Pacira Pharmaceuticals, Inc.
Form 10-Q
October 30, 2014
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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

For the Quarterly Period Ended September 30, 2014

OR

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

For the transition period from to

Commission File Number: 001-35060

PACIRA PHARMACEUTICALS, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	51-0619477
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

5 Sylvan Way, Suite 300
Parsippany, New Jersey, 07054
(Address and Zip Code of Principal Executive Offices)

(973) 254-3560
(Registrant’s Telephone Number, Including Area Code)

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

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

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

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

As of October 28, 2014, 36,055,639 shares of the registrant’s common stock, $0.001 par value per share, were outstanding.

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PART I — FINANCIAL INFORMATION

Item 1. FINANCIAL STATEMENTS

PACIRA PHARMACEUTICALS, INC.
CONSOLIDATED BALANCE SHEETS

(Unaudited)
(In thousands, except share and per share amounts)

	September 30, 2014	December 31, 2013 (Note 2)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 17,756	$ 12,515
Restricted cash	1,829	1,633
Short-term investments	131,972	59,637
Accounts receivable, net	20,517	14,590
Inventories	23,662	15,557
Prepaid expenses and other current assets	3,504	2,819
Total current assets	199,240	106,751
Long-term investments	24,527	—
Fixed assets, net	56,148	48,182
Goodwill	22,048	10,328
Intangibles, net	483	1,157
Other assets	2,948	3,402
Total assets	$ 305,394	$ 169,820
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 7,747	$ 3,069
Accrued expenses	23,383	17,885
Convertible senior notes	102,065	98,961
Current portion of royalty interest obligation	602	1,020
Current portion of deferred revenue	1,426	1,008
Total current liabilities	135,223	121,943
Royalty interest obligation	—	226
Deferred revenue	9,864	3,212
Other liabilities	5,235	3,190
Total liabilities	150,322	128,571
Commitments and contingencies (Note 12)		
Stockholders' equity:		
Preferred stock, par value $0.001; 5,000,000 shares authorized, none issued and outstanding at September 30, 2014 and December 31, 2013	—	—
Common stock, par value $0.001, 250,000,000 shares authorized; 36,021,855 shares issued and outstanding at September 30, 2014; 33,636,442 shares issued and outstanding at December 31, 2013	36	34
Additional paid-in capital	470,975	337,639

Accumulated deficit	(315,947)	(296,429)
Accumulated other comprehensive income	8	5
Total stockholders’ equity	155,072	41,249
Total liabilities and stockholders’ equity	$ 305,394	$ 169,820

See accompanying condensed notes to consolidated financial statements.

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PACIRA PHARMACEUTICALS, INC.
CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Revenues:				
Net product sales	$50,920	$22,408	$132,697	$49,520
Collaborative licensing and development revenue	357	243	930	729
Royalty revenue	771	608	2,249	1,737
Total revenues	52,048	23,259	135,876	51,986
Operating expenses:				
Cost of goods sold	20,391	14,791	58,472	36,396
Research and development	4,425	5,962	14,844	16,724
Selling, general and administrative	28,217	15,320	75,643	42,336
Total operating expenses	53,033	36,073	148,959	95,456
Loss from operations	(985)	(12,814)	(13,083)	(43,470)
Other (expense) income:				
Interest income	134	62	237	207
Interest expense	(2,037)	(1,892)	(6,222)	(5,325)
Loss on early extinguishment of debt	—	—	—	(3,398)
Royalty interest obligation	(73)	(132)	(330)	(379)
Other, net	(43)	(8)	(120)	(30)
Total other expense, net	(2,019)	(1,970)	(6,435)	(8,925)
Loss before income taxes	(3,004)	(14,784)	(19,518)	(52,395)
Income tax benefit	—	—	—	442
Net loss	$(3,004)	$(14,784)	$(19,518)	$(51,953)
Net loss per share:				
Basic and diluted net loss per common share	$(0.08)	$(0.44)	$(0.56)	$(1.57)
Weighted average common shares outstanding:				
Basic and diluted	35,943	33,360	35,039	33,051

See accompanying condensed notes to consolidated financial statements.

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PACIRA PHARMACEUTICALS, INC.
CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

(Unaudited)
(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Net loss	$(3,004)	$(14,784)	$(19,518)	$(51,953)
Other comprehensive income (loss):				
Net unrealized gain (loss) on investments	39	3	3	(10)
Total other comprehensive income (loss)	39	3	3	(10)
Comprehensive loss	$(2,965)	$(14,781)	$(19,515)	$(51,963)

See accompanying condensed notes to consolidated financial statements.

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PACIRA PHARMACEUTICALS, INC.
CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
For the Nine Months Ended September 30, 2014

(Unaudited)
(In thousands)

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Income	Total
	Shares	Amount				
Balances at December 31, 2013	33,636	$34	$337,639	$(296,429)	$ 5	$41,249
Follow-on public offering, net	1,840	2	110,405	—	—	110,407
Exercise of stock options	511	—	5,732	—	—	5,732
Cashless exercise of warrants	35	—	—	—	—	—
Stock-based compensation	—	—	17,199	—	—	17,199
Net unrealized gain on investments	—	—	—	—	3	3
Net loss	—	—	—	(19,518)	—	(19,518)
Balances at September 30, 2014	36,022	$36	$470,975	$(315,947)	$ 8	$155,072

See accompanying condensed notes to consolidated financial statements.

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PACIRA PHARMACEUTICALS, INC.
CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)
(In thousands)

	Nine Months Ended September 30, 2014	2013
Operating activities:		
Net loss	$(19,518)	$(51,953)
Adjustments to reconcile net loss to net cash provided by (used in) operating activities:		
Depreciation of fixed assets and amortization of intangibles	7,328	4,047
Amortization of unfavorable lease obligation and debt issuance costs	365	337
Amortization of debt discount	3,104	2,924
Loss on disposal of fixed assets	157	31
Loss on early extinguishment of debt	—	3,398
Stock-based compensation	17,199	8,227
Changes in operating assets and liabilities:		
Restricted cash	(196)	(452)
Accounts receivable, net	(5,927)	(5,419)
Inventories	(8,105)	(3,529)
Prepaid expenses and other assets	(696)	(638)
Accounts payable and accrued expenses	10,176	6,421
Royalty interest obligation	(641)	(336)
Other liabilities	2,142	735
Deferred revenue	7,070	(729)
Net cash provided by (used in) operating activities	12,458	(36,936)
Investing activities:		
Purchases of fixed assets	(14,777)	(9,368)
Purchases of short-term investments	(140,410)	(102,114)
Sales of short-term investments	68,016	54,564
Purchases of long-term investments	(24,465)	—
Payment of contingent consideration	(11,720)	(1,241)
Net cash used in investing activities	(123,356)	(58,159)
Financing activities:		
Proceeds from follow-on public offering, net	110,407	—
Proceeds from exercise of stock options and warrants	5,732	3,043
Proceeds from convertible senior notes	—	120,000
Repayment of debt	—	(27,500)
Payment of debt issuance and financing costs	—	(7,191)
Net cash provided by financing activities	116,139	88,352
Net increase (decrease) in cash and cash equivalents	5,241	(6,743)
Cash and cash equivalents, beginning of period	12,515	10,126
Cash and cash equivalents, end of period	$17,756	$3,383
Supplemental cash flow information:		
Cash paid for interest, including royalty interest obligation	$4,873	$3,157
Non-cash investing and financing activities:		
Equity component of convertible senior notes	$—	$24,936

See accompanying condensed notes to consolidated financial statements.

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PACIRA PHARMACEUTICALS, INC.
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1—DESCRIPTION OF BUSINESS

Pacira Pharmaceuticals, Inc. and its subsidiaries (collectively, the “Company” or “Pacira”) is a specialty pharmaceutical company focused on the development, commercialization and manufacture of proprietary pharmaceutical products, based on its proprietary DepoFoam® extended release drug delivery technology, for use in hospitals and ambulatory surgery centers. The Company’s lead product, EXPAREL®, which consists of bupivacaine encapsulated in DepoFoam, was approved by the United States Food and Drug Administration, or FDA, on October 28, 2011 and launched commercially in April 2012. DepoFoam is also the basis for the Company’s other FDA-approved commercial product, DepoCyt(e), which the Company manufactures for its commercial partners.

Pacira Pharmaceuticals, Inc. is the holding company for its California operating subsidiary of the same name, which was acquired from Skyepharma Holding, Inc., or Skyepharma, in March 2007, referred to herein as the Acquisition.

Pacira is subject to risks common to companies in similar industries and stages of development, including, but not limited to, competition from larger companies, reliance on revenue from few customers and products, reliance on a single manufacturing site, new technological innovations, dependence on key personnel, reliance on third-party service providers and sole source suppliers, protection of proprietary technology and compliance with government regulations.

NOTE 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation

These interim consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America, or GAAP, and in accordance with the rules and regulations of the Securities and Exchange Commission for interim reporting. Pursuant to these rules and regulations, certain information and footnote disclosures normally included in complete annual financial statements have been condensed or omitted. Therefore, these interim financial statements should be read in conjunction with the audited annual consolidated financial statements and notes thereto included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013.

The consolidated financial statements at September 30, 2014, and for the three and nine months ended September 30, 2014 and 2013, are unaudited, but include all adjustments (consisting of only normal recurring adjustments) which, in the opinion of management, are necessary to present fairly the financial information set forth herein in accordance with GAAP. The balance sheet as of December 31, 2013 has been derived from the audited consolidated financial statements included in the Company’s Annual Report on Form 10-K for the year ended December 31, 2013. The consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. Intercompany accounts and transactions have been eliminated in consolidation.

The results of operations for the interim periods are not necessarily indicative of results that may be expected for any other interim period or for the full year. The Company has incurred losses since inception.

Concentration of Major Customers

The Company’s customers are national and regional wholesalers of pharmaceutical products as well as commercial, collaborative and licensing partners. The Company sells EXPAREL through a drop-ship program under which orders are processed through wholesalers (including AmerisourceBergen Health Corporation, Cardinal Health, Inc. and McKesson Drug Company), but shipments of the product are sent directly to individual accounts, such as hospitals, ambulatory surgery centers and individual doctors. The table below includes the percentage of revenue comprised by the three largest customers (i.e., wholesalers or commercial partners) in each period presented:

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	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Largest customer	34%	32%	33%	33%
Second largest customer	29%	27%	29%	27%
Third largest customer	24%	18%	23%	17%
	87%	77%	85%	77%

No other individual customer accounted for more than 10% of the Company's revenues for these periods.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update 2014-09, Revenue from Contracts with Customers, which requires that an entity recognize the amount of revenue to which it expects to be entitled for the transfer of promised goods or services to its customers. In order to achieve this core principle, an entity should apply the following steps: (1) identify the contract(s) with a 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; and (5) recognize revenue when (or as) the entity satisfies a performance obligation. This update will replace existing revenue recognition guidance under GAAP when it becomes effective for the Company beginning January 1, 2017, with early adoption not permitted. The updated standard will permit the use of either the retrospective or cumulative effect transition method. The Company is currently evaluating the impact of this update on its consolidated financial statements.

NOTE 3—INVENTORIES

The components of inventories are as follows (in thousands):

	September 30, 2014	December 31, 2013
Raw materials	$8,944	$5,290
Work-in-process	10,398	6,321
Finished goods	4,320	3,946
Total	$23,662	$15,557

NOTE 4—FIXED ASSETS

Fixed assets, summarized by major category, consist of the following (in thousands):

	September 30, 2014	December 31, 2013
Machinery and laboratory equipment	$23,274	$19,570
Computer equipment and software	3,465	2,476
Office furniture and equipment	954	441
Leasehold improvements	26,210	24,852
Construction in progress	19,736	13,419
Total	73,639	60,758
Less: accumulated depreciation	(17,491)	(12,576)
Fixed assets, net	$56,148	$48,182

For the three months ended September 30, 2014 and 2013, depreciation expense was $2.3 and $0.8 million, respectively, and for the nine months ended September 30, 2014 and 2013, depreciation expense was $6.7 and $2.5

million, respectively. For the three months ended September 30, 2014 and 2013, the Company capitalized interest on the construction of its manufacturing sites of $0.1 and $0.3 million, respectively, and for the nine months ended September 30, 2014 and 2013, capitalized interest on the construction of its manufacturing sites was $0.3 and $0.9 million, respectively.

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NOTE 5—GOODWILL AND INTANGIBLE ASSETS

The Company's goodwill arose in April 2012 from a contingent milestone payment to Skyepharma in connection with the Acquisition. The Acquisition was accounted for under Statement of Financial Accounting Standards 141, Accounting for Business Combinations, which was the effective GAAP at the Acquisition date. In connection with the Acquisition, the Company agreed to certain earn-out payments based on a percentage of net sales of EXPAREL collected and certain other yet-to-be-developed products, as well as milestone payments for EXPAREL, as follows:

(i) $10.0 million upon the first commercial sale in the United States;
(ii) $4.0 million upon the first commercial sale in a major EU country (United Kingdom, France, Germany, Italy and Spain);
(iii) $8.0 million when annual net sales collected reach $100.0 million;
(iv) $8.0 million when annual net sales collected reach $250.0 million; and
(v) $32.0 million when annual net sales collected reach $500.0 million.

The first milestone was met in April 2012, resulting in a $10.0 million payment to Skyepharma. The Company recorded this payment net of a $2.0 million contingent consideration liability recognized at the time of the Acquisition, resulting in $8.0 million recorded as goodwill. In September 2014, the Company made an $8.0 million milestone payment to Skyepharma in connection with achieving $100.0 million of EXPAREL net sales collected. For purposes of meeting future milestone payments, annual net sales are measured on a rolling quarterly basis. Cumulatively through September 30, 2014, the Company has recorded an additional $6.1 million as goodwill for earn-out payments which are based on a percentage of net sales of EXPAREL collected. Any remaining earn-out payments will also be treated as additional costs of the Acquisition and, therefore, recorded as goodwill if and when each contingency is resolved.

The change in the carrying value of goodwill is summarized as follows (in thousands):

	Carrying Value
Balance at December 31, 2013	$10,328
Milestone payments triggered by collections of net sales of EXPAREL	8,000
Percentage payments on collections of net sales of EXPAREL	3,720
Balance at September 30, 2014	$22,048

Intangible assets, net, consist of core technology, developed technology and trademarks and trade names acquired in the Acquisition and are summarized as follows (in thousands):

September 30, 2014	Gross Carrying Value	Accumulated Amortization	Intangible Assets, Net	Estimated Useful Life
Amortizable intangible assets:				
Core technology	$2,900	$(2,417)	$483	9 Years
Developed technology	11,700	(11,700)	—	7 Years
Trademarks and trade names	400	(400)	—	7 Years
Total intangible assets	$15,000	$(14,517)	$483	

December 31, 2013	Gross Carrying Value	Accumulated Amortization	Intangible Assets, Net	Estimated Useful Life
Amortizable intangible assets:				
Core technology	$2,900	$(2,175)	$725	9 Years
Developed technology	11,700	(11,282)	418	7 Years
Trademarks and trade names	400	(386)	14	7 Years

Total intangible assets	$15,000	$(13,843)	$1,157

Amortization expense for intangibles was $0.1 million for the three months ended September 30, 2014 and $0.5 million for the three months ended September 30, 2013. Amortization expense for intangibles was $0.7 million for the nine months ended September 30, 2014 and $1.5 million for the nine months ended September 30, 2013. The approximate

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amortization expense for intangibles, all of which are subject to amortization on a straight-line basis, is as follows (in thousands):

Year	Total
2014 (remaining three months)	$80
2015	322
2016	81
Total	$483

NOTE 6—DEBT

The composition of the Company's debt and financing obligations is as follows (in thousands):

	September 30, 2014	December 31, 2013
Debt:		
Convertible senior notes	$120,000	$120,000
Discount on debt	(17,935)	(21,039)
Total debt, net of debt discount	102,065	98,961
Royalty interest obligation	602	1,246
Total debt and financing obligations	$102,667	$100,207

On January 23, 2013, the Company completed a private placement of $120.0 million in aggregate principal amount of 3.25% convertible senior notes due 2019, or Notes, and entered into an indenture agreement, or Indenture, with respect to the Notes. The Notes accrue interest at a fixed rate of 3.25% per year, payable semiannually in arrears on February 1 and August 1 of each year. The Notes mature on February 1, 2019.

The net proceeds from the offering of the Notes were $115.3 million after deducting the initial purchasers' discounts and commissions and the offering expenses payable by the Company. The net proceeds from the Notes were used by the Company to repay the entire balance of the Company's then existing credit facility. In connection with the extinguishment of the credit facility, the Company prepaid the remaining principal amount of $27.5 million, a $1.7 million end of term fee, a $0.8 million prepayment penalty and $0.2 million of accrued interest. The Company recorded a loss on extinguishment of debt of $3.4 million, comprised of the prepayment penalty, the remaining unamortized debt issuance costs and the end of term fee.

On or after August 1, 2018, until the close of business on the second scheduled trading day immediately preceding February 1, 2019, holders may convert their Notes at any time. Upon conversion, holders will receive cash up to the principal amount of the Notes and, with respect to any excess conversion value, cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at the Company's option. The initial conversion rate for the Notes was 40.2945 shares of common stock per $1,000 principal amount, which is equivalent to an initial conversion price of approximately $24.82 per share of the Company's common stock. The conversion rate will be subject to adjustment in some events but will not be adjusted for any accrued and unpaid interest.

Holders may convert their Notes prior to August 1, 2018, only if certain circumstances are met. One such circumstance which would allow conversion of the Notes during a calendar quarter would be if during the previous calendar quarter, the sales price of the Company's common stock was greater than 130% of the conversion price then applicable for at least 20 out of the last 30 consecutive trading days of the quarter. During the quarter ended September 30, 2014, this condition for conversion was met. As a result, the Notes are classified as a current obligation and will be convertible until December 31, 2014. As of September 30, 2014, the Notes had a market price of $3,908 per $1,000 principal amount, compared to an estimated conversion value of $3,905. Since the market price of the

Notes is currently above the estimated conversion value, the Company does not anticipate that holders will elect to convert their Notes. Additionally, in the event of conversion, holders would forgo all future interest payments, any unpaid accrued interest and the possibility of further stock price appreciation. If conversion requests are received, the settlement of the Notes will be paid pursuant to the terms of the Indenture, which state that the principal must be settled in cash. In the event that all of the Notes are converted, the Company would be required to repay the $120.0 million in principal value and approximately $349 million of cash or issue approximately 3.6 million shares of

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its common stock (or a combination of cash and shares of its common stock) to settle the conversion premium as of September 30, 2014, causing dilution to the Company’s shareholders.

While the Notes are classified in the Company’s consolidated balance sheets at September 30, 2014 and December 31, 2013 as a current obligation, the future convertibility and resulting balance sheet classification of this liability will be monitored at each quarterly reporting date and will be analyzed dependent upon market prices of the Company’s common stock during the prescribed measurement periods. In the event that the holders of the Notes continue to have the election to convert the Notes at any time during the prescribed measurement period, the Notes will continue to be considered a current obligation and classified as such. Prior to February 1, 2018, in the event that none of the conversion conditions are satisfied, the Notes would be reclassified as a long-term liability.

Under Accounting Standards Codification 470-20, Debt with Conversion and Other Options, an entity must separately account for the liability and equity components of convertible debt instruments (such as the Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer’s economic interest cost. The equity component is recorded in additional paid-in capital in the consolidated balance sheet at the issuance date and that equity component is treated as a discount on the liability component of the Notes. The initial carrying value of the liability component of $95.1 million was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The carrying value of the equity component, representing the conversion option, was determined by deducting the fair value of the liability component from the par value of the Notes. The equity component is not re-measured as long as it continues to meet the conditions for equity classification.

The Company allocated the total transaction costs of $4.7 million related to the issuance of the Notes to the liability and equity components of the Notes based on their relative values. Transaction costs attributable to the liability component are amortized to interest expense over the six-year term of the Notes, and transaction costs attributable to the equity component are netted with the equity component in stockholders’ equity.

The following table sets forth the total interest expense recognized in relation to the Notes (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Contractual interest expense	$975	$975	$2,925	$2,687
Amortization of debt issuance costs	155	155	465	429
Amortization of debt discount	1,035	1,035	3,104	2,863
Total	$2,165	$2,165	$6,494	$5,979
Effective interest rate	7.22 %	7.22 %	7.22 %	7.22 %

NOTE 7—FINANCIAL INSTRUMENTS

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or be paid to transfer a liability in the principal or most advantageous market in an orderly transaction. To increase consistency and comparability in fair value measurements, the FASB established a three-level hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels are:

- Level 1—Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

- Level 2—Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.
- Level 3—Unobservable inputs that are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

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The carrying value of financial instruments including cash and cash equivalents, restricted cash, accounts receivable and accounts payable approximate their respective fair values due to the short-term nature of these items. The fair value of the Company's Notes at September 30, 2014 is calculated utilizing market quotations from an over-the-counter trading market for these Notes (Level 2). The carrying amount and fair value of the Notes are as follows (in thousands):

Financial Liabilities Carried at Historical Cost	Carrying Value	Fair Value Measurements Using Level 1	Level 2	Level 3
September 30, 2014				
Convertible senior notes *	$102,065	$—	$468,972	$—

* The fair value of the Notes was based on the Company's closing stock price of $96.92 per share at September 30, 2014 compared to a conversion price of $24.82 per share which, if converted, would result in an approximate conversion premium of 3.6 million shares or $349 million of cash. The maximum conversion premium that can be due on the Notes is 4.8 million shares, which assumes no increases in the conversion rate for certain corporate events.

Short-term investments consist of asset-backed securities collateralized by credit card receivables, investment grade commercial paper and corporate bonds with initial maturities of greater than three months at the date of purchase, but less than one year. Long-term investments consist of corporate bonds with initial maturities greater than one year at the date of purchase. The net unrealized gains from the Company's short-term and long-term investments are reported in other comprehensive income (loss). At September 30, 2014, all of the Company's short-term and long-term investments are classified as available for sale investments and are determined to be Level 2 instruments, which are measured at fair value using standard industry models with observable inputs. The fair value of the commercial paper is measured based on a standard industry model that uses the three-month Treasury bill rate as an observable input. The fair value of the asset-backed securities and corporate bonds is principally measured or corroborated by trade data for identical issues in which related trading activity is not sufficiently frequent to be considered a Level 1 input or that of comparable securities. At September 30, 2014, the Company's short-term investments were rated A or better by Standard & Poor's and had maturities ranging from 116 to 365 days from the date of purchase. The Company's long-term investments were also rated A or better by Standard & Poor's and had maturities ranging from 20 to 37 months from the date of purchase.

The following summarizes the Company's investments at September 30, 2014 and December 31, 2013 (in thousands):

September 30, 2014	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Level 2)
Debt securities:				
Short-term:				
Asset-backed securities	$15,013	$—	$(5)	$15,008
Commercial paper	5,744	6	—	5,750
Corporate bonds	111,269	6	(61)	111,214
Subtotal	132,026	12	(66)	131,972
Long-term:				
Corporate bonds	24,465	70	(8)	24,527
Total	$156,491	$82	$(74)	$156,499

December 31, 2013	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Level 2)
Debt securities:				
Commercial paper	$17,986	$11	$—	$17,997
Corporate bonds	30,808	1	(7)	30,802
Asset-backed securities	10,838	1	(1)	10,838

Total	$59,632	$13	$(8)	$59,637

Certain assets and liabilities are measured at fair value on a nonrecurring basis, including assets and liabilities acquired in a business combination and long-lived assets, which would be recognized at fair value if deemed to be impaired or if reclassified as assets held for sale. The fair value in these instances would be determined using Level 3 inputs. At September 30, 2014, the Company had no financial instruments that were measured using Level 3 inputs.

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Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, short-term investments, long-term investments and accounts receivable. The Company maintains its cash and cash equivalents with high-credit quality financial institutions. At times, such amounts may exceed federally-insured limits. The Company performs ongoing credit evaluations of its customers as warranted and generally does not require collateral.

As of September 30, 2014, three customers each accounted for over 10% of the Company's accounts receivable, at 36%, 26% and 25%, respectively (for a definition of the Company's customers, see Note 2, Summary of Significant Accounting Policies, under concentration of major customers). At December 31, 2013, three customers each accounted for over 10% of the Company's accounts receivable, at 31%, 31% and 20%, respectively. Revenues are primarily derived from major wholesalers and pharmaceutical companies that generally have significant cash resources. Allowances for doubtful accounts receivable are maintained based on historical payment patterns, aging of accounts receivable and actual write-off history. As of September 30, 2014 and December 31, 2013, no allowances for doubtful accounts were deemed necessary by the Company on its accounts receivable.

NOTE 8—STOCK PLANS

Stock-Based Compensation

The Company recognized stock-based compensation expense in its consolidated statements of operations as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Cost of goods sold	$1,187	$414	$2,323	$1,041
Research and development	1,823	1,660	5,537	3,124
Selling, general and administrative	4,676	1,703	9,339	4,062
Total	$7,686	$3,777	$17,199	$8,227
Stock-based compensation from:				
Stock options	$7,579	$3,777	$17,092	$8,227
Employee stock purchase plan	107	—	107	—
Total	$7,686	$3,777	$17,199	$8,227

In September 2013, in connection with the resignations of two directors, the Board of Directors of the Company approved amendments to the stock options held by each of the departing directors. The amendments (i) accelerated the vesting of the unvested portion of certain options, and (ii) extended the period during which each departing director could exercise all vested options to September 30, 2015. As a result of these amendments, the Company recognized an additional $0.2 million in stock-based compensation expense.

Stock Incentive Plans

In April 2014, the Company's Board of Directors adopted the 2014 Inducement Plan which authorized 175,000 shares of common stock to be granted as equity awards to new employees. In June 2014, the Company's Board of Directors and stockholders approved an amendment to the 2011 Stock Incentive Plan, now known as the Amended and Restated 2011 Stock Incentive Plan. Under the amendment, an additional 2,750,000 shares of common stock were authorized for issuance as equity awards under the plan. The Amended and Restated 2011 Stock Incentive Plan became effective on June 3, 2014.

2014 Employee Stock Purchase Plan

In April 2014, the Company's Board of Directors adopted the 2014 Employee Stock Purchase Plan, or ESPP, which was subsequently approved by the Company's stockholders and became effective on June 3, 2014. The purpose of the ESPP is to provide a vehicle for eligible employees to purchase shares of the Company's common stock at a discounted price and to help retain and motivate current employees as well as attract new talent. Under the ESPP, up to 500,000 shares of common stock may be sold under the plan which expires on June 3, 2024. The ESPP is intended to qualify as an "employee stock

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purchase plan" within the meaning of Section 423 of the Internal Revenue Code. The initial offering period of the ESPP began on September 1, 2014 and will end on December 31, 2014. Thereafter, six-month offering periods will begin on January 1st and July 1st of each year. During an offering period, eligible employees will have the opportunity to elect to purchase shares of the Company's common stock on the purchase dates of June 30 and December 31. The per share purchase price will be equal to the lesser of 85% of the fair market value of the Company's common stock on either the offering date or the purchase date. No shares were purchased during the three months ended September 30, 2014 as the current offering period ends on December 31, 2014.

The following tables contain information about the Company's stock plans at September 30, 2014:

Stock Incentive Plan	Awards Reserved for Issuance	Awards Issued	Awards Available for Grant
2007 Stock Incentive Plan	2,022,837	2,022,837	—
Amended and Restated 2011 Stock Incentive Plan	5,931,700	4,365,865	1,565,835
2014 Inducement Plan	175,000	77,000	98,000
	8,129,537	6,465,702	1,663,835

Employee Stock Purchase Plan	Shares Reserved for Purchase	Shares Purchased	Shares Available for Purchase
2014 Employee Stock Purchase Plan	500,000	—	500,000

The following table summarizes the Company's stock option activity and related information for the nine months ended September 30, 2014:

Stock Options	Number of Shares	Weighted Average Exercise Price
Outstanding at December 31, 2013	3,840,038	$13.50
Granted	1,559,525	79.00
Exercised	(511,186)	11.22
Forfeited	(131,577)	40.98
Expired	(561)	21.70
Outstanding at September 30, 2014	4,756,239	34.46

NOTE 9—STOCKHOLDERS' EQUITY

Accumulated Other Comprehensive Income

The following table illustrates the changes in the balances of the Company's accumulated other comprehensive income for the periods presented (in thousands):

	Nine Months Ended September 30,	
	2014	2013
Net unrealized gains (losses) from available for sale investments:		
Balance at beginning of period	$5	$27
Other comprehensive gain (loss) before reclassifications	3	(10)
Amounts reclassified from accumulated other comprehensive income	—	—
Balance at end of period	$8	$17

Underwritten Public Offering

In April 2014, the Company completed a follow-on underwritten public offering of 1,840,000 shares of common stock, including the shares issued to cover the underwriters' overallotment option, at $64.00 per share. The Company received proceeds of $110.4 million as a result of the offering, net of underwriters' fees and related expenses.

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NOTE 10—NET INCOME (LOSS) PER SHARE

Basic net income (loss) per share is calculated by dividing the net income (loss) attributable to common shares by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is calculated by dividing the net income (loss) attributable to common shares by the weighted average number of shares outstanding plus dilutive potential common stock outstanding during the period. Potential common shares include the shares of common stock issuable upon the exercise of outstanding stock options, warrants and the purchase of shares from the employee stock purchase plan (using the treasury stock method) as well as the conversion of the excess conversion value on the Notes. As discussed in Note 6, Debt, the Company must settle the principal of the Notes in cash upon conversion, and it may settle any conversion premium in either cash or stock at the Company's discretion. For purposes of calculating the dilutive impact, it is presumed that the conversion premium will be settled in common stock.

Potential common shares are excluded from the diluted net income (loss) per share computation to the extent that they would be antidilutive. Because the Company reported a net loss for all periods presented, no potentially dilutive securities have been included in the computation of diluted net loss per share.

The following table sets forth the computation of basic and diluted loss per share for the three and nine months ended September 30, 2014 and 2013 (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Numerator:				
Net loss	$(3,004)	$(14,784)	$(19,518)	$(51,953)
Denominator:				
Weighted average shares of common stock outstanding	35,943	33,360	35,039	33,051
Net loss per share:				
Basic and diluted net loss per share of common stock	$(0.08)	$(0.44)	$(0.56)	$(1.57)

For the three month periods ended September 30, 2014 and 2013, the number of potential common shares which were excluded from the diluted net loss per share calculation using the treasury stock method was 5.6 million and 3.7 million, respectively. For the nine month periods ended September 30, 2014 and 2013, the number of potential common shares which were excluded from the diluted net loss per share calculation using the treasury stock method was 5.3 million and 2.8 million, respectively.

The following outstanding stock options, conversion premium on the Notes, warrants and employee stock purchase plan units which could dilute basic earnings per share in the future are as follows (in thousands):

	Three Months Ended September 30, 2014	Nine Months Ended September 30, 2014
Weighted average number of stock options outstanding	4,842	4,285
Conversion premium on the Notes	3,602	3,311
Weighted average number of warrants outstanding	17	40
Employee stock purchase plan	6	2
Total	8,467	7,638

NOTE 11—TAXES

Income Tax Benefit

For the nine months ended September 30, 2014, there was no provision for income taxes since the Company has incurred net operating losses since inception.

During the nine months ended September 30, 2013, the Company received $0.4 million from the sale of unused net operating losses through the State of New Jersey's Economic Development Authority Technology Business Tax Certificate Transfer Program. As a result, the Company recorded an income tax benefit by reversing the valuation allowance for the related

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net deferred tax assets. The Company continues to maintain a full valuation allowance on its remaining net deferred tax assets because there is significant doubt regarding the Company's ability to utilize such net deferred tax assets.

NOTE 12—COMMITMENTS AND CONTINGENCIES

Leases

The Company leases research and development, manufacturing and warehouse facilities in San Diego, California and its corporate headquarters in Parsippany, New Jersey. The three leases in San Diego run through August 2020. In March 2014, the Company amended the lease for its corporate headquarters which increased the size of the leased premises and extended the lease term through March 2028.

As of September 30, 2014, annual aggregate minimum payments due under the Company's lease obligations are as follows (in thousands):
Year