trade secrets.

Generally, our success will depend on our ability and the ability of us and our licensors to obtain and maintain patents and proprietary rights for our potential products both in the United States and in foreign countries. Patents may not be issued from any of these applications currently on file, or, if issued, may not provide sufficient protection. Our patent position, like that of many biotechnology and pharmaceutical companies, is uncertain and involves complex legal and technical questions for

38

Table of Contents

which important legal principles are unresolved. We may not develop or obtain rights to products or processes that are patentable. Even if we do obtain patents, such patents may not adequately protect the technology we own or have licensed. In addition, others may challenge, seek to invalidate, infringe or circumvent any patents we own or license and rights we receive under those patents may not provide competitive advantages to us. For example, our European patent related to Agglomerated forms of Captisol was limited during an opposition proceeding and the rejection of our European patent application related to High Purity Captisol is currently being appealed.

We have obtained patent protection in the United States through 2025 on one or more Agglomerated forms of Captisol and through 2029 on one or more High Purity forms of Captisol. We also have filed patent applications covering the Captisol product that if issued, would not be set to expire until 2033 (for example, our patent WO 2013/130666, filed February 27, 2013, contains composition of matter and use claims). There is no guarantee that our patents will be sufficient to prevent competitors from creating a generic form of Captisol and competing against us, or from developing combination patents for products that will prevent us from developing products using those APIs. In addition, most of the agreements in our Captisol outlicensing business, provide that once the relevant patent expires, the amount of royalties we receive will be reduced or eliminated.

Our collaborative partners may change their strategy or the focus of their development and commercialization efforts with respect to our partnered programs, and the success of our partnered programs could be adversely affected.

If our collaborative partners terminate their collaborations with us or do not commit sufficient resources to the development, manufacture, marketing or distribution of our partnered programs, we could be required to devote additional resources to our partnered programs, seek new collaborative partners or abandon such partnered programs, all of which could have an adverse effect on our business.

Third party intellectual property may prevent us or our partners from developing our potential products and we may owe a portion of any payments we receive from our collaborative partners to one or more third parties.

Our success will depend on our ability and the ability of our collaborative partners to avoid infringing the proprietary rights of others, both in the United States and in foreign countries. In addition, disputes with licensors under our license agreements may arise which could result in additional financial liability or loss of important technology and potential products and related revenue, if any. Further, the manufacture, use or sale of our potential products or our collaborative partners' products or potential products may infringe the patent rights of others. This could impact Captisol, Promacta, Kyprolis, Duavee, Viviant, Conbriza, Nexterone, and other products or potential products.

Several drug companies and research and academic institutions have developed technologies, filed patent applications or received patents for technologies that may be related to our business. Others have filed patent applications and received patents that conflict with patents or patent applications we have licensed for our use, either by claiming the same methods or compounds or by claiming methods or compounds that could dominate those licensed to us. In addition, we may not be aware of all patents or patent applications that may impact our ability to make, use or sell any of our potential products. For example, U.S. patent applications may be kept confidential while pending in the United States Patent and Trademark Office and patent applications filed in foreign countries are often first published six months or more after filing.

Disputes with our collaborative partners could delay our ability and the ability of our collaborative partners to achieve milestones or our receipt of other payments. In addition, other possible disputes could delay, interrupt or terminate the research, development and commercialization of certain potential products being developed by either our collaborative partners or by us. The occurrence of any of the foregoing problems could be time-consuming and expensive and could adversely affect our business.

Third parties have not directly threatened an action or claim against us, although we do periodically receive other communications or have other conversations with the owners of other patents or other intellectual property. If others obtain patents with conflicting claims, we may be required to obtain licenses to those patents or to develop or obtain alternative technology. We may not be able to obtain any such licenses on acceptable terms, or at all. Any failure to obtain such licenses could delay or prevent us from pursuing the development or commercialization of our potential products.

In general, litigation claims can be expensive and time consuming to bring or defend against and could result in settlements or damages that could significantly impact our results of operations and financial condition. We cannot predict or determine the occurrence or outcome of these matters or reasonably estimate the amount or range of amounts of any fines or penalties that might result from a settlement or an adverse outcome. However, a settlement or an adverse outcome could have a material adverse effect on our financial position, liquidity and results of operations.

Table of Contents

The existence of a material weakness in our internal controls over financial reporting could have a material adverse impact on our ability to produce timely and accurate financial statements.*

The Sarbanes-Oxley Act requires that we report annually on the effectiveness of our internal controls over financial reporting. Among other things, we must perform systems and processes evaluation testing. This includes an assessment of our internal controls to allow management to report on, and our independent public accounting firm to attest to, our internal controls over financial reporting, as required by Section 404 of the Sarbanes-Oxley Act. Management performed an assessment of the effectiveness of our internal control over financial reporting as of September 30, 2015 using criteria established by the Internal Control-Integrated Framework (2013) issued by the Committee of Sponsoring Organizations of the Treadway Commission (“COSO”). Based on this assessment, management determined that, as of September 30, 2015, a material weakness exists in our internal control over financial reporting of the accounting for and disclosures of the calculation of certain contingent liabilities in the consolidated financial statements. Because of this material weakness, management concluded that the Company did not maintain effective internal control over financial reporting as of September 30, 2015, based on the COSO framework.

For information on the progress of the remediation of the material weakness, see “Item 4. Controls and Procedures” above. Our future assessment, or the future assessment by our independent registered public accounting firm, may reveal additional material weaknesses in our internal controls. If not remediated, a material weakness, and any future potential material weaknesses identified by management could result in future errors in our financial statements or in documents we file with the SEC. Further, if we cannot produce reliable financial reports, our business and financial condition could be harmed, investors could lose confidence in our reported financial information, or the market price of our stock could decline significantly. In addition, our ability to obtain additional financing to operate and expand our business, or obtain additional financing on favorable terms, could be materially and adversely affected, which, in turn, could materially and adversely affect our business, our financial condition and the market value of our securities.

We may undertake strategic acquisitions in the future and any difficulties from integrating such acquisitions could adversely affect our stock price, operating results and results of operations.

We may acquire companies, businesses and products that complement or augment our existing business. We may not be able to integrate any acquired business successfully or operate any acquired business profitably. Integrating any newly acquired business could be expensive and time-consuming. Integration efforts often take a significant amount of time, place a significant strain on managerial, operational and financial resources and could prove to be more difficult or expensive than we predict. The diversion of our management's attention and any delay or difficulties encountered in connection with any future acquisitions we may consummate could result in the disruption of our on-going business or inconsistencies in standards and controls that could negatively affect our ability to maintain third-party relationships. Moreover, we may need to raise additional funds through public or private debt or equity financing, or issue additional shares, to acquire any businesses or products, which may result in dilution for stockholders or the incurrence of indebtedness.

As part of our efforts to acquire companies, business or product candidates or to enter into other significant transactions, we conduct business, legal and financial due diligence with the goal of identifying and evaluating material risks involved in the transaction. Despite our efforts, we ultimately may be unsuccessful in ascertaining or evaluating all such risks and, as a result, might not realize the intended advantages of the transaction. If we fail to realize the expected benefits from acquisitions we may consummate in the future or have consummated in the past, whether as a result of unidentified risks, integration difficulties, regulatory setbacks, litigation with current or former

employees and other events, our business, results of operations and financial condition could be adversely affected. If we acquire product candidates, we will also need to make certain assumptions about, among other things, development costs, the likelihood of receiving regulatory approval and the market for such product candidates. Our assumptions may prove to be incorrect, which could cause us to fail to realize the anticipated benefits of these transactions.

In addition, we will likely experience significant charges to earnings in connection with our efforts, if any, to consummate acquisitions. For transactions that are ultimately not consummated, these charges may include fees and expenses for investment bankers, attorneys, accountants and other advisors in connection with our efforts. Even if our efforts are successful, we may incur, as part of a transaction, substantial charges for closure costs associated with elimination of duplicate operations and facilities and acquired In-Process Research and Development, or IPR&D, charges. In either case, the incurrence of these charges could adversely affect our results of operations for particular quarterly or annual periods.

We may not be able to hire and/or retain key employees.

Table of Contents

If we are unable to hire and/or retain key employees, we may not have sufficient resources to successfully manage our assets or our business, and we may not be able to perform our obligations under various contracts and commitments. Furthermore, there can be no assurance that we will be able to retain all of our key management and scientific personnel. If we fail to retain such key employees, it could materially and adversely affect our business, financial condition, results of operations or the market price of our stock.

Aggregate revenues based on sales of our other products may not meet expectations.

Revenues based on sales of Duavee, Conbriza, Noxafil IV and Nexterone may not meet expectations. Any setback that may occur with respect to these products could impair our operating results and/or reduce the market price of our stock. Setbacks for these products could include problems with shipping, distribution, manufacturing, product safety, marketing, government regulation or reimbursement, licenses and approvals, intellectual property rights, competition with existing or new products and physician or patient acceptance of the product, as well as higher than expected total rebates, returns or discounts. These products also are or may become subject to generic competition. Any such setback could reduce our revenue.

If plaintiffs bring product liability lawsuits against us or our partners, we or our partners may incur substantial liabilities and may be required to limit commercialization of our approved products and product candidates, and we may be subject to other liabilities related to the sale of our prior commercial product lines.

As is common in our industry, our partners and we face an inherent risk of product liability as a result of the clinical testing of our product candidates in clinical trials and face an even greater risk for commercialized products. Although we are not currently a party to product liability litigation, if we are sued, we may be held liable if any product or product candidate we develop causes injury or is found otherwise unsuitable during product testing, manufacturing, marketing or sale. Regardless of merit or eventual outcome, liability claims may result in decreased demand for any product candidates or products that we may develop, injury to our reputation, discontinuation of clinical trials, costs to defend litigation, substantial monetary awards to clinical trial participants or patients, loss of revenue and the inability to commercialize any products that we develop. We have product liability insurance that covers our clinical trials up to a \$10.0 million annual limit. If we are sued for any injury caused by our product candidates or any future products, our liability could exceed our total assets.

If our partners do not reach the market with our partnered programs before our competitors offer products for the same or similar uses, or if our partners are not effective in marketing our partnered programs, our revenues from product sales, if any, will be reduced.

We face intense competition in our development activities. Our competitors might succeed in obtaining regulatory approval for competitive products more rapidly than our partners can for our partnered programs. In addition, competitors might develop technologies and products that are less expensive and perceived to be safer or more effective than those being developed by us or our partners, which could impair our product development and render our technology obsolete.

If our business does not perform according to our expectations, we may not have sufficient resources to operate our business as currently contemplated.

We believe that our capital resources, including our currently available cash, cash equivalents, and short-term investments as well as our current and future royalty revenues, will be adequate to fund our operations at their current levels at least for the next 12 months. However, changes may occur that would cause us to consume available capital resources before that time and we may need to complete additional equity or debt financings to fund our operations.

Our inability to obtain additional financing could adversely affect our business. Financings may not be available at all or on terms favorable to us. In addition, these financings, if completed, may not meet our capital needs and could result in substantial dilution to our stockholders. If adequate funds are not available, we may be required to delay, reduce the scope of or eliminate one or more of our research or drug development programs. We may also be required to liquidate our business or file for bankruptcy protection. Alternatively, we may be forced to attempt to continue development by entering into arrangements with collaborative partners or others that require us to relinquish some or all of our rights to technologies or drug candidates that we would not otherwise relinquish.

We recently sold \$245.0 million aggregate principal amount of 0.75% Convertible Senior Notes, which may impact our financial results, result in the dilution of existing stockholders, and restrict our ability to take advantage of future opportunities.

Table of Contents

In August of 2014, we sold \$245.0 million aggregate principal amount of 0.75% Convertible Senior Notes due 2019, or the 2019 Convertible Senior Notes. We will be required to pay interest on the 2019 Convertible Senior Notes until they come due or are converted, and the payment of that interest will reduce our net income. The sale of the 2019 Convertible Senior Notes may also affect our earnings per share figures, as accounting procedures require that we include in our calculation of earnings per share the number of shares of our common stock into which the 2019 Convertible Senior Notes are convertible. The 2019 Convertible Senior Notes may be converted, under the conditions and at the premium specified in the 2019 Convertible Senior Notes, into cash and shares of our common stock, if any (subject to our right to pay cash in lieu of all or a portion of such shares). If shares of our common stock are issued to the holders of the 2019 Convertible Senior Notes upon conversion, there will be dilution to our shareholders equity. Upon the occurrence of certain circumstances, holders of the 2019 Convertible Senior Notes may require us to purchase all or a portion of their notes for cash, which may require the use of a substantial amount of cash. If such cash is not available, we may be required to sell other assets or enter into alternate financing arrangements at terms that may or may not be desirable. The existence of the 2019 Convertible Senior Notes and the obligations that we incurred by issuing them may restrict our ability to take advantage of certain future opportunities, such as engaging in future debt or equity financing activities. As of September 30, 2015, no events have occurred which would trigger settlement of the notes in cash.

Our ability to use our net operating losses, or NOLs, to offset taxes that would otherwise be due could be limited or lost entirely.

As of September 30, 2015, we reported deferred tax assets of approximately \$216 million, which represent a significant portion of our total assets. The use of our NOLs is subject to uncertainty because, in addition to the factors discussed below, it is dependent upon the amount of taxable income we generate. There can be no assurance that we will have sufficient taxable income, if any, in future years to use the NOLs before they expire. If we have uncertainties surrounding our ability to continue to generate future taxable income to realize these tax assets, a valuation allowance will be established to offset our deferred tax assets. Valuation allowances are recorded to reduce deferred tax assets when it is more likely than not (greater than 50%) that a tax benefit will not be realized. In addition, even if we generate taxable income, realization of our NOLs to offset taxes that would otherwise be due could be restricted by annual limitations on use of NOLs triggered by a past or future “ownership change” under Section 382 of the Internal Revenue Code and similar state provisions. An “ownership change” may occur when there is a 50% or greater change in total ownership of our company by one or more 5% shareholders within a three-year period. The loss of some or all of our NOLs could materially and adversely affect our business, financial condition and results of operations. In addition, California and certain states have suspended use of NOLs for certain taxable years, and other states may consider similar measures. As a result, we may incur higher state income tax expense in the future. Depending on our future tax position, continued suspension of our ability to use NOLs in states in which we are subject to income tax could have an adverse impact on our operating results and financial condition. The calculation of the amount of our net operating loss carryforwards may be changed as a result of a challenge by the IRS or other governmental authority or our learning of new information about the ownership of, and transactions in, our securities.

Our shareholder rights plan, concentration of ownership and charter documents may hinder or prevent change of control transactions.

Our shareholder rights plan and provisions contained in our certificate of incorporation and bylaws may discourage transactions involving an actual or potential change in our ownership. In addition, our Board of Directors may issue shares of common or preferred stock without any further action by the stockholders. Our directors and certain of our institutional investors, collectively beneficially own a significant portion of our outstanding common stock. We have in the past granted waivers to investors allowing them to increase their ownership level above the limit set forth in our shareholder rights agreement. Such restrictions, circumstances and issuances may have the effect of delaying or preventing a change in our ownership. If changes in our ownership are discouraged, delayed or prevented, it would be

more difficult for our current Board of Directors to be removed and replaced, even if you or our other stockholders believe that such actions are in the best interests of us and our stockholders.

Table of Contents

Funding of our drug development programs may not result in future revenues.

Our drug development programs may require substantial additional capital to successfully complete, arising from costs to: conduct research, preclinical testing and human studies; establish pilot scale and commercial scale manufacturing processes and facilities; and establish and develop quality control, regulatory, marketing, sales and administrative capabilities to support these programs. While we expect to fund our research and development activities from cash generated from royalties and milestones from our partners in various past and future collaborations to the extent possible, if we are unable to do so, we may need to complete additional equity or debt financings or seek other external means of financing. These financings could depress our stock price. If additional funds are required to support our operations and we are unable to obtain them on terms favorable to us, we may be required to cease or reduce further development or commercialization of our products, to sell some or all of our technology or assets or to merge with another entity.

Our results of operations and liquidity needs could be materially negatively affected by market fluctuations and economic downturn.

Our results of operations could be materially negatively affected by economic conditions generally, both in the United States and elsewhere around the world. Continuing concerns over inflation, energy costs, geopolitical issues, the availability and cost of credit, and the U.S. financial markets have contributed to increased volatility and diminished expectations for the economy and the markets going forward. Domestic and international equity markets periodically experience heightened volatility and turmoil. These events may have an adverse effect on us. In the event of a market downturn, our results of operations could be adversely affected by those factors in many ways, including making it more difficult for us to raise funds if necessary, and our stock price may further decline. We cannot provide assurance that our investments are not subject to adverse changes in market value. If our investments experience adverse changes in market value, we may have less capital to fund our operations.

Our stock price has been volatile and could experience a sudden decline in value.

The market prices for securities of biotechnology and pharmaceutical companies have historically been highly volatile, and the market has recently experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. Continued volatility in the overall capital markets could reduce the market price of our common stock in spite of our operating performance. Further, high stock price volatility could result in higher stock-based compensation expense.

Our common stock has experienced significant price and volume fluctuations and may continue to experience volatility in the future. Many factors may have a significant impact on the market price of our common stock, including, but not limited to, the following factors: results of or delays in our preclinical studies and clinical trials; the success of our collaboration agreements; publicity regarding actual or potential medical results relating to products under development by us or others; announcements of technological innovations or new commercial products by us or others; developments in patent or other proprietary rights by us or others; comments or opinions by securities analysts or major stockholders; future sales of our common stock by existing stockholders; regulatory developments or changes in regulatory guidance; litigation or threats of litigation; economic and other external factors or other disaster or crises; the departure of any of our officers, directors or key employees; period-to-period fluctuations in financial results; and price and volume fluctuations in the overall stock market.

Impairment charges pertaining to goodwill, identifiable intangible assets or other long-lived assets from our mergers and acquisitions could have an adverse impact on our results of operations and the market value of our common stock.

The total purchase price pertaining to our acquisitions in recent years of Pharmacoepia, Neurogen, Metabasis and CyDex have been allocated to net tangible assets, identifiable intangible assets, in-process research and development and goodwill. To the extent the value of goodwill or identifiable intangible assets or other long-lived assets become impaired, we will be required to incur material charges relating to the impairment. Any impairment charges could have a material adverse impact on our results of operations and the market value of our common stock.

Table of Contents

The occurrence of a catastrophic disaster could damage our facilities beyond insurance limits or we could lose key data which could cause us to curtail or cease operations.

We are vulnerable to damage and/or loss of vital data from natural disasters, such as earthquakes, tornadoes, power loss, fire, floods and similar events, as well as from accidental loss or destruction. If any disaster were to occur, our ability to operate our business could be seriously impaired. We have property, liability, and business interruption insurance which may not be adequate to cover our losses resulting from disasters or other similar significant business interruptions, and we do not plan to purchase additional insurance to cover such losses due to the cost of obtaining such coverage. Any significant losses that are not recoverable under our insurance policies could seriously impair our business, financial condition and prospects.

We rely on information technology and any failure, inadequacy, interruption or security lapse of that technology, including any cyber security incidents, could harm our ability to operate our business effectively.

Our business is increasingly dependent on critical, complex and interdependent information technology systems, including internet-based systems, to support business processes as well as internal and external communications. Despite the implementation of security measures, our internal computer systems and those of our collaborative partners are vulnerable to damage from cyber-attacks, computer viruses, security breaches, unauthorized access, natural disasters, terrorism, war and telecommunication and electrical failures. System failures, accidents or security breaches could cause interruptions in our operations, could lead to the loss of trade secrets or other intellectual property, could lead to the public exposure of personal information of our employees and others, and could result in a material disruption of our clinical and commercialization activities and business operations, in addition to possibly requiring substantial expenditures to remedy. To the extent that any disruption or security breach were to result in a loss of, or damage to, our data or applications, or inappropriate disclosure of confidential or proprietary information, we could incur liability and our business and financial condition could be harmed.

Table of Contents

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

Purchases of Equity Securities By the Issuer and Affiliated Purchasers

The following table presents information regarding repurchases by us of our common stock during the three and nine months ended September 30, 2015 under the stock repurchase program approved by our board of directors in September 2015, under which we may acquire up to \$200 million of our common stock in open market and negotiated purchases for a period of up to three years.

ISSUER PURCHASES OF EQUITY SECURITIES

	Total Number of Shares Purchased	Average Price Paid Per Share	Total Number of Shares Purchased as Part of Publicly Announced Plans or Programs	Maximum Dollar Value of Shares that May Yet Be Purchased Under the Program (in thousands)
September 1 - September 30, 2015	6,120	\$ 79.92	6,120	\$ 199,510
Total	6,120	\$ 79.92	6,120	\$ 199,510

ITEM 6. EXHIBITS

The Exhibit Index to this Quarterly Report on Form 10-Q is incorporated herein by reference.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: November 9, 2015

By: /s/ Matthew Korenberg
Matthew Korenberg
Vice President, Finance and Chief Financial Officer
Duly Authorized Officer and Principal Financial Officer

Table of Contents

EXHIBIT INDEX

Exhibit Number Description

10.1†	Fourth Amendment to Sublicense Agreement, dated September 17, 2015 by and among the Company, Pharmacopeia, LLC. and Retrophin, Inc.
31.1	Certification by Principal Executive Officer, Pursuant to Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
31.2	Certification by Principal Financial Officer, Pursuant to Rules 13a-14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002.
32.1	Certifications by Principal Executive Officer and Principal Financial Officer, Pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document
101.SCH	XBRL Taxonomy Extension Schema Document
101.CAL	XBRL Taxonomy Extension Calculation Linkbase Document
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document
101.LAB	XBRL Taxonomy Extension Label Linkbase Document
101.PRE	XBRL Taxonomy Extension Presentation Linkbase Document

† Confidential treatment has been requested for portions of this exhibit. These portions have been omitted and submitted separately to the Securities and Exchange Commission.