SEATTLE GENETICS INC /WA
Form 10-Q
October 26, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)
QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 30, 2018
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 0-32405

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

Delaware	91-1874389
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)

21823 30th Drive SE
Bothell, Washington 98021
(Address of principal executive offices, including zip code)
(Registrant's telephone number, including area code): (425) 527-4000

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 every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files). Yes No
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, smaller reporting company, or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act.

Large accelerated filer	Accelerated filer
Non-accelerated filer	Smaller reporting company

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

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

As of October 22, 2018, there were 160,145,888 shares of the registrant's common stock outstanding.

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

Seattle Genetics, Inc.
Condensed Consolidated Balance Sheets
(Unaudited)
(In thousands, except par value)

	September 30, 2018	December 31, 2017
Assets		
Current assets:		
Cash and cash equivalents	$ 115,457	$ 160,945
Short-term investments	347,619	252,226
Accounts receivable, net	152,520	84,774
Inventories	75,172	59,978
Prepaid expenses and other current assets	26,180	19,138
Total current assets	716,948	577,061
Property and equipment, net	100,966	103,756
Long-term investments	22,635	—
In-process research and development	300,000	—
Goodwill	251,017	—
Other non-current assets	176,279	197,132
Total assets	$ 1,567,845	$ 877,949
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and accrued liabilities	$ 157,157	$ 132,672
Current portion of deferred revenue	36,495	34,457
Total current liabilities	193,652	167,129
Long-term liabilities:		
Deferred revenue, less current portion	6,004	30,618
Other long-term liabilities	3,668	2,633
Total long-term liabilities	9,672	33,251
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, $0.001 par value, 5,000 shares authorized; none issued	—	—
Common stock, $0.001 par value, 250,000 shares authorized; 160,053 shares issued and outstanding at September 30, 2018 and 144,395 shares issued and outstanding at December 31, 2017	160	144
Additional paid-in capital	2,569,449	1,806,159
Accumulated other comprehensive income (loss)	(305)	63,836
Accumulated deficit	(1,204,783)	(1,192,570)
Total stockholders' equity	1,364,521	677,569
Total liabilities and stockholders' equity	$ 1,567,845	$ 877,949

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

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Seattle Genetics, Inc.
Condensed Consolidated Statements of Comprehensive Income (Loss)
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues:				
Net product sales	$126,976	$79,177	$344,776	$223,841
Collaboration and license agreement revenues	19,786	39,444	76,524	82,779
Royalty revenues	22,662	16,670	58,887	46,025
Total revenues	169,424	135,291	480,187	352,645
Costs and expenses:				
Cost of sales	12,348	9,019	35,863	24,555
Cost of royalty revenues	5,320	5,196	16,845	13,900
Research and development	140,175	113,606	415,537	346,196
Selling, general and administrative	57,155	39,667	181,629	118,783
Total costs and expenses	214,998	167,488	649,874	503,434
Loss from operations	(45,574)	(32,197)	(169,687)	(150,789)
Investment and other income (loss), net	(21,872)	82,218	66,799	84,460
Net income (loss)	$(67,446)	$50,021	$(102,888)	$(66,329)
Net income (loss) per share - basic	$(0.42)	$0.35	$(0.66)	$(0.46)
Net income (loss) per share - diluted	$(0.42)	$0.34	$(0.66)	$(0.46)
Shares used in computation of per share amounts - basic	159,304	143,357	156,799	142,876
Shares used in computation of per share amounts - diluted	159,304	148,068	156,799	142,876
Comprehensive income (loss):				
Net income (loss)	$(67,446)	$50,021	$(102,888)	$(66,329)
Other comprehensive income (loss):				
Unrealized gain (loss) on securities available-for-sale, net of tax of $0, $5,915, $0, and $11,087, respectively	(144)	9,627	(12)	18,044
Foreign currency translation gain (loss)	13	14	(10)	16
Total other comprehensive income (loss)	(131)	9,641	(22)	18,060
Comprehensive income (loss)	$(67,577)	$59,662	$(102,910)	$(48,269)

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

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Seattle Genetics, Inc.
Condensed Consolidated Statements of Cash Flows
(Unaudited)
(In thousands)

	Nine Months Ended September 30,	
	2018	2017
Operating activities:		
Net loss	$(102,888)	$(66,329)
Adjustments to reconcile net loss to net cash used by operating activities		
Share-based compensation	53,168	47,899
Depreciation and amortization	19,045	16,393
Amortization of premiums, accretion of discounts, and (gains) losses on debt securities	(1,384)	653
Gains on equity securities	(62,882)	—
Gain on Immunomedics warrant derivative	—	(76,699)
Income tax benefit on unrealized loss on available-for-sale securities	—	(5,415)
Deferred income taxes	—	(5,672)
Other long-term liabilities	1,035	(102)
Changes in operating assets and liabilities		
Accounts receivable, net	(51,472)	(28,504)
Inventories	(15,194)	7,287
Prepaid expenses and other assets	4,183	(2,084)
Accounts payable and accrued liabilities	2,152	6,208
Deferred revenue	(25,014)	(10,141)
Net cash used by operating activities	(179,251)	(116,506)
Investing activities:		
Purchases of securities	(374,356)	(445,659)
Proceeds from maturities of securities	270,721	538,200
Proceeds from sales of securities	140,352	60,056
Purchases of property and equipment	(14,941)	(42,615)
Acquisition of Cascadian Therapeutics, Inc., net of cash acquired	(598,151)	—
Net cash provided (used) by investing activities	(576,375)	109,982
Financing activities:		
Net proceeds from issuance of common stock	658,242	—
Proceeds from exercise of stock options and employee stock purchase plan	51,896	25,991
Net cash provided by financing activities	710,138	25,991
Net increase (decrease) in cash and cash equivalents	(45,488)	19,467
Cash and cash equivalents at beginning of period	160,945	108,673
Cash and cash equivalents at end of period	$115,457	$128,140

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

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Seattle Genetics, Inc.
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Summary of significant accounting policies

Basis of presentation

The accompanying unaudited condensed consolidated financial statements reflect the accounts of Seattle Genetics, Inc. and its wholly-owned subsidiaries (collectively "Seattle Genetics," "we," "our," or "us"). All intercompany transactions and balances have been eliminated. We acquired Cascadian Therapeutics, Inc., or Cascadian, in March 2018, as further described in Note 3. Management has determined that we operate in one segment: the development and sale of pharmaceutical products on our own behalf or in collaboration with others. Substantially all of our assets and revenues are related to operations in the U.S.; however, we also have subsidiaries in Australia, Canada, Ireland, Luxembourg, Switzerland, and the United Kingdom.

The condensed consolidated balance sheet data as of December 31, 2017 were derived from audited financial statements not included in this quarterly report on Form 10-Q. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission, or SEC, and generally accepted accounting principles in the United States of America, or GAAP, for unaudited condensed consolidated financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The accompanying unaudited condensed consolidated financial statements reflect all adjustments consisting of normal recurring adjustments that, in the opinion of management, are necessary for a fair statement of our financial position and results of our operations as of and for the periods presented.

These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in our Annual Report on Form 10-K for the year ended December 31, 2017, as filed with the SEC.

The preparation of financial statements in accordance with GAAP requires us to make estimates, assumptions, and judgments that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The results of our operations for the three and nine month periods ended September 30, 2018 are not necessarily indicative of the results to be expected for the full year or any other interim period.

Non-cash investing activities

We had $1.2 million and $1.0 million of accrued capital expenditures as of September 30, 2018 and December 31, 2017, respectively. Accrued capital expenditures have been treated as a non-cash investing activity and, accordingly, have not been included in the statement of cash flows until such amounts have been paid in cash.

Investments

We adopted Accounting Standards Update, or ASU, "ASU 2016-01, Financial Instruments: Overall" on January 1, 2018, which addressed certain aspects of recognition, measurement, presentation and disclosure of financial instruments, including that changes in the fair value of equity securities be recorded in income or loss rather than accumulated other comprehensive income or loss in stockholders' equity. We used the modified retrospective method and recognized a $64.1 million cumulative effect of initially applying this ASU as an adjustment to decrease the opening accumulated deficit at January 1, 2018. Accordingly, comparative information has not been adjusted and continues to be reported under previous accounting standards. The implementation of this standard increases the volatility of net income or loss to the extent that we continue to hold equity securities.

We invest primarily in debt securities. These debt securities are classified as available-for-sale, which are reported at estimated fair value with unrealized gains and losses included in accumulated other comprehensive income and loss in stockholders' equity. Realized gains, realized losses and declines in the value of investments judged to be other-than-temporary are included in investment and other income (loss), net. The cost of investments for purposes of computing realized and unrealized gains and losses is based on the specific identification method. Amortization of premiums and accretion of discounts on debt securities are included in investment and other income (loss), net.

Interest and dividends earned on all securities are included in investment and other income (loss), net. We classify investments in debt securities maturing within one year of the reporting date, or where management's intent is to use the investments to fund current operations or to make them available for current operations, as short-term investments. We also hold certain equity securities, which are reported at estimated fair value.

If the estimated fair value of a debt security is below its carrying value, we evaluate whether it is more likely than not that we will sell the security before its anticipated recovery in market value and whether evidence indicating that the cost of the investment is recoverable within a reasonable period of time outweighs evidence to the contrary. We also evaluate whether or not we intend to sell the investment. If the impairment is considered to be other-than-temporary, the security is written down to its estimated fair value. In addition, we consider whether credit losses exist for any securities. A credit loss exists if the present

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value of cash flows expected to be collected is less than the amortized cost basis of the security. Other-than-temporary declines in estimated fair value and credit losses are included in investment and other income (loss), net.

Business combinations, including acquired in-process research and development and goodwill

We account for business combinations using the acquisition method, recording the acquisition-date fair value of total consideration over the acquisition-date fair value of net assets acquired as goodwill.

Fair value is typically estimated using the present value of future discounted cash flows, an income approach. The significant estimates in the discounted cash flow model primarily include the discount rate, rates of future revenue growth and/or profitability of the acquired business, and working capital effects. The discount rate considers the relevant risk associated with business-specific characteristics and the uncertainty related to the ability to achieve the projected cash flows.

In-process research and development assets are accounted for as indefinite-lived intangible assets and maintained on the balance sheet until either the underlying project is completed or the asset becomes impaired. If the project is completed, the carrying value of the related intangible asset is amortized to cost of sales over the remaining estimated life of the asset beginning in the period in which the project is completed. If the asset becomes impaired or is abandoned, the carrying value of the related intangible asset is written down to its fair value and an impairment charge is recorded in the period in which the impairment occurs.

We evaluate indefinite-lived intangible assets and goodwill for impairment annually, as of October 1, or more frequently when events or circumstances indicate that impairment may have occurred. As part of the impairment evaluation, we may elect to perform an assessment of qualitative factors. If this qualitative assessment indicates that it is more likely than not that the fair value of the indefinite-lived intangible asset or the reporting unit (for goodwill) is less than its carrying value, we then would proceed with the quantitative impairment test to compare the fair value to the carrying value and record an impairment charge if the carrying value exceeds the fair value.

Acquisition-related costs, including banking, legal, accounting, valuation, and other similar costs, are expensed in the periods in which the costs are incurred. The results of operations of the acquired business are included in the consolidated financial statements from the acquisition date.

Long-term incentive plans

We have established Long-Term Incentive Plans, or LTIPs. The LTIPs provide eligible employees with the opportunity to receive performance-based incentive compensation, which may be comprised of cash, stock options, and/or restricted stock units. The payment of cash and the grant or vesting of equity are contingent upon the achievement of pre-determined regulatory milestones. We record compensation expense over the estimated service period for each milestone subject to the achievement of the milestone being considered probable in accordance with the provisions of Accounting Standards Codification Topic 450, Contingencies. At each reporting date, we assess whether achievement of a milestone is considered probable and, if so, record compensation expense based on the portion of the service period elapsed to date with respect to that milestone, with a cumulative catch-up, net of estimated forfeitures.

During the first quarter of 2018, an LTIP milestone was achieved related to the U.S. Food and Drug Administration, or FDA, approval of a label expansion in the U.S. for ADCETRIS, based on clinical trial data from the ECHELON-1 study. As of September 30, 2018, the estimated unrecognized compensation expense related to all LTIPs was $35.4 million. The total estimate of unrecognized compensation expense could change in the future for several reasons, including the addition or termination of employees or the addition, termination, or modification of an LTIP.

Revenue recognition

We adopted Accounting Standards Codification Topic 606—Revenue from Contracts with Customers, or Topic 606, on January 1, 2018, resulting in a change to our accounting policy for revenue recognition. We used the modified retrospective method and recognized the cumulative effect of initially applying Topic 606 as an adjustment to decrease the opening accumulated deficit at January 1, 2018. Accordingly, comparative information has not been adjusted and continues to be reported under previous accounting standards. Refer to Note 2 for additional information.

Our revenues are comprised of ADCETRIS net product sales, amounts earned under our collaboration and licensing agreements, and royalties. Revenue recognition occurs when a customer obtains control of promised goods or services

in an amount that reflects the consideration we expect to receive in exchange for those goods or services. The period between when we transfer control of promised goods or services and when we receive payment is expected to be one year or less, and that expectation is consistent with our historical experience. As such, we do not adjust our revenues for the effects of a significant financing component.

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Net product sales

We sell ADCETRIS through a limited number of pharmaceutical distributors in the U.S. and Canada. Customers order ADCETRIS through these distributors, and we typically ship product directly to the customer. The delivery of ADCETRIS to the end-user site represents a single performance obligation for these transactions. We record product sales at the point in time when title and risk of loss pass, which generally occurs upon delivery of the product to the customer. The transaction price for product sales represents the amount we expect to receive, which is net of estimated government-mandated rebates and chargebacks, distribution fees, estimated product returns and other deductions. Accruals are established for these deductions, and actual amounts incurred are offset against applicable accruals. We reflect these accruals as either a reduction in the related account receivable from the distributor or as an accrued liability, depending on the nature of the sales deduction. Sales deductions are based on management's estimates that consider payor mix in target markets and experience to-date. These estimates involve a substantial degree of judgment. We have applied a portfolio approach as a practical expedient for estimating net product sales from ADCETRIS.

Government-mandated rebates and chargebacks: We have entered into a Medicaid Drug Rebate Agreement, or MDRA, with the Centers for Medicare & Medicaid Services. This agreement provides for a rebate based on covered purchases of ADCETRIS. Medicaid rebates are invoiced to us by the various state Medicaid programs. We estimate Medicaid rebates using the most-likely-amount approach, based on a variety of factors, including our experience to-date.

We have also completed a Federal Supply Schedule, or FSS, agreement under which certain U.S. government purchasers receive a discount on eligible purchases of ADCETRIS. In addition, we have entered into a Pharmaceutical Pricing Agreement with the Secretary of Health and Human Services, which enables certain entities that qualify for government pricing under the Public Health Services Act, or PHS, to receive discounts on their qualified purchases of ADCETRIS. Under these agreements, distributors process a chargeback to us for the difference between wholesale acquisition cost and the applicable discounted price. As a result of our direct-ship distribution model, we can identify the entities purchasing ADCETRIS and this information enables us to estimate expected chargebacks for FSS and PHS purchases based on each entity's eligibility for the FSS and PHS programs. We also review historical rebate and chargeback information to further refine these estimates.

Distribution fees, product returns and other deductions: Our distributors charge a volume-based fee for distribution services that they perform for us. We allow for the return of product that is within 30 days of its expiration date or that is damaged. We estimate product returns based on our experience to-date using the most-likely-amount approach. In addition, we consider our direct-ship distribution model, our belief that product is not typically held in the distribution channel, and the expected rapid use of the product by healthcare providers. We provide financial assistance to qualifying patients that are underinsured or cannot cover the cost of commercial coinsurance amounts through SeaGen Secure. SeaGen Secure is available to patients in the U.S. and its territories who meet various financial and treatment need criteria. Estimated contributions for commercial coinsurance under SeaGen Secure are deducted from gross sales and are based on an analysis of expected plan utilization. These estimates are adjusted as necessary to reflect our actual experience.

Collaboration and license agreement revenues

We have collaboration and license agreements with a number of biotechnology and pharmaceutical companies. Our proprietary technology for linking cytotoxic agents to monoclonal antibodies called antibody-drug conjugates, or ADCs, is the basis for many of these collaboration and license agreements, including the ADC collaborations that we have entered into in the ordinary course of business, under which we granted our collaborators research and commercial licenses to our technology and typically provide technology transfer services, technical advice, supplies and services for a period of time.

Our collaboration and license agreements include contractual milestones. Generally, the milestone events coincide with the progression of the collaborators' product candidates. These consist of development milestones (such as designation of a product candidate or initiation of preclinical studies and the initiation of phase 1, phase 2, or phase 3 clinical trials), regulatory milestones (such as the filing of regulatory applications for marketing approval), and

commercialization milestones (such as first commercial sale in a particular market and product sales in excess of a pre-specified threshold). Our ADC collaborators are solely responsible for the development of their product candidates, and the achievement of milestones in any of the categories identified above is based solely on the collaborators' efforts. Since we do not take a substantive role or control the research, development or commercialization of any products generated by our ADC collaborators, we are not able to reasonably estimate when, if at all, any milestone payments or royalties may be payable to us by our ADC collaborators. As such, the milestone payments associated with our ADC collaborations involve a substantial degree of uncertainty and risk that they may never be received. In the case of our ADCETRIS collaboration with Takeda Pharmaceutical Company Limited, or Takeda, we may be involved in certain development activities; however, the achievement of milestone events under the agreement is primarily based on activities undertaken by Takeda.

ADC collaborations are initially evaluated as to whether the intellectual property licenses granted by us represent distinct performance obligations. If they are determined to be distinct, the value of the intellectual property licenses would be recognized up-front while the research and development service fees would be recognized as the performance obligations are

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satisfied. Variable consideration is assessed at each reporting period as to whether it is not subject to significant future reversal and, therefore, should be included in the transaction price at the inception of the contract. If a contract includes a fixed or minimum amount of research and development support, this also would be included in the transaction price. Changes to ADC collaborations, such as the extensions of the research term or increasing the number of targets or technology covered under an existing agreement, are assessed for whether they represent a modification or should be accounted for as a new contract.

We have concluded that the license of intellectual property in our current ADC collaborations is not distinct from the perspective of our customers at the time of initial transfer, since we do not license intellectual property without related technology transfer and research and development support services. Our performance obligations under our collaborations include such things as providing intellectual property licenses, performing technology transfer, performing research and development consulting services, providing reagents, ADCs, and other materials, and notifying the customer of any enhancements to licensed technology or new technology that we discover, among others. We determined our performance obligations under our current ADC collaborations as evaluated at contract inception were not distinct and represented a single performance obligation. Revenue is recognized using a proportional performance model, representing the transfer of goods or services as activities are performed over the term of the agreement. Upfront payments are also amortized to revenue over the performance period. Upfront payment contract liabilities resulting from our collaborations do not represent a financing component as the payment is not financing the transfer of goods or services, and the technology underlying the licenses granted reflects research and development expenses already incurred by us.

When no performance obligations are required of us, or following the completion of the performance obligation period, such amounts are recognized as revenue upon transfer of control of the goods or services to the customer. Generally, all amounts received or due other than sales-based milestones and royalties are classified as collaboration and license agreement revenues. Sales-based milestones and royalties are recognized as royalty revenue in the period the related sale occurred.

We generally invoice our collaborators and licensees on a monthly or quarterly basis, or upon the completion of the effort or achievement of a milestone, based on the terms of each agreement. Deferred revenue arises from amounts received in advance of the culmination of the earnings process and is recognized as revenue in future periods as performance obligations are satisfied. Deferred revenue expected to be recognized within the next twelve months is classified as a current liability.

Royalty revenues and cost of royalty revenues

Royalty revenues primarily reflect amounts earned under the ADCETRIS collaboration with Takeda. These royalties include commercial sales-based milestones and sales royalties that relate predominantly to the license of intellectual property. Sales royalties are based on a percentage of Takeda’s net sales of ADCETRIS, with rates that range from the mid-teens to the mid-twenties based on sales volume. Takeda bears a portion of third-party royalty costs owed on its sales of ADCETRIS. This amount is included in royalty revenues. Cost of royalty revenues reflects amounts owed to our third-party licensors related to Takeda’s sales of ADCETRIS. These amounts are recognized in the period in which the related sales by Takeda occur.

Recent accounting pronouncements not yet adopted

In February 2016, the Financial Accounting Standards Board, or FASB, issued “ASU 2016-02, Leases.” The standard requires entities to recognize in the consolidated balance sheet a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term. We will adopt the standard on January 1, 2019 using the modified retrospective method of adoption. We expect that the adoption of the standard will result in the recognition of additional assets and liabilities related to our existing operating leases in the consolidated balance sheets. We are continuing to evaluate the impact of this standard on our existing leases.

In June 2016, FASB issued “ASU 2016-13, Financial Instruments: Credit Losses.” The objective of the standard is to provide information about expected credit losses on financial instruments at each reporting date and to change how other-than-temporary impairments on investment securities are recorded. The standard will become effective for us beginning on January 1, 2020, with early adoption permitted. We are currently evaluating the guidance to determine

the potential impact on our financial condition, results of operations, cash flows, and financial statement disclosures. In August 2018, FASB issued “ASU 2018-15, Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract.” The objective of the standard is to align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software. The standard will become effective for us beginning on January 1, 2020, with early adoption permitted. We are currently evaluating the guidance to determine the potential impact on our financial condition, results of operations, cash flows, and financial statement disclosures.

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2. Revenue from contracts with customers

On January 1, 2018, we adopted Topic 606 applying the modified retrospective method to all contracts that were not completed as of January 1, 2018. Results for reporting periods beginning after January 1, 2018 were presented under Topic 606, while prior period amounts were not adjusted and reported under the accounting standards in effect for the prior periods. We recorded the following cumulative effect as of January 1, 2018, itemized here (in thousands) and further described below:

Collaboration and license agreement revenues	$10,281
Royalty revenues	22,230
Cost of royalty revenues	(5,955)
Accumulated deficit – (debit) credit	$26,556

Impact to net product sales

Topic 606 does not generally change the practice under which we recognize product revenue from sales of ADCETRIS.

Impact to collaboration and license agreement revenues

The achievement of development milestones under our collaborations will be recorded during the period their achievement becomes probable, which may result in earlier recognition as compared to previous accounting principles. Each of our current ADC collaborations contain a single performance obligation under Topic 606.

The Takeda ADCETRIS collaboration is the only ongoing collaboration that was significantly impacted by the adoption of Topic 606. The Takeda ADCETRIS collaboration provides for the global co-development of ADCETRIS and the commercialization of ADCETRIS by Takeda in its territory. Under this collaboration, we have retained commercial rights for ADCETRIS in the U.S. and its territories and in Canada, and Takeda has commercial rights in the rest of the world and pays us a royalty. Our performance obligations under the collaboration include providing intellectual property licenses, performing technology transfer, providing research and development services for co-funded activities, allowing access to data, submitting regulatory filings and other information for co-funded activities, and providing manufacturing support including supply of ADCETRIS drug components, finished ADCETRIS product, and know-how. We determined that our performance obligations under the collaboration as evaluated at contract inception were not distinct and represented a single performance obligation, and that the obligations for goods and services provided would be completed over the performance period of the agreement. Any payments received by us from Takeda, including the upfront payment, progress-dependent development and regulatory milestone payments, reimbursement for drug product supplied, and net development cost reimbursement payments, are recognized as revenue upon transfer of control of the goods or services over the ten-year development period (December 2009 through November 2019) of the collaboration, within collaboration and license agreement revenues. Updates to the Takeda ADCETRIS collaboration transaction price for variable consideration, such as approval of the co-development annual budget and binding production forecast, are considered at each reporting period as to whether they are not subject to significant future reversal. Shipments of drug supply that occurred after the expiration of the drug supply agreement in September 2018 were recorded as a separate performance obligation.

Impact to royalty revenues

Commercial sales-based milestones and sales royalties, primarily earned under the Takeda ADCETRIS collaboration, are recorded in the period of the related sales by Takeda, based on estimates if actual information is not yet available, rather than recording them as reported by the customer one quarter in arrears under previous accounting guidance. Takeda also bears a portion of third-party royalty costs owed on its sales of ADCETRIS which is included in royalty revenues.

Disaggregation of total revenues

We have one marketed product, ADCETRIS. Substantially all of our product revenues are recorded in the U.S. Substantially all of our royalty revenues are from our collaboration with Takeda. Collaboration and license agreement revenues by collaborator are summarized as follows (in thousands):

	Three months	Nine months

	ended September 30, 2018	ended September 30, 2018
Takeda	$ 18,805	$ 41,122
AbbVie	300	13,000
Genmab	—	7,000
GSK	—	6,000
Other	681	9,402
Collaboration and license agreement revenues	$ 19,786	$ 76,524

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Contract balances and performance obligations

Contract assets consist of unbilled receivables related to the Takeda ADCETRIS collaboration and were $12.7 million and $1.0 million as of January 1, 2018 and September 30, 2018, respectively. These were recorded in prepaid expenses and other current assets on the consolidated balance sheet. The decrease from January 1, 2018 to September 30, 2018 was primarily due to reimbursement for drug product supplied against the 2018 production forecast during the nine months ended September 30, 2018.

Contract liabilities consist of deferred revenue primarily related to our remaining performance obligations under the Takeda ADCETRIS collaboration and are presented as line items on the consolidated balance sheet. Deferred revenue will be recognized as the remaining performance obligations are satisfied through November 2019.

We recognized collaboration and license agreement revenues of $26.0 million during the nine months ended September 30, 2018 that were included in the deferred revenue balance as of January 1, 2018. For the three and nine months ended September 30, 2018, collaboration and license agreement revenues from Takeda also included substantially all of a $10.0 million regulatory milestone.

Impacts to September 30, 2018 condensed consolidated financial statements (in thousands)

	As reported	Adjustments	Balances without the adoption of Topic 606
Condensed Consolidated Balance Sheet data:			
Accounts receivable, net	$152,520	$ (16,730)	$135,790
Prepaid expenses and other current assets	26,180	(990)	25,190
Current portion of deferred revenue	36,495	(99)	36,396
Deferred revenue, less current portion	6,004	(16)	5,988
Accumulated deficit	(1,204,783)	(17,605)	(1,222,388)
Condensed Consolidated Statements of Comprehensive Loss data:			
Three months ended September 30, 2018			
Collaboration and license agreement revenues	$19,786	$ 7,448	$27,234
Royalty revenues	22,662	(1,747)	20,915
Total revenues	169,424	5,701	175,125
Cost of royalty revenues	5,320	826	6,146
Net loss	(67,446)	4,875	(62,571)
Nine months ended September 30, 2018			
Collaboration and license agreement revenues	$76,524	$ 9,407	$85,931
Royalty revenues	58,887	179	59,066
Total revenues	480,187	9,586	489,773
Cost of royalty revenues	16,845	634	17,479
Net loss	(102,888)	8,952	(93,936)

3. Acquisition of Cascadian

In March 2018, we acquired all issued and outstanding shares of Cascadian, a clinical-stage biopharmaceutical company based in Seattle, Washington, for $10.00 per share in cash, or approximately $614.1 million, which was funded by an underwritten public offering as further described in Note 5. The acquisition of Cascadian expanded our late-stage pipeline, providing global rights to tucatinib, an investigational oral tyrosine kinase inhibitor, or TKI, that is currently being evaluated in a phase 2 trial called HER2CLIMB for patients with HER2 positive metastatic breast cancer who have been previously treated with HER2-targeted agents, including patients with or without brain metastases.

The acquisition of Cascadian was accounted for as a business combination. During the nine months ended September 30, 2018, we incurred $8.5 million in acquisition-related costs, which were recorded in selling, general and administrative expenses.

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The preliminary purchase price allocation of the assets acquired and liabilities assumed based on their estimated fair values as of the acquisition date was as follows (in thousands):

Cash and cash equivalents	$15,919
Short-term and long-term investments	66,491
Prepaid expenses and other assets	2,215
Property and equipment	566
In-process research and development	300,000
Goodwill	251,017
Accounts payable and accrued liabilities	(22,138)
Total purchase price	$614,070

The amount allocated to in-process research and development was based on the present value of future discounted cash flows, which was based on significant estimates. These estimates included the number of potential patients and market price of a future tucatinib-based regimen, costs required to conduct clinical trials and potentially commercialize tucatinib, as well as estimates for probability of success and the discount rate. Goodwill primarily was attributed to tucatinib's potential application in other treatment settings, intangible assets that do not qualify for separate recognition, and synergies with our existing pipeline and capabilities. Goodwill is not expected to be deductible for tax purposes. The amount allocated to goodwill is preliminary, since the acquisition accounting is not yet finalized as it relates to income taxes.

The financial information in the table below summarizes the combined results of operations of Seattle Genetics and Cascadian on a pro forma basis, for the period in which the acquisition occurred and the comparative period as though the companies had been combined as of January 1, 2017. Pro forma adjustments have been made primarily related to acquisition-related transaction costs and employee costs. The following unaudited pro forma financial information is presented for informational purposes only and is not necessarily indicative of the results of operations that would have been achieved had the acquisition occurred as of January 1, 2017 or indicative of future results (in thousands, except for per share information):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues	$169,424	$135,291	$480,187	$352,645
Net income (loss)	(67,446)	35,960	(131,822)	(136,401)
Net income (loss) per share - basic	(0.42)	0.23	(0.83)	(0.88)
Net income (loss) per share - diluted	(0.42)	0.22	(0.83)	(0.88)

4. Net income (loss) per share

Basic net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per share is computed by dividing net income (loss) by the weighted average number of common shares and dilutive potential common shares outstanding during the period. Dilutive potential common shares include incremental common shares issuable upon the vesting of unvested restricted stock units and the exercise of outstanding stock options, calculated using the treasury stock method.

For the three months ended September 30, 2018 and the nine months ended September 30, 2018 and 2017, we excluded all restricted stock units and stock options from the per share calculations as such securities were anti-dilutive. For the three months ended September 30, 2017, we excluded stock options with an exercise price greater than the average price from the per share calculations. The weighted average number of restricted stock units and stock options that were excluded totaled approximately 13,258,000 and 3,460,000 for the three months ended September 30, 2018 and 2017, respectively, and approximately 13,338,000 and 13,367,000 for the nine months ended September 30, 2018 and 2017, respectively.

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The following table presents the computations of basic and diluted net income (loss) per share (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income (loss)	$(67,446)	$50,021	$(102,888)	$(66,329)
Weighted average common shares outstanding - basic	159,304	143,357	156,799	142,876
Dilutive potential common shares	—	4,711	—	—
Weighted average common shares outstanding - diluted	159,304	148,068	156,799	142,876
Net income (loss) per share - basic	$(0.42)	$0.35	$(0.66)	$(0.46)
Net income (loss) per share - diluted	$(0.42)	$0.34	$(0.66)	$(0.46)

5. Common stock

In February 2018, we completed an underwritten public offering of 13,269,230 shares of our common stock at a public offering price of $52.00 per share. The offering resulted in net proceeds to us of $658.2 million, after deducting underwriting discounts, commissions, and other offering expenses. The primary use of the net proceeds was to fund the acquisition of Cascadian.

6. Investments

As of September 30, 2018 and December 31, 2017, we held common stock of Immunomedics, Inc., or Immunomedics, and Unum Therapeutics, Inc., or Unum, each holding purchased in connection with strategic collaborations with the respective company. The collaboration agreement with Immunomedics was terminated in 2017. As of September 30, 2018 and December 31, 2017, the fair values of these equity securities were $169.4 million and $188.4 million, respectively.

Investment and other income (loss), net includes the realized and unrealized holding gains and losses on these equity securities. During the three and nine months ended September 30, 2018, we recognized a net loss of $23.8 million and a net gain of $62.9 million, respectively, from changes in the fair values of these equity securities. This included the impact of selling a portion of our Immunomedics common stock holdings for $91.9 million during the nine months ended September 30, 2018. Net unrealized gains recognized during the nine months ended September 30, 2018 on equity securities still held at that date were $34.6 million.

In 2017, investment and other income (loss), net also included activity related to an Immunomedics warrant derivative prior to the warrant's exercise by us in December 2017. During the three and nine months ended September 30, 2017, we recognized net gains from changes in the fair value of the warrant derivative of $78.7 million and $76.7 million, respectively, and related income tax benefits of $2.7 million and $5.4 million, respectively.

We also held debt securities, which consisted of the following (in thousands):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
September 30, 2018				
U.S. Treasury securities	$370,551	$—	$(297)	$370,254
Contractual maturities (at date of purchase)				
Due in one year or less	$284,377			$284,230
Due in one to two years	86,174			86,024
Total	$370,551			