LIGAND PHARMACEUTICALS INC
Form 10-Q
November 08, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

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x Quarterly Report Pursuant to Section 13 or 15 (d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2013
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: 001-33093

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)	92037 (Zip Code)

(858) 550-7500
(Registrant's Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o
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 x No o
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 Filero	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). Yes o No x
As of October 29, 2013, the registrant had 20,410,247 shares of common stock outstanding.

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LIGAND PHARMACEUTICALS INCORPORATED
QUARTERLY REPORT

FORM 10-Q

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PART I. FINANCIAL INFORMATION
ITEM 1. FINANCIAL STATEMENTS
LIGAND PHARMACEUTICALS INCORPORATED
CONDENSED CONSOLIDATED BALANCE SHEETS
(Unaudited)
(in thousands, except share data)

	September 30, 2013	December 31, 2012
ASSETS		
Current assets:		
Cash and cash equivalents	$3,271	$12,381
Accounts receivable	5,507	4,589
Inventory	1,838	1,697
Other current assets	1,512	829
Current portion of co-promote termination payments receivable	4,507	4,327
Total current assets	16,635	23,823
Restricted cash and investments	4,968	2,767
Property and equipment, net	834	788
Deferred income taxes	8	8
Intangible assets, net	53,692	55,912
Goodwill	12,238	12,238
Commercial license rights	4,571	—
Long-term portion of co-promote termination payments receivable	8,387	8,207
Other assets	344	517
Total assets	$101,677	$104,260
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$4,304	$5,854
Accrued liabilities	4,619	4,961
Current portion of contingent liabilities	1,879	356
Current portion of deferred income taxes	1,581	1,581
Current portion of note payable	12,375	14,835
Current portion of co-promote termination liability	4,507	4,327
Current portion of lease exit obligations	2,860	3,039
Current portion of deferred revenue	336	486
Total current liabilities	32,461	35,439
Long-term portion of note payable	—	13,443
Long-term portion of co-promote termination liability	8,387	8,207
Long-term portion of deferred revenue, net	2,085	2,369
Long-term portion of lease exit obligations	3,725	5,963
Deferred income taxes	962	725
Long-term portion of contingent liabilities	8,552	10,543
Other long-term liabilities	690	1,086
Total liabilities	56,862	77,775
Commitments and Contingencies		
Stockholders' equity:		
Common stock, $0.001 par value; 33,333,333 shares authorized; 21,528,284 and 21,278,606 shares issued and outstanding at September 30, 2013 and December 31, 2012, respectively	22	21

Additional paid-in capital	758,080	751,503
Accumulated other comprehensive income	2,201	—
Accumulated deficit	(673,208)	(682,759)
Treasury stock, at cost; 1,118,222 shares at September 30, 2013 and December 31, 2012, respectively	(42,280)	(42,280)
Total stockholders' equity	44,815	26,485
Total liabilities and stockholders' equity	$101,677	$104,260

See accompanying notes.

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LIGAND PHARMACEUTICALS INCORPORATED
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(in thousands, except share data)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2013	2012	2013	2012
Revenues:				
Royalties	$5,724	$3,213	$16,466	$9,256
Material sales	6,728	1,818	12,260	4,150
Collaborative research and development and other revenues	553	1,344	5,511	4,347
Total revenues	13,005	6,375	34,237	17,753
Operating costs and expenses:				
Cost of sales	2,538	683	4,416	1,273
Research and development	2,414	2,647	6,900	8,315
General and administrative	4,756	4,306	13,564	11,579
Lease exit and termination costs	227	164	359	666
Write-off of in-process research and development	—	—	480	—
Total operating costs and expenses	9,935	7,800	25,719	21,833
Income (loss) from operations	3,070	(1,425)	8,518	(4,080)
Other (expense) income:				
Interest expense, net	(394)	(735)	(1,755)	(2,198)
(Increase) decrease in contingent liabilities	(532)	2,093	368	1,191
Other, net	(119)	15	69	272
Total other (expense) income, net	(1,045)	1,373	(1,318)	(735)
Income (loss) before income taxes	2,025	(52)	7,200	(4,815)
Income tax expense	(60)	(142)	(237)	(445)
Income (loss) from continuing operations	1,965	(194)	6,963	(5,260)
Discontinued operations:				
Gain on sale of Avinza Product Line before income taxes	—	—	2,588	3,656
Income tax benefit on discontinued operations	—	—	—	14
Income from discontinued operations	—	—	2,588	3,670
Net income (loss):	$1,965	$(194)	$9,551	$(1,590)
Basic per share amounts:				
Income (loss) from continuing operations	$0.10	$(0.01)	$0.34	$(0.27)
Income from discontinued operations	—	—	0.13	0.19
Net income (loss)	$0.10	$(0.01)	$0.47	$(0.08)
Diluted per share amounts:				
Income (loss) from continuing operations	$0.09	$(0.01)	$0.33	$(0.27)
Income from discontinued operations	—	—	0.13	0.19
Net income (loss)	$0.09	$(0.01)	$0.46	$(0.08)
Weighted average number of common shares-basic	20,357,558	19,917,676	20,268,261	19,791,793
Weighted average number of common shares-diluted	20,843,742	19,917,676	20,562,622	19,791,793

See accompanying notes.

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

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Net income (loss)	$1,965	$(194)	$9,551	$(1,590)
Unrealized net gain on available-for-sale securities, net of tax of $0	806	—	2,201	—
Comprehensive income (loss)	$2,771	$(194)	$11,752	$(1,590)

See accompanying notes.

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

	Nine Months Ended September 30,	
	2013	2012
Operating activities		
Net income (loss)	$9,551	$(1,590)
Less: gain from discontinued operations	2,588	3,670
Income (loss) from continuing operations	6,963	(5,260)
Adjustments to reconcile net income (loss) to net cash used in operating activities:		
Non-cash change in estimated fair value of contingent liabilities	(368)	(1,191)
Write-off of in-process research and development	480	—
Depreciation and amortization	2,007	1,978
Share-based compensation	4,149	3,116
Deferred income taxes	237	446
Accretion of note payable	321	362
Other	(13)	(14)
Changes in operating assets and liabilities:		
Accounts receivable	(918)	3,953
Inventory	86	(798)
Other current assets	(683)	329
Other long-term assets	173	322
Accounts payable and accrued liabilities	(2,306)	(3,009)
Other liabilities	(396)	15
Deferred revenue	(434)	(1,710)
Net cash provided by (used in) operating activities of continuing operations	9,298	(1,461)
Net cash used in operating activities of discontinued operations	(642)	(550)
Net cash provided by (used in) operating activities	8,656	(2,011)
Investing activities		
Purchase of commercial license rights	(3,571)	—
Payments to CVR holders and former license holders	(100)	(8,049)
Purchases of property and equipment	(263)	(633)
Proceeds from sale of property and equipment	3	17
Proceeds from sale of short-term investments	—	10,000
Other	(40)	—
Net cash (used in) provided by investing activities	(3,971)	1,335
Financing activities		
Proceeds from issuance of debt	—	7,500
Repayment of debt	(16,224)	(10,000)
Net proceeds from issuance of common stock	—	2,647
Net proceeds from employee stock purchase plan	84	68
Net proceeds from stock option exercises	2,345	466
Net cash (used in) provided by financing activities	(13,795)	681
Net (decrease) increase in cash and cash equivalents	(9,110)	5
Cash and cash equivalents at beginning of period	12,381	7,041
Cash and cash equivalents at end of period	$3,271	$7,046
Supplemental Disclosure of cash flow information		

Interest paid	$1,566	$1,854
Taxes paid	5	15
Supplemental schedule of non-cash activity		
Liability for commercial license rights	$1,000	$—
Accrued inventory purchases	227	449
Unrealized gain on AFS investments	2,201	—

See accompanying notes.

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

1. Basis of Presentation

Ligand Pharmaceuticals Incorporated, a Delaware corporation (the "Company" or "Ligand") is a biopharmaceutical company with a business model that is based upon the concept of developing or acquiring revenue generating assets and coupling them to a lean corporate cost structure. By diversifying the portfolio of assets across numerous technology types, therapeutic areas, drug targets, and industry partners, the Company offers investors an opportunity to invest in the increasingly complicated and unpredictable pharmaceutical industry. These therapies address the unmet medical needs of patients for a broad spectrum of diseases including hepatitis, multiple myeloma, muscle wasting, Alzheimer's disease, dyslipidemia, diabetes, anemia, asthma, FSGS and osteoporosis. Ligand has established multiple alliances with the world's leading pharmaceutical companies including GlaxoSmithKline, Onyx Pharmaceuticals (recently acquired by Amgen), Merck, Pfizer, Baxter International, Bristol-Myers Squibb, Lundbeck Inc., and Spectrum Pharmaceuticals, Inc. The Company's principal market is the United States. The Company sold its Oncology Product Line ("Oncology") and Avinza Product Line ("Avinza") on October 25, 2006 and February 26, 2007, respectively. The operating results for Oncology and Avinza have been presented in the accompanying consolidated financial statements as "Discontinued Operations."

The Company has incurred significant losses since its inception. As of September 30, 2013, the Company's accumulated deficit was approximately $673.2 million and the Company had negative working capital of approximately $15.8 million. Management believes that cash flows from operations will improve due to Captisol® sales, an increase in revenues driven primarily from continued increases in Promacta® and Kyprolis® sales, and also from anticipated new license and milestone revenues. In the event revenues and operating cash flows are not meeting expectations, management plans to reduce discretionary expenses. However, it is possible that the Company may be required to seek additional financing. There can be no assurance that additional financing will be available on terms acceptable to management, or at all. Management believes its currently available cash and cash equivalents as well as its current and future royalty, license and milestone revenues will be sufficient to satisfy its anticipated operating and capital requirements through at least the next 12 months. The Company's future operating and capital requirements will depend on many factors, including, but not limited to: the pace of scientific progress in its research and development programs; the potential success of these programs; the scope and results of preclinical testing and clinical trials; the time and costs involved in obtaining regulatory approvals; the costs involved in preparing, filing, prosecuting, maintaining and enforcing patent claims; competing technological and market developments; the amount of royalties on sales of the commercial products of its partners; the efforts of its collaborative partners; obligations under its operating lease agreements; costs associated with future acquisitions and the capital requirements of any companies the Company may acquire in the future. The ability of the Company to achieve its operational targets is dependent upon the Company's ability to further implement its business plan and generate sufficient operating cash flow.

Principles of Consolidation

The accompanying consolidated financial statements include Ligand and its wholly owned subsidiaries, Ligand JVR, Allergan Ligand Retinoid Therapeutics, Seragen, Inc. ("Seragen"), Pharmacopeia, Inc. ("Pharmacopeia"), Neurogen Corporation ("Neurogen"), Metabasis Therapeutics, Inc. ("Metabasis"), CyDex Pharmaceuticals, Inc. ("CyDex") and Nexus VI LLC ("Nexus"). 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, 2013 and for the three and nine months ended September 30, 2013 and 2012 have been prepared in accordance with accounting principles generally accepted in the United States of America for interim financial information. Accordingly, they do not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for annual financial statements. The Company’s condensed consolidated balance sheet at December 31, 2012 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by accounting principles generally accepted in the United States of America for complete financial statements. 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, 2013 are not necessarily indicative of the results that may be expected for the year ending December 31, 2013. 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, 2012.

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Use of Estimates

The preparation of condensed consolidated financial statements in conformity with generally accepted accounting principles requires the use of estimates and assumptions that affect the reported amounts of assets and liabilities, including disclosure of contingent assets and liabilities, at the date of the condensed consolidated financial statements, and the reported amounts of revenue and expenses during the reporting period. The Company's critical accounting policies are those that are both most important to the Company's financial condition and results of operations and require the most difficult, subjective or complex judgments on the part of management in their application, often as a result of the need to make estimates about the effect of matters that are inherently uncertain. Because of the uncertainty of factors surrounding the estimates or judgments used in the preparation of the consolidated financial statements, actual results may materially vary from these estimates.

Reclassifications

Certain reclassifications have been made to the previously issued statement of operations for the three and nine months ended September 30, 2012 for comparability purposes. These reclassifications had no effect on the reported net income, stockholders' equity, and operating cash flows as previously reported.

Earnings (Loss) Per Share

Basic earnings (loss) per share is calculated by dividing net income or loss by the weighted average number of common shares and vested restricted stock units outstanding. Diluted earnings per share is computed by dividing net income or loss by the weighted average number of common shares and vested restricted stock units outstanding and the weighted average number of dilutive common stock equivalents, including stock options and non-vested restricted stock units. Common stock equivalents are only included in the diluted earnings per share calculation when their effect is dilutive. The total number of potential common shares excluded from the computation of diluted loss per share because their inclusion would have been anti-dilutive was 0.9 million and 1.3 million, at September 30, 2013 and 2012, respectively.

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

	Three months ended September 30,		Nine months ended September 30,	
	2013	2012	2013	2012
Net income (loss) from continuing operations	$1,965	$(194)	$6,963	$(5,260)
Net income from discontinued operations	—	—	2,588	3,670
Net income (loss)	$1,965	$(194)	$9,551	$(1,590)
Shares used to compute basic income (loss) per share	20,357,558	19,917,676	20,268,261	19,791,793
Dilutive potential common shares:				
Restricted stock	77,609	—	62,051	—
Stock options	408,575	—	232,310	—
Shares used to compute diluted income (loss) per share	20,843,742	19,917,676	20,562,622	19,791,793
Basic per share amounts:				
Income (loss) from continuing operations	$0.10	$(0.01)	$0.34	$(0.27)
Income from discontinued operations	—	—	0.13	0.19
Net income (loss)	$0.10	$(0.01)	$0.47	$(0.08)

Diluted per share amounts:				
Income (loss) from continuing operations	$0.09	$(0.01)	$0.33	$(0.27)
Income from discontinued operations	—	—	0.13	0.19
Net income (loss)	$0.09	$(0.01)	$0.46	$(0.08)

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Cash, Cash Equivalents and Short-term Investments

Cash and cash equivalents consist of cash and highly liquid securities with maturities at the date of acquisition of three months or less. Non-restricted equity and debt securities with a maturity of more than three months are considered short-term investments.

Restricted Cash and Investments

Restricted cash and investments consist of certificates of deposit held with a financial institution as collateral under a facility lease including third-party service provider arrangements and available-for-sale securities received by the Company as a result of milestone payments from a licensee. The fair value of the Company's available-for-sale securities are determined using quoted market prices in active markets and are discounted based on trading restrictions.

The following table summarizes the various investment categories at September 30, 2013 and December 31, 2012 (in thousands):

	Cost	Gross unrealized gains	Gross unrealized losses	Estimated fair value
September 30, 2013				
Available-for-sale securities	$1,426	$2,201	$—	$3,627
Certificates of deposit - restricted	1,341	—	—	1,341
	$2,767	$2,201	$—	$4,968
December 31, 2012				
Available-for-sale securities	$1,426	$—	$—	$1,426
Certificates of deposit-restricted	1,341	—	—	1,341
	$2,767	$—	$—	$2,767

Concentrations of Credit Risk

Financial instruments that potentially subject the Company to significant concentrations of credit risk consist primarily of cash equivalents, investments and accounts receivable.

The Company invests its excess cash principally in United States government debt securities, investment grade corporate debt securities and certificates of deposit. The Company has 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. The Company has not experienced any significant losses on its cash equivalents, short-term investments or restricted investments for the periods ending September 30, 2013 and December 31, 2012.

As of September 30, 2013 and December 31, 2012, cash deposits held at financial institutions in excess of FDIC insured amounts of $250,000 were approximately $2.8 million and $11.9 million, respectively.

Accounts receivable from two customers was 48% and 39% of total accounts receivable at September 30, 2013. Accounts receivable from two customers was 53% and 35% of total accounts receivable at December 31, 2012.

The Company currently obtains Captisol from a sole-source supplier. If this supplier was not able to supply the requested amounts of Captisol, the Company would be unable to continue to derive revenues from the sale of Captisol

until it obtained an alternative source, which might take a considerable length of time.

Inventory

Inventory is stated at the lower of cost or market. The Company determines cost using the first-in, first-out method. The Company analyzes its inventory levels periodically and writes down inventory 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.

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Property and Equipment

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

	September 30, 2013	December 31, 2012
Lab and office equipment	$4,541	$4,374
Leasehold improvements	213	145
Computer equipment and software	1,025	1,150
	5,779	5,669
Less accumulated depreciation and amortization	(4,945)	(4,881)
	$834	$788

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 their estimated useful lives or their related lease term, whichever is shorter. Depreciation expense of $0.1 million and $0.2 million was recognized for the three and nine months ended September 30, 2013 and 2012, respectively.

Other Current Assets

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

	September 30, 2013	December 31, 2012
Prepaid expenses	$1,393	$801
Other receivables	119	28
	$1,512	$829

Goodwill and Other Identifiable Intangible Assets

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

	September 30, 2013	December 31, 2012
Indefinite lived intangible assets		
Acquired in-process research and development	$12,556	$13,036
Goodwill	12,238	12,238
Definite lived intangible assets		
Complete technology	15,267	15,227
Trade name	2,642	2,642
Customer relationships	29,600	29,600
	47,509	47,469
Accumulated amortization	(6,373)	(4,593)
Total goodwill and other identifiable intangible assets, net	$65,930	$68,150

The Company accounts for goodwill and other intangible assets in accordance with Accounting Standards Codification Topic 350-Intangibles-Goodwill and Other ("ASC 350") which, among other things, establishes

standards for goodwill acquired in a business combination, eliminates the amortization of goodwill and requires the carrying value of goodwill and certain non-amortizing intangibles to be evaluated for impairment on an annual basis. The Company considers its market capitalization and

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the carrying value of its assets and liabilities, including goodwill, when performing its goodwill impairment test. If the carrying value of the assets and liabilities, including goodwill, were to exceed the Company's estimation of the fair value, the Company would record an impairment charge in an amount equal to the excess of the carrying value of goodwill over the implied fair value of the goodwill. The Company performs an evaluation of goodwill and other intangibles as of December 31 of each year, absent any indicators of earlier impairment, to ensure that impairment charges, if applicable, are reflected in our financial results before December 31 of each year. When it is determined that impairment has occurred, a charge to operations is recorded. Goodwill and other intangible asset balances are included in the identifiable assets of the business segment to which they have been assigned. Any goodwill impairment, as well as the amortization of other purchased intangible assets, is charged against the respective business segments' operating income.

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 the three and nine months ended September 30, 2013 and 2012, respectively. Estimated amortization expense for the year ending December 31, 2013 through 2017 is $2.4 million per year.

Acquired In-Process Research and Development

Intangible assets related to acquired in-process research and development (IPR&D) are considered to be indefinite-lived until the completion or abandonment of the associated research and development efforts. During the period the assets are considered to be indefinite-lived, they will not be amortized but will be tested for impairment on an annual basis and between annual tests if the Company becomes aware of any events occurring or changes in circumstances that would indicate a reduction in the fair value of the IPR&D projects below their respective carrying amounts. If and when development is complete, which generally occurs if and when regulatory approval to market a product is obtained, the associated assets would be deemed finite-lived and would then be amortized based on their respective estimated useful lives at that point in time. For the nine months ended September 30, 2013, the Company recorded a non-cash impairment charge of $0.5 million for the write-off of IPR&D for Captisol-enabled IV Clopidogrel. The asset was impaired upon notification from the Medicines Company that they intended to terminate the license agreement and return the rights of the compound to the Company. Captisol-enabled IV Clopidogrel is an intravenous option of the anti-platelet medication designed for situations where the administration of oral platelet inhibitors is not feasible or desirable. For the three months ended September 30, 2013 and the three and nine months ended September 30, 2012, there was no impairment of IPR&D.

Impairment of Long-Lived Assets

Management reviews long-lived assets for impairment annually or whenever events or changes in circumstances indicate the carrying amount of an asset may not be recoverable. Recoverability of assets to be held and used is measured by a comparison of the carrying amount of an asset to future undiscounted net cash flows expected to be generated by the asset. If such assets are considered to be impaired, the impairment to be recognized is measured as the amount by which the carrying amount of the assets exceeds the fair value of the assets. Fair value for the Company's long-lived assets is determined using the expected cash flows discounted at a rate commensurate with the risk involved. As of September 30, 2013, management does not believe there have been any events or circumstances indicating that the carrying amount of its long-lived assets may not be recoverable.

Commercial license rights

Commercial license rights represent a portfolio of future milestone and royalty payment rights acquired in accordance with the Royalty Stream and Milestone Payments Purchase Agreement entered into with Selexis SA ("Selexis") in April 2013. The portfolio consists of over 15 Selexis commercial license agreement programs with various pharmaceutical-company counterparties. The purchase price was $4.6 million, inclusive of acquisition costs. The

Company paid $3.6 million upon closing and will pay $1 million in April 2014. 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.

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Accrued Liabilities

Accrued liabilities consist of the following (in thousands):

	September 30, 2013	December 31, 2012
Compensation	$1,734	$1,807
Professional fees	280	199
Other	2,605	2,955
	$4,619	$4,961

Other Long-Term Liabilities

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

	September 30, 2013	December 31, 2012
Deposits	$336	$538
Deferred rent	354	334
Other	—	214
	$690	$1,086

Contingent Liabilities

In connection with the Company’s acquisition of CyDex in January 2011, the Company recorded a $17.6 million contingent liability, inclusive of the $4.3 million payment made in January 2012, 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, and the change in fair value is recorded in the Company’s consolidated statements 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, 2013 and December 31, 2012 was $8.7 million and $10.9 million, respectively. The Company recorded a fair value adjustment to increase the liability for CyDex related contingent liabilities of $1.2 million for the three months ended September 30, 2013 and an adjustment to decrease the liability of $2.1 million for the nine months ended September 30, 2013. The Company recorded fair value adjustments to increase the liability for CyDex related contingent liabilities of $0.1 million for the three months ended September 30, 2012 and adjustments to decrease the liability $2.1 million for the nine months ended September 30, 2012. Additionally, the Company recorded cash payments of $0.1 million for the Topiramate orphan drug designation milestone for the three and nine months ended September 30, 2013. The Company recorded a cash payment of $3.5 million for the FDA approval milestone of Kyprolis for the three months ended September 30, 2012. The Company recorded cash payments of $4.3 million for the January 2012 guaranteed payment, $0.2 million for the 2011 revenue sharing payment, and $3.5 million for the FDA approval milestone of Kyprolis for the nine months ended September 30, 2012. There was no revenue sharing payment made for the three and nine months ended September 30, 2013.

In connection with the Company’s acquisition of Metabasis in January 2010, the Company issued 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 Metabasis’ partnership with Roche (which has been terminated) or 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. Changes in the fair values are reported in the statement of operations as income (decreases) or expense (increases). 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 $1.7 million and $0 as of September 30, 2013 and December 31, 2012, respectively. The Company recorded decrease in the liability for Metabasis related CVRs of $0.7 million for the three months ended September 30, 2013 and an increase of $1.7 million for the nine months ended September 30, 2013. The

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Company recorded no change in the liability for CVRs during the three months ended September 30, 2012 and a decrease in the liability for CVRs of $1.1 million during the nine months ended September 30, 2012.

In connection with the Company's acquisition of Neurogen in December 2009, the Company issued to Neurogen stockholders four CVRs; real estate, Aplindore, VR1 and H3, that entitle them to cash and/or shares of third-party stock under certain circumstances. The Company recorded the acquisition-date fair value of the CVRs as part of the purchase price. In February 2010, the Company completed the sale of the real estate and subsequently distributed the proceeds to the holders of the real estate CVR. As a result and after final settlement of all related expenses, the real estate CVR was terminated in August 2010. In 2012, the Company received a notice from a collaboration partner that it was terminating its agreement related to VR1 for convenience and subsequently the Company recorded a decrease in the fair value of the liability for the related CVR of $0.2 million. Additionally, per the CVR agreement, no payment event date for the H3 program can occur after December 23, 2012 and the Company recorded a decrease in the fair value of the liability for the related CVR of $0.5 million. There are no remaining CVR obligations under the agreement with the former Neurogen shareholders.

Revenue Recognition

Royalties on sales of products commercialized by the Company’s partners are recognized in the quarter reported by the respective partner.

Revenue from material sales is recognized upon transfer of title, which normally passes upon shipment to the customer. The Company’s credit and exchange policy includes provisions for the return of product between 30 to 90 days, depending on the specific terms of the individual agreement, when that product (1) does not meet specifications, (2) is damaged in shipment (in limited circumstances where title does not transfer until delivery), or (3) is exchanged for an alternative grade of Captisol.

Nonrefundable, up-front license fees and milestone payments with standalone value that are not dependent on any future performance by us under our collaboration agreements are recognized as revenue upon the earlier of when payments are received or collection is assured, but are deferred if the Company has continuing performance obligations. Amounts received under multiple-element arrangements requiring ongoing services or performance by the Company are recognized over the period of such services or performance. 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.

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 involve the bundling of a license with the option to purchase manufactured product. Licenses are granted to pharmaceutical companies for the use of Captisol in the development of pharmaceutical compounds. The licenses may be granted for the use of the Captisol product 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. The Company believes that its 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 and the customer is able to procure inventory from another manufacturer in the absence of contractual provisions for exclusive supply by the Company.

Revenue from milestones is recognized when earned, as evidenced by written acknowledgement from the collaborator, provided that (i) 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 (ii) 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.

Allowance for Doubtful Accounts

The Company maintains an allowance for doubtful accounts based on the best estimate of the amount of probable losses in the Company's existing accounts receivable. Accounts receivable that are outstanding longer than their contractual payment terms, ranging from 30 to 90 days, are considered past due. When determining the allowance for doubtful accounts, several factors are taken into consideration, including historical write-off experience and review of specific customer accounts

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for collectability. Account balances are charged off against the allowance after collection efforts have been exhausted and the potential for recovery is considered remote. There was no allowance for doubtful accounts included in the balance sheets at September 30, 2013 and December 31, 2012.

Accounting for Share-Based Compensation

Share-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. Compensation cost for consultant awards is recognized over each separate tranche's vesting period. The following table summarizes share-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,	
	2013	2012	2013	2012
Share-based compensation expense as a component of:				
Research and development expenses	$438	$263	$1,272	$1,211
General and administrative expenses	1,095	750	2,877	1,905
	$1,533	$1,013	$4,149	$