EXELIXIS, INC.
Form 10-Q
November 01, 2017
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 29, 2017
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number: 000-30235
EXELIXIS, INC.
(Exact name of registrant as specified in its charter)

Delaware	04-3257395
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

210 East Grand Ave.
South San Francisco, CA 94080
(650) 837-7000
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)
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 ý 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 during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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	ý	Accelerated filer	¨
Non-accelerated filer	¨ (Do not check if a smaller reporting company)	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 7(a)(2)(B) of the Securities Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
As of October 24, 2017, there were 295,853,210 shares of the registrant's common stock outstanding.

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PART I - FINANCIAL INFORMATION
Item 1. Financial Statements
EXELIXIS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)
(unaudited)

	September 30, 2017	December 31, 2016*
ASSETS		
Current assets:		
Cash and cash equivalents	$ 149,357	$151,686
Short-term investments	217,741	268,117
Trade and other receivables	90,005	40,444
Inventory, net	5,806	3,338
Prepaid expenses and other current assets	8,012	5,416
Total current assets	470,921	469,001
Long-term investments	50,569	55,601
Long-term restricted cash and investments	4,650	4,150
Property and equipment, net	19,256	2,071
Goodwill	63,684	63,684
Other long-term assets	692	1,232
Total assets	$ 609,772	$595,739
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 5,988	$6,565
Accrued compensation and benefits	19,914	20,334
Accrued clinical trial liabilities	16,181	14,131
Accrued collaboration liabilities	9,137	2,046
Current portion of deferred revenue	31,377	19,665
Convertible notes	—	109,122
Term loan payable	—	80,000
Other current liabilities	26,356	16,923
Total current liabilities	108,953	268,786
Long-term portion of deferred revenue	246,092	237,094
Other long-term liabilities	16,012	541
Total liabilities	371,057	506,421
Commitments		
Stockholders' equity		
Preferred stock, $0.001 par value, 10,000,000 shares authorized and no shares issued	—	—
Common stock, $0.001 par value; 400,000,000 shares authorized; issued and outstanding: 295,700,576 and 289,923,798 at September 30, 2017 and December 31, 2016, respectively	296	290
Additional paid-in capital	2,106,132	2,072,591
Accumulated other comprehensive loss	(52)	(416)
Accumulated deficit	(1,867,661)	(1,983,147)
Total stockholders' equity	238,715	89,318
Total liabilities and stockholders' equity	$ 609,772	$595,739

* The condensed consolidated balance sheet as of December 31, 2016 has been derived from the audited financial statements as of that date.

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

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EXELIXIS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Revenues:				
Net product revenues	$96,416	$42,742	$253,297	$83,459
Collaboration revenues	56,094	19,452	79,108	30,414
Total revenues	152,510	62,194	332,405	113,873
Operating expenses:				
Cost of goods sold	4,658	2,455	10,875	4,700
Research and development	28,543	20,256	79,967	72,166
Selling, general and administrative	38,129	32,463	113,116	103,143
Restructuring (recovery) charge	—	(244)	(32)	871
Total operating expenses	71,330	54,930	203,926	180,880
Income (loss) from operations	81,180	7,264	128,479	(67,007)
Other income (expense), net:				
Interest income and other, net	3,408	3,059	6,098	4,010
Interest expense	—	(7,834)	(8,679)	(28,575)
Loss on extinguishment of debt	—	(13,773)	(6,239)	(13,773)
Total other income (expense), net	3,408	(18,548)	(8,820)	(38,338)
Income (loss) before income taxes	84,588	(11,284)	119,659	(105,345)
Income tax expense	3,206	—	3,921	—
Net income (loss)	$81,382	$(11,284)	$115,738	$(105,345)
Net income (loss) per share, basic	$0.28	$(0.04)	$0.39	$(0.44)
Net income (loss) per share, diluted	$0.26	$(0.04)	$0.37	$(0.44)
Shares used in computing net income (loss) per share, basic	294,269	256,319	292,776	238,024
Shares used in computing net income (loss) per share, diluted	312,940	256,319	311,555	238,024

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

EXELIXIS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(in thousands)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Net income (loss)	$81,382	$(11,284)	$115,738	$(105,345)
Other comprehensive income (loss) [1]	67	(209)	364	152
Comprehensive income (loss)	$81,449	$(11,493)	$116,102	$(105,193)

(1) Other comprehensive income (loss) consisted solely of unrealized gains or losses, net, on available-for-sale securities arising during the periods presented. There were nominal or no reclassification adjustments to net income (loss) resulting from realized gains or losses on the sale of securities and there was no income tax expense related to other comprehensive income during those periods.

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

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EXELIXIS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine Months Ended September 30,	
	2017	2016
Net income (loss)	$115,738	$(105,345)
Adjustments to reconcile net income (loss) to net cash provided by operating activities:		
Depreciation and amortization	842	754
Stock-based compensation expense	15,029	18,346
Loss on extinguishment of debt	6,239	13,773
Amortization of debt discounts and debt issuance costs	182	8,295
Interest paid in kind	(11,825)	5,939
Gain on other equity investments	(2,980)	(2,494)
Other	1,530	1,332
Changes in assets and liabilities:		
Trade and other receivables	(49,241)	(85,026)
Inventory, net	(2,468)	(676)
Prepaid expenses and other current assets	(2,530)	(3,342)
Other long-term assets	689	535
Accounts payable	(577)	(2,436)
Accrued compensation and benefits	(420)	12,357
Accrued clinical trial liabilities	2,050	(3,184)
Accrued collaboration liabilities	7,091	7,772
Deferred revenue	20,710	251,512
Other current and long-term liabilities	12,199	7,183
Net cash provided by operating activities	112,258	125,295
Cash flows from investing activities:		
Purchases of property and equipment	(3,449)	(1,116)
Proceeds from sale of property and equipment	14	92
Purchases of investments	(248,046)	(258,509)
Proceeds from maturities of investments	266,335	100,635
Proceeds from sale of investments	37,294	2,266
Purchase of restricted cash and investments	(11,150)	(4,150)
Proceeds from maturities of restricted cash and investments	10,650	2,650
Proceeds from other equity investments	2,980	2,494
Net cash provided by (used in) investing activities	54,628	(155,638)
Cash flows from financing activities:		
Repayment of convertible notes and term loan payable	(185,788)	—
Payment on conversion of convertible notes	—	(7,134)
Proceeds from exercise of stock options	16,532	9,296
Proceeds from employee stock purchase plan	3,053	479
Taxes paid related to net share settlement of equity awards	(3,012)	(2,713)
Net cash used in financing activities	(169,215)	(72)
Net decrease in cash and cash equivalents	(2,329)	(30,415)
Cash and cash equivalents at beginning of period	151,686	141,634
Cash and cash equivalents at end of period	$149,357	$111,219
Supplemental cash flow disclosure - non-cash investing and financing activity:		

Construction-in-progress deemed to have been acquired under build-to-suit lease	$14,530	$—
Issuance of common stock in settlement of convertible notes	$—	$285,308

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

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EXELIXIS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Exelixis, Inc. ("Exelixis," "we," "our" or "us") is a biotechnology company committed to the discovery, development and commercialization of new medicines to improve care and outcomes for people with cancer. Since our founding in 1994, three products discovered at Exelixis have progressed through clinical development, received regulatory approval, and entered the marketplace. Two are derived from cabozantinib, an inhibitor of multiple tyrosine kinases including VEGF, MET, AXL and RET receptors: CABOMETYX® (cabozantinib) tablets approved for previously treated advanced renal cell carcinoma ("RCC") and COMETRIQ® (cabozantinib) capsules approved for progressive, metastatic medullary thyroid cancer. The third product, COTELLIC® (cobimetinib) tablets, is a reversible inhibitor of MEK, marketed under a collaboration with Genentech (a member of the Roche Group), and is approved as part of a combination regimen to treat advanced melanoma.

Basis of Consolidation

The condensed consolidated financial statements include the accounts of Exelixis and those of our wholly-owned subsidiaries. These entities' functional currency is the United States ("U.S.") dollar. All intercompany balances and transactions have been eliminated.

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the U.S. for interim financial information and pursuant to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In our opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of the results of operations and cash flows for the periods presented have been included.

We have adopted a 52- or 53-week fiscal year policy that generally ends on the Friday closest to December 31st. Fiscal year 2017 will end on December 29, 2017 and fiscal year 2016 ended on December 30, 2016. For convenience, references in this report as of and for the fiscal periods ended September 29, 2017 and September 30, 2016, and as of and for the fiscal years ended December 29, 2017 and December 30, 2016, are indicated as being as of and for the periods ended September 30, 2017 and September 30, 2016, and the years ended December 31, 2017 and December 31, 2016, respectively.

Operating results for the nine months ended September 30, 2017 are not necessarily indicative of the results that may be expected for the year ending December 31, 2017 or for any future period. These financial statements and notes should be read in conjunction with the consolidated financial statements and notes thereto for the year ended December 31, 2016, included in our Annual Report on Form 10-K filed with the SEC on February 27, 2017.

Use of Estimates

The preparation of our condensed consolidated financial statements conforms to accounting principles generally accepted in the U.S. which requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosures. On an ongoing basis, management evaluates its estimates including, but not limited to, those related to revenue recognition, including deductions from revenues (such as rebates, chargebacks, sales returns and sales allowances), the period of performance, identification of deliverables and evaluation of milestones with respect to our collaborations, the amounts of revenues and expenses under our profit and loss sharing agreement, recoverability of inventory, certain accrued liabilities including accrued clinical trial liability, and stock-based compensation. We base our estimates on historical experience and on various other market-specific and other relevant assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ materially from those estimates.

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Reclassifications

Certain prior period amounts in the condensed consolidated financial statements have been reclassified to conform to current period presentation. We reclassified $1.8 million in payable to our customers from Other current liabilities to Trade and other receivables in the accompanying December 31, 2016 Condensed Consolidated Balance Sheet. We have also reclassified the related balances between line items in Changes in assets and liabilities in the accompanying Condensed Consolidated Statement of Cash Flows for the nine months ended September 30, 2016 to conform the presentation of those line items to the corresponding presentation of assets and liabilities in our accompanying Condensed Consolidated Balance Sheets.

Segment Information

We operate as a single reportable segment.

Stock-Based Compensation

In January 2017, we adopted Accounting Standards Update ("ASU") No. 2016-09, Compensation—Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting, ("ASU 2016-09"). ASU 2016-09 is aimed at the simplification of several aspects of the accounting for employee share-based payment transactions, including accounting for forfeitures, income tax consequences and classification on the statement of cash flows.

Pursuant to the adoption of ASU 2016-09, we have made an election to record forfeitures when they occur. Previously, stock-based compensation was based on the number of awards expected to vest after considering estimated forfeitures. The change in accounting principle with regards to forfeitures was adopted using a modified retrospective approach, with a cumulative adjustment of $0.3 million to accumulated deficit and additional paid-in-capital as of January 1, 2017. No prior periods were restated as a result of this change in accounting principle.

As a result of the adoption of ASU 2016-09, as of January 1, 2017 we also recorded an increase to the federal and state net operating losses of $56.9 million for excess tax benefits previously not included. The resulting increase to the deferred tax assets of approximately $21.2 million was offset by a corresponding increase to the valuation allowance, resulting in a net zero impact to both our income tax expense in our Condensed Consolidated Statements of Operations and our deferred tax assets and liabilities in our Condensed Consolidated Balance Sheets.

ASU 2016-09 also requires that cash paid to taxing authorities when directly withholding shares for tax withholding purposes be classified as a financing activity on our Condensed Consolidated Statement of Cash Flows. Previously, we classified such payments as operating cash flows. The change in accounting principle with regards to such cash flows was adopted using a retrospective approach. Accordingly, we recorded a reclassification that resulted in an increase in cash provided by operating activities by $2.7 million along with a corresponding increase in cash used in financing activities in our Condensed Consolidated Statement of Cash Flows for the nine months ended September 30, 2016.

Recent Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board ("FASB") issued ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) ("ASU 2014-09"). In August 2015, the FASB issued ASU No. 2015-14, Revenue from Contracts with Customers (Topic 606): Deferral of the Effective Date, which delayed the effective date of ASU 2014-09 by one year. ASU 2014-09, as amended, becomes effective for us in the first quarter of fiscal year 2018, which is when we will adopt the standard. ASU 2014-09 also permits two methods of adoption: retrospectively to each prior reporting period presented (full retrospective method), or retrospectively with the cumulative effect of initially applying the guidance recognized at the date of initial application (the modified retrospective method). We will adopt ASU 2014-09 using the modified retrospective method.

The core principle of ASU 2014-09 is that an entity should recognize revenue when it transfers promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. ASU 2014-09 defines a five step process to achieve this core principle and, in doing so, has created the possibility that more judgment and estimates may be required within the revenue recognition process than required under existing U.S. generally accepted accounting pronouncements. We have substantially completed our analysis on the adoption of ASU 2014-09 and have determined the adoption will not have a material impact on the recognition of revenue from product sales. ASU 2014-09 will impact the timing of recognition of revenue for our collaboration arrangements with Ipsen Pharma SAS ("Ipsen") and Takeda Pharmaceutical Company

Ltd. (“Takeda”). We expect to reclassify deferred revenue

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to accumulated deficit (a concept known as “lost revenue”) for amounts associated with these collaboration arrangements upon recording our transition adjustment in the first quarter of 2018, primarily due to the timing of recognition of revenue related to intellectual property licenses that we have transferred for development and commercialization of our products. Additionally, for all of our collaboration arrangements, the timing of recognition of certain of our development and regulatory milestones could change as a result of the variable consideration guidance included in ASU 2014-09. ASU 2014-09 will also require additional disclosures regarding our revenue transactions.

NOTE 2: COLLABORATION AGREEMENTS

Ipsen Collaboration

In February 2016, we entered into a collaboration and license agreement (the “Ipsen Collaboration Agreement”) with Ipsen for the commercialization and further development of cabozantinib. Pursuant to the terms of the Ipsen Collaboration Agreement, Ipsen received exclusive commercialization rights for current and potential future cabozantinib indications outside of the U.S., Canada and Japan (the “Ipsen Territory”). The Ipsen Collaboration Agreement was subsequently amended in December 2016 (the “Amendment”) to include commercialization rights in Canada in the Ipsen Territory. We have also agreed to collaborate with Ipsen on the development of cabozantinib for current and potential future indications.

In consideration for the exclusive license and other rights contained in the Ipsen Collaboration Agreement, Ipsen paid us an upfront nonrefundable payment of $200.0 million in March 2016. Additionally, as a result of the Amendment, we received a $10.0 million upfront nonrefundable payment from Ipsen in December 2016 and, as a result of the approval of cabozantinib in second-line RCC by the European Commission (“EC”) in September 2016, we received a $60.0 million milestone in November 2016. We are receiving a 2% royalty on the initial $50.0 million of net sales by Ipsen, and are entitled to receive a 12% royalty on the next $100.0 million of net sales by Ipsen. After the initial $150.0 million of sales, we are entitled to receive a tiered royalty of 22% to 26% on annual net sales by Ipsen; these tiers will reset each calendar year. We are primarily responsible for funding cabozantinib-related development costs for those trials in existence at the time we entered into the Ipsen Collaboration Agreement; global development costs for additional trials are shared between the parties, with Ipsen reimbursing us for 35% of such costs, provided Ipsen opts in to participate in such additional trials. Pursuant to the terms of the Ipsen Collaboration Agreement, we will remain responsible for the manufacture and supply of cabozantinib for all development and commercialization activities. As part of the collaboration agreement, we entered into a supply agreement pursuant to which we will supply finished, labeled drug product to Ipsen for distribution in the Ipsen Territories at our cost, as defined in the agreement, which excludes the 3% royalty we are required to pay GlaxoSmithKline (“GSK”) on Ipsen’s Net Sales of any product incorporating cabozantinib.

The Ipsen Collaboration Agreement contains multiple deliverables consisting of intellectual property licenses, delivery of products and/or materials containing cabozantinib to Ipsen for all development and commercial activities, research and development services, and participation on the joint steering, development and commercialization committees (as defined in the Ipsen Collaboration Agreement). We determined that these deliverables do not have stand-alone value and accordingly, combined these deliverables into a single unit of accounting and allocated the entire arrangement consideration to that combined unit of accounting. As a result, the upfront payment of $200.0 million, received in the first quarter of 2016 and the $10.0 million upfront payment received in December 2016 in consideration for the development and commercialization rights in Canada are being recognized ratably over the term of the Ipsen Collaboration Agreement, through early 2030, which is the current estimated patent expiration of cabozantinib in the European Union. At the time we entered into the Ipsen Collaboration Agreement, we also determined that the $60.0 million milestone we achieved upon the approval of cabozantinib by the EC in second-line RCC was not substantive due to the relatively low degree of uncertainty and relatively low amount of effort required on our part to achieve the milestone as of the date of the collaboration agreement; the $60.0 million was deferred entirely until the date of the European Medicines Agency’s (the “EMA”) approval of cabozantinib in second-line RCC in September 2016 and has been and will continue to be recognized ratably over the remainder of the term of the Ipsen Collaboration Agreement. The two $10.0 million milestones for the first commercial sales of CABOMETYX in Germany and the United Kingdom were determined to be substantive at the time we entered into the Ipsen

Collaboration Agreement and were recognized as collaboration revenues in the fourth quarter of 2016. We determined that the remaining development and regulatory milestones are substantive and will be recognized as revenue in the periods in which they are achieved. We consider the contingent payments due to us upon the achievement of specified sales volumes to be similar to royalty payments. Reimbursements for development costs are classified as revenue as the development services represent our ongoing major or central operations.

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During the three months ended March 31, 2017, we reclassified $9.0 million of deferred revenue to Accrued collaboration liabilities and Other long-term liabilities, and accordingly adjusted our amortization of the upfront payment of $200.0 million as a result of a change in operational responsibilities for certain clinical programs in the Ipsen Territory. As of September 30, 2017, we had paid $2.1 million toward the $9.0 million of reimbursements due to Ipsen for these clinical programs.

In September 2017, we recognized two milestones totaling $45.0 million resulting from Ipsen's receipt of the validation from the EMA for the application for variation to the CABOMETYX marketing authorization for the addition of a new indication in first-line treatment of advanced RCC in adults. The two milestones were determined to be substantive at the time we entered into the Ipsen Collaboration Agreement and were recognized as collaboration revenues in the third quarter of 2017. Payment for the first milestone of $20.0 million is due in the fourth quarter of 2017 and payment for the second milestone of $25.0 million is due in the first quarter of 2018.

See "Note 2 - Collaboration Agreements" to our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the SEC on February 27, 2017 for additional description of our collaboration agreement with Ipsen.

During the three and nine months ended September 30, 2017 and 2016, collaboration revenues under the Ipsen Collaboration Agreement were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Milestones achieved	$45,000	$—	$45,000	$—
Amortization of upfront payments and deferred milestone	4,742	3,780	13,788	8,570
Royalty revenue	371	—	814	—
Development cost reimbursements	1,123	—	2,322	—
Product supply agreement revenue	1,681	—	3,483	—
Cost of supplied product	(1,681)	—	(3,483)	—
Royalty payable to GSK on net sales by Ipsen	(557)	—	(1,221)	—
Collaboration revenues under the Ipsen Collaboration Agreement	$50,679	$3,780	$60,703	$8,570

As of September 30, 2017, short-term and long-term deferred revenue relating to the Ipsen Collaboration Agreement was $19.0 million and $215.0 million, respectively.

Genentech Collaboration

In December 2006, we out-licensed the further development and commercialization of cobimetinib to Genentech pursuant to a worldwide collaboration agreement (the "Genentech Collaboration Agreement"). Under the terms of the Genentech Collaboration Agreement for cobimetinib, we are entitled to a share of profits and losses received in connection with cobimetinib's commercialization in the U.S. This profit and loss share has multiple tiers: we are entitled to 50% of profits and losses from the first $200.0 million of U.S. actual sales, decreasing to 30% of profits and losses from U.S. actual sales in excess of $400.0 million. Separately, we are entitled to low double-digit royalties on net sales outside the U.S. In November 2013, we exercised an option under the Genentech Collaboration Agreement to co-promote COTELLIC in the U.S., which allows for us to provide up to 25% of the total sales force for approved cobimetinib indications in the U.S. In 2015, we began fielding 25% of the sales force promoting COTELLIC in combination with Zelboraf® as a treatment for patients with BRAF mutation-positive advanced melanoma.

On June 3, 2016, we filed a Demand for Arbitration before JAMS in San Francisco, California asserting claims against Genentech related to its clinical development, pricing and commercialization of COTELLIC, and cost and revenue allocations arising from COTELLIC's commercialization in the U.S. Our arbitration demand asserted that Genentech breached the Genentech Collaboration Agreement by, amongst other breaches, failing to meet its diligence and good faith obligations.

On July 13, 2016, Genentech asserted a counterclaim for breach of contract seeking monetary damages and interest related to the cost allocations under the Genentech Collaboration Agreement. On December 29, 2016, however, Genentech withdrew its counterclaim against us and stated that it would unilaterally change its approach to the

allocation

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of promotional expenses arising from commercialization of the COTELLIC plus Zelboraf combination therapy, both retrospectively and prospectively. The revised allocation approach substantially reduced our exposure to costs associated with promotion of the COTELLIC plus Zelboraf combination in the U.S. However, other significant issues remained in dispute between the parties. Genentech's action did not address the claims in our demand for arbitration related to Genentech's clinical development of cobimetinib, or pricing or promotional costs for COTELLIC in the U.S. and it did not fully resolve claims over revenue allocation. In addition, Genentech's unilateral action did not clarify how it intended to allocate promotional costs incurred with respect to the promotion of other combination therapies that include COTELLIC for other indications that may be developed or are in development and may be approved. As a result, we continued to press our position before the arbitral panel to obtain a just resolution of these claims.

On June 8, 2017, the parties settled the arbitration, which was dismissed with prejudice. The settlement was memorialized in a settlement agreement dated July 19, 2017, that included a mutual release of all claims arising out of or related in any way to the causes of actions and/or claims that were asserted or could have been asserted based on the facts alleged in the arbitration. The settlement does not provide for payments in settlement of the asserted claims; as part of the settlement, on July 19, 2017, the parties entered into an amendment to the Genentech Collaboration Agreement. Pursuant to the terms of the amendment, we continue to be entitled to a share of U.S. profits and losses received in connection with the commercialization of COTELLIC in accordance with the profit share tiers as originally set forth in the collaboration agreement, which share continues to decrease as sales of COTELLIC increase. However, effective as of July 1, 2017, the revenue for each sale of COTELLIC applied to the profit and loss statement for the collaboration agreement (the "Collaboration P&L") is being calculated using the average of the quarterly net selling prices of COTELLIC and any additional branded Genentech product(s) prescribed with COTELLIC in such sale. While we also continue to share U.S. commercialization costs for COTELLIC, the amendment expressly sets forth that the amount of commercialization costs Genentech is entitled to allocate to the Collaboration P&L is to be reduced based on the number of Genentech products in any given combination including COTELLIC. In addition, the amendment also sets forth the parties' confirmation and agreement that we have exercised our co-promotion option and that, as such, we have the option to co-promote current and future Genentech combinations that include COTELLIC in the U.S.

During the three and nine months ended September 30, 2017 and 2016, ex-U.S. royalty revenues and U.S. losses under the Genentech Collaboration Agreement were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Royalty revenues on ex-U.S. sales of COTELLIC included in Collaboration revenues	$1,392	$672	$5,057	$1,844
U.S. losses included in Selling, general and administrative expenses [1]	$(891)	$(2,922)	$(2,298)	$(14,845)

(1) A portion of the accrual for losses for the three and nine months ended September 30, 2016 were reversed in December 2016 when we were relieved of our obligation to pay certain disputed costs as a result of Genentech's unilateral change to its approach to the allocation of promotional expenses arising from commercialization of the COTELLIC plus Zelboraf combination therapy.

The U.S. losses under the Genentech Collaboration Agreement include our share of the net loss from the collaboration, as well as personnel and other costs we have incurred to co-promote COTELLIC plus Zelboraf in the U.S.

Royalty revenues from the Genentech Collaboration Agreement are based on amounts reported to us by Genentech and are recorded when such information becomes available to us. For prior periods, from the launch of COTELLIC through December 31, 2016, such information was not available until the following quarter, meaning that historically we recorded royalty revenues on a one quarter lag. Beginning in 2017, such information became available to us in the current quarter. As a result of this change, during the nine months ended September 30, 2017, in addition to the royalties reported to us for that period we also recorded $1.1 million in royalties for the sales activity related to the

three months ended December 31, 2016.

Takeda Collaboration

On January 30, 2017, we entered into a collaboration and license agreement (the “Takeda Collaboration Agreement”) with Takeda for the commercialization and further clinical development of cabozantinib in Japan. Pursuant to the terms of the Takeda Collaboration Agreement, Takeda will have exclusive commercialization rights for current and potential future cabozantinib indications in Japan. The companies have also agreed to collaborate on the clinical

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development of cabozantinib in Japan. The operation and strategic direction of the parties' collaboration is governed through a joint executive committee and appropriate subcommittees.

In consideration for the exclusive license and other rights contained in the Takeda Collaboration Agreement, Takeda paid us an upfront nonrefundable payment of $50.0 million in February 2017. We will be eligible to receive development, regulatory and first-sales milestones of up to $95.0 million related to second-line RCC, first-line RCC and second-line hepatocellular carcinoma ("HCC"), as well as additional development, regulatory and first-sale milestone payments for potential future indications. The Takeda Collaboration Agreement also provides that we will be eligible to receive pre-specified payments of up to $83.0 million associated with potential sales milestones. We will also receive royalties on net sales of cabozantinib in Japan at an initial tiered rate of 15% to 24% on net sales for the first $300.0 million of cumulative net sales. Thereafter, the royalty rate will be adjusted to 20% to 30% on annual net sales.

Takeda will be responsible for 20% of the costs associated with the global cabozantinib development plan's current and future trials, provided Takeda opts to participate in such future trials, and 100% of costs associated with cabozantinib development activities that are exclusively for the benefit of Japan. Pursuant to the terms of the Takeda Collaboration Agreement, we will remain responsible for the manufacture and supply of cabozantinib for all development and commercialization activities under the collaboration. As part of the collaboration, the parties will enter into appropriate supply agreements for the manufacture and supply of cabozantinib for Takeda's territory.

During the three and nine months ended September 30, 2017, collaboration revenues under the Takeda Collaboration Agreement were as follows (in thousands):

	Three Months Ended September 30,	Nine Months Ended September 30,
Amortization of upfront payment	$ 2,830	$ 7,547
Development cost reimbursements	1,193	3,301
Collaboration revenues under the Takeda Collaboration Agreement	$ 4,023	$ 10,848

There was no such revenue during the comparable periods in 2016. As of September 30, 2017, short-term and long-term deferred revenue relating to the Takeda Collaboration Agreement was $11.3 million and $31.1 million, respectively.

The Takeda Collaboration Agreement may be terminated for cause by either party based on uncured material breach by the other party, bankruptcy of the other party or for safety reasons. For clarity, Takeda's failure to achieve specified levels of commercial performance, based upon sales volume and/or promotional effort, during the first six years following the first commercial sale of cabozantinib in Japan shall constitute a material breach of the Takeda Collaboration Agreement. We may terminate the agreement if Takeda challenges or opposes any patent covered by the Takeda Collaboration Agreement. At any time prior to August 1, 2023, the parties may mutually agree to terminate the Takeda Collaboration Agreement if Japan's Pharmaceuticals and Medical Devices Agency is unlikely to grant approval of the marketing authorization application in any cancer indication in Japan. After the commercial launch of cabozantinib in Japan, Takeda may terminate the Takeda Collaboration Agreement upon twelve months' prior written notice following the third anniversary of the first commercial sale of cabozantinib in Japan. Upon termination by either party, all licenses granted by us to Takeda will automatically terminate, and the licenses granted by Takeda to us shall survive such termination and shall automatically become worldwide.

The Takeda Collaboration Agreement contains multiple deliverables consisting of intellectual property licenses, delivery of products and/or materials containing cabozantinib to Takeda for all development and commercial activities, research and development services, and participation on the joint executive, development and commercialization committees (as defined in the Takeda Collaboration Agreement). We determined that these deliverables, other than the commercial supply and joint commercialization committee participation, are non-contingent in nature. The commercial supply deliverable was deemed contingent, primarily due to the fact that there is uncertainty around approval in Japan, which is dependent on successful clinical trial results from a study in

Japanese patients. We also determined that the non-contingent deliverables do not have stand-alone value, because each one of them has value only if we meet our obligation as a whole to provide Takeda with research and development services, including clinical supply of cabozantinib under the Takeda Collaboration Agreement. Accordingly, we combined the non-contingent deliverables into a single unit of accounting and allocated the $50.0 million upfront fee to that combined unit of accounting. We also determined that the level of effort required of us to meet our obligations under the Takeda Collaboration Agreement is not expected to vary significantly over

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the development period of the Takeda Collaboration Agreement. As a result, the upfront payment of $50.0 million, received in the first quarter of 2017, will be recognized ratably over the development period of the Takeda Collaboration Agreement of approximately four years. We determined that the development and regulatory milestones are substantive and will be recognized as revenue in the periods in which they are achieved. We consider the contingent payments due to us upon the achievement of specified sales volumes to be similar to royalty payments. We will record reimbursements for development costs as revenue as the development services represent a part of our ongoing major or central operations.

Bristol-Myers Squibb Collaboration - First-Line Advanced RCC, Bladder Cancer and HCC Combination Studies

In February 2017, we entered into a clinical trial collaboration agreement with Bristol-Myers Squibb Company (the "BMS Collaboration Agreement") for the purpose of evaluating the combination of cabozantinib and nivolumab with or without ipilimumab in various tumor types, including, in RCC, HCC and bladder cancer. To date, a phase 3 trial in first-line advanced RCC and a phase 2 trial in HCC evaluating these combinations has been initiated. Pursuant to the terms of the BMS Collaboration Agreement, each party will grant to the other a non-exclusive, worldwide (within the collaboration territory as defined in the BMS Collaboration Agreement), non-transferable, royalty-free license to use the other party's compounds in the conduct of each clinical trial. The parties' efforts are governed through a joint development committee established to guide and oversee the collaboration's operation. Each trial will be conducted under a combination Investigational New Drug Application, unless otherwise required by a regulatory authority. Each party will be responsible for supplying drug product for the applicable clinical trial in accordance with the terms of the supply agreement entered into between the parties in April 2017, and costs for each such trial will be shared equally between the parties, unless two Bristol-Myers Squibb Company ("BMS") compounds will be utilized in such trial, in which case BMS will bear two-thirds of the costs and we will bear one-third of the costs for such study treatment arms. Unless earlier terminated, the BMS Collaboration Agreement will remain in effect until the completion of all clinical trials under the collaboration, all related trial data has been delivered to both parties and the completion of any then agreed upon analysis. Ipsen has opted in to participate in the phase 3 pivotal trial in first-line advanced RCC and will have access to the results to support potential future regulatory submissions. Ipsen may also participate in future studies at its choosing.

The Roche Group Collaboration

In February 2017, we established a clinical trial collaboration with The Roche Group ("Roche") for the purpose of evaluating the safety and tolerability of cabozantinib in combination with Roche's atezolizumab in patients with locally advanced or metastatic solid tumors. Each party is responsible for supplying drug product for the applicable clinical trial in accordance with the terms of the clinical supply agreement entered into by the parties in February 2017. Based on the dose-escalation results, the trial has the potential to enroll up to four expansion cohorts, including a cohort of patients with previously untreated advanced clear cell RCC and three cohorts of urothelial carcinoma, namely platinum eligible first-line patients, first or second-line platinum ineligible patients and patients previously treated with platinum-containing chemotherapy. The trial was initiated in June 2017 and is open for enrollment. We are the sponsor of the trial, and Roche is responsible for supplying atezolizumab to us. Ipsen has opted to participate in the study and will have access to the results to support potential future development in its territories.

GlaxoSmithKline Collaboration

In October 2002, we established a collaboration with GSK to discover and develop novel therapeutics in the areas of vascular biology, inflammatory disease and oncology. Under the terms of the product development and commercialization agreement, GSK had the right to choose cabozantinib for further development and commercialization, but notified us in October 2008 that it had waived its right to select the compound for such activities. As a result, we retained the rights to develop, commercialize, and license cabozantinib, subject to payment to GSK of a 3% royalty on net sales of any product incorporating cabozantinib. The product development and commercialization agreement was terminated during 2014, although GSK will continue to be entitled to a 3% royalty on net sales by us or our collaboration partners of any product incorporating cabozantinib, including COMETRIQ and CABOMETYX.

During the three and nine months ended September 30, 2017 and 2016, royalties owed to GSK in connection with the sales of COMETRIQ and CABOMETYX were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Royalties owed to GSK	$3,446	$1,277	$8,809	$2,495

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Royalties owed to GSK are included in Cost of goods sold for sales by us and as a reduction of Collaboration revenues for sales by Ipsen in the accompanying Condensed Consolidated Statements of Operations.

Other Collaborations

During the nine months ended September 30, 2017, we recognized $2.5 million in contract revenues from a milestone payment received from BMS related to its ROR gamma program.

During the three and nine months ended September 30, 2016, we recognized $15.0 million in contract revenues from a milestone payment earned from Daiichi Sankyo Company, Limited ("Daiichi Sankyo") related to its worldwide license of our compounds that modulate the mineralocorticoid receptor ("MR"), including CS-3150 (an isomer of XL550). During the nine months ended September 30, 2016, we also recognized $5.0 million in contract revenues from a milestone payment earned from Merck related to its worldwide license of our phosphoinositide-3 kinase-delta program.

See "Note 2 - Collaboration Agreements" to our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the SEC on February 27, 2017 for a description of our existing collaboration agreements.

NOTE 3: CASH AND INVESTMENTS

All of our cash equivalents and investments are classified as available-for-sale. The following tables summarize cash and cash equivalents, investments, and restricted cash and investments by balance sheet line item as of September 30, 2017 and December 31, 2016 (in thousands):

	September 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents	$149,357	$ —	$ —	$149,357
Short-term investments	217,805	17	(81)	217,741
Long-term investments	50,557	41	(29)	50,569
Long-term restricted cash and investments	4,650	—	—	4,650
Total cash and investments	$422,369	$ 58	$ (110)	$422,317

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents	$151,686	$ —	$ —	$151,686
Short-term investments	268,234	13	(130)	268,117
Long-term investments	55,792	1	(192)	55,601
Long-term restricted cash and investments	4,150	—	—	4,150
Total cash and investments	$479,862	$ 14	$ (322)	$479,554

Under our loan and security agreement with Silicon Valley Bank, we were required to maintain compensating balances on deposit in one or more investment accounts with Silicon Valley Bank or one of its affiliates. The total collateral balance of $81.6 million as of December 31, 2016 is reflected in our Condensed Consolidated Balance Sheet in short-term investments; as a result of our repayment of the term loan with Silicon Valley Bank, the compensating balance requirement was terminated as of March 29, 2017. See "Note 7 - Debt" to our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the SEC on February 27, 2017 for more information regarding the collateral balance requirements under our Silicon Valley Bank loan and security agreement.

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The following tables summarize our cash equivalents and investments by security type as of September 30, 2017 and December 31, 2016. The amounts presented exclude cash, but include investments classified as cash equivalents (in thousands):

	September 30, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Money market funds	$42,797	$ —	$ —	$42,797
Commercial paper	168,738	—	—	168,738
Corporate bonds	187,197	58	(95)	187,160
U.S. Treasury and government sponsored enterprises	14,659	—	(15)	14,644
Total investments	$413,391	$ 58	$ (110)	$413,339

	December 31, 2016			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Money market funds	$71,457	$ —	$ —	$71,457
Commercial paper	165,375	—	—	165,375
Corporate bonds	152,712	3	(308)	152,407
U.S. Treasury and government sponsored enterprises	70,730	11	(14)	70,727
Total investments	$460,274	$ 14	$ (322)	$459,966

Gains and losses on the sales of investments available-for-sale were nominal or zero during the three and nine months ended September 30, 2017 and 2016.

All of our investments are subject to a quarterly impairment review. During the nine months ended September 30, 2017 and 2016 we did not record any other-than-temporary impairment charges on our available-for-sale securities. As of September 30, 2017, there were 84 investments in an unrealized loss position with gross unrealized losses of $0.1 million and an aggregate fair value of $134.9 million. The investments in an unrealized loss position comprise corporate bonds with an aggregate fair value of $124.9 million and securities issued by U.S. Treasury and government sponsored enterprises with an aggregate fair value of $10.0 million. The unrealized losses were not attributed to credit risk, but rather associated with the changes in interest rates. Based on the scheduled maturities of our investments, we concluded that the unrealized losses in our investment securities are not other-than-temporary, as it is more likely than not that we will hold these investments for a period of time sufficient for a recovery of our cost basis.

The following table summarizes the fair value of securities classified as available-for-sale by contractual maturity as of September 30, 2017 (in thousands):

	Mature within One Year	After One Year through Five Years	Fair Value
Money market funds	$42,797	$—	$42,797
Commercial paper	168,738	—	168,738
Corporate bonds	136,592	50,568	187,160
U.S. Treasury and government sponsored enterprises	14,644	—	14,644
Total investments	$362,771	$50,568	$413,339

Cash is excluded from the table above. The classification of certain restricted investments is dependent upon the term of the underlying restriction on the asset and not the maturity date of the investment. Therefore, certain long-term restricted cash and investments have contractual maturities within one year.

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NOTE 4. INVENTORY

Inventory consists of the following (in thousands):

	September 30, 2017	December 31, 2016
Raw materials	$ 378	$ 863
Work in process	2,951	2,343
Finished goods	2,856	738
Total	6,185	3,944
Less: non-current portion included in Other long-term assets	(379)	(606)
Inventory, net	$ 5,806	$ 3,338

We generally relieve inventory on a first-expiry, first-out basis. A portion of the manufacturing costs for inventory was incurred prior to regulatory approval of CABOMETYX and COMETRIQ and therefore was expensed as research and development costs when those costs were incurred, rather than capitalized as inventory. Write-downs related to excess and expiring inventory are charged to either Cost of goods sold or the cost of supplied product included in Collaboration revenues. Such write-downs were $1.2 million for the nine months ended September 30, 2017 and $0.4 million for the comparable period in 2016. The non-current portion of inventory is expected to be used or sold in future periods more than 12 months from the date presented. As of September 30, 2017, the non-current portion of inventory consists of finished goods. As of December 31, 2016, the non-current portion of inventory consists of raw materials and a portion of the active pharmaceutical ingredient that is included in work in process inventories.

NOTE 5. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following (in thousands):

	September 30, 2017	December 31, 2016
Computer equipment and software	$ 14,242	$ 13,738
Leasehold improvements	4,715	6,646
Laboratory equipment	5,836	4,310
Furniture and fixtures	1,954	2,240
Construction-in-progress	15,627	19
	42,374	26,953
Less: accumulated depreciation and amortization	(23,118)	(24,882)
Property and equipment, net	$ 19,256	$ 2,071

Depreciation expense was $0.8 million during both the nine months ended September 30, 2017 and 2016.

Build-to-Suit Lease

On May 2, 2017, we entered into a Lease Agreement (the “Lease”) with Ascentris 105, LLC (“Ascentris”), to lease 110,783 square feet of space in office and research facilities located at 1851, 1801, and 1751 Harbor Bay Parkway, Alameda, California (the “Premises”). On October 16, 2017, we executed an amendment to the Lease for 19,778 square feet of additional space located at the Premises with terms consistent with the original Lease. See “Note 12. Commitments” for a description of the Lease.

In connection with the Lease, we received a tenant improvement allowance of $6.7 million from Ascentris, for the costs associated with the design, development and construction of tenant improvements for the Premises. We are obligated to fund all costs incurred in excess of the tenant improvement allowance and to certain indemnification obligations related to the construction activities. We evaluated our involvement during the construction period and determined the scope of the tenant improvements on portions of the Premises including the building shells did not qualify as “normal tenant improvements” under Accounting Standards Codification topic 840, Leases. Accordingly, for accounting purposes, we are the deemed owner of such portions of the Premises during the construction period. As such, we will capitalize the construction costs as a build-to-suit property within property and equipment, net, including the estimated fair value of the

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building shells that we are deemed to own at the lease inception date, as determined using a third-party appraisal. The capitalized construction costs will also include the estimated tenant improvements incurred by Ascentris. Accordingly, we capitalized $14.5 million of costs related to the Lease in construction-in-progress as of May 2, 2017, with a corresponding build-to-suit lease obligation in Other long-term liabilities. As of September 30, 2017, we have capitalized an additional $0.5 million to construction in progress for improvements to the Premises.

Once the construction is complete, we will consider the requirements for sale-leaseback accounting treatment, including evaluating whether all risks of ownership have been transferred back to Ascentris, as evidenced by a lack of continuing involvement in the leased property. If the arrangement does not qualify for sale-leaseback accounting treatment, the building assets will remain on our consolidated balance sheets at their historical cost.

NOTE 6. DEBT

The amortized carrying amount of our debt consists of the following (in thousands):

	September 30, 2017	December 31, 2016
Secured Convertible Notes due 2018 ("Deerfield Notes")	$ —	$ 109,122
Term loan payable	—	80,000
Total debt	$ —	$ 189,122

See "Note 7 - Debt" to our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2016 filed with the SEC on February 27, 2017 for additional information on the terms of our debt, including a description of the material features of the Deerfield Notes.

Deerfield Notes

On June 28, 2017, we repaid all amounts outstanding under the Deerfield Notes. The repayment amount totaled $123.8 million which comprised $113.9 million in principal, including $13.9 million of interest paid in kind paid through the repayment date, a $5.8 million prepayment penalty associated with the early repayment of the notes and $4.2 million in accrued and unpaid interest. As a result of the early repayment, there was a $6.2 million loss on the extinguishment of the debt which comprised the prepayment penalty and the unamortized fees and costs on the date of the repayment.

Prior to our early repayment of the notes, the outstanding principal amount of the Deerfield Notes bore interest at the rate of 7.5% per annum to be paid in cash, quarterly in arrears, and 7.5% per annum to be paid in kind, quarterly in arrears, for a total interest rate of 15% per annum. The following is a summary of interest expense for the Deerfield Notes (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Stated coupon interest	$ —	$ 2,031	$ 4,151	$ 5,939
Interest paid in kind	—	2,031	4,151	5,939
Amortization of debt discount and debt issuance costs	—	121	182	327
Total interest expense	$ —	$ 4,183	$ 8,484	$ 12,205

The balance of unamortized fees and costs was $0.4 million as of December 31, 2016, which was recorded as a reduction of the carrying amount of the Deerfield Notes on the accompanying Condensed Consolidated Balance Sheet.

Silicon Valley Bank Loan and Security Agreement

On March 29, 2017, we repaid all amounts outstanding under our term loan with Silicon Valley Bank. The repayment included $80.0 million in principal plus $0.1 million in accrued and unpaid interest. There was no gain or loss on the extinguishment of debt as a result of the repayment of the term loan. Prior to our early repayment of the term loan, the principal amount outstanding under the term loan had accrued interest at 1.0% per annum, which was due and payable monthly.

In accordance with the terms of the loan and security agreement, we were required to maintain an amount equal to at least 100%, but not to exceed 107%, of the outstanding principal balance of the term loan on deposit in one or more

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investment accounts with Silicon Valley Bank or one of its affiliates as support for our obligations under the loan and security agreement. We were entitled to retain income earned on the amounts maintained in such accounts. The total collateral balance as of December 31, 2016 was $81.6 million and was reflected in our Condensed Consolidated Balance Sheet in Short-term investments as the amounts were not restricted as to withdrawal. As a result of our repayment of the term loan, the compensating balance requirement was terminated as of March 29, 2017.

NOTE 7. 2014 WARRANTS

In connection with an amendment to the note purchase agreement for the Secured Convertible Notes due 2015, (the "Original Deerfield Notes"), in January 2014 we issued two-year warrants to purchase an aggregate of 1,000,000 shares of our common stock at an exercise price of $9.70 per share (the "2014 Warrants"). Subsequent to our March 2015 notification of our election to extend the maturity date of the Deerfield Notes, the exercise price of the 2014 Warrants was reset to $3.445 per share, the term was extended by two years to January 22, 2018, and the 2014 Warrants were transferred to Additional paid-in capital as of that date at their then estimated fair value of $1.5 million as their terms had become fixed.

On September 11, 2017, we issued an aggregate of 877,451 shares of common stock pursuant to the cashless exercises of the 2014 Warrants issued to an accredited investor transferee. The number of shares issued upon exercise was net of 122,549 shares withheld to effect the cashless exercise of the 2014 Warrants in accordance with their terms.

NOTE 8. STOCK-BASED COMPENSATION

We recorded and allocated employee stock-based compensation expense for our equity incentive plans and our 2000 Employee Stock Purchase Plan ("ESPP") as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Research and development expense	$1,663	$1,165	$4,741	$7,894
Selling, general and administrative expense	3,626	2,438	10,288	10,452
Total stock-based compensation expense	$5,289	$3,603	$15,029	$18,346

We use the Black-Scholes Merton option pricing model to value our stock options and ESPP purchases. The weighted average grant-date fair value per share of our stock options and ESPP purchases was as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Stock options	$11.75	$8.59	$10.32	$4.31
ESPP	$6.85	$1.51	$5.29	$1.65

The fair value of stock options and ESPP purchases was estimated using the following assumptions:

	Stock Options			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Risk-free interest rate	1.70 %	1.07 %	1.68 %	1.09 %
Dividend yield	— %	— %	— %	— %
Expected volatility	58 %	76 %	61 %	76 %
Expected life	4.0 years	4.5 years	4.1 years	4.4 years

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	ESPP			
	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Risk-free interest rate	1.14 %	0.37 %	0.88 %	0.39 %
Dividend yield	— %	— %	— %	— %
Expected volatility	55 %	63 %	61 %	66 %
Expected life	6 months	6 months	6 months	6 months

We considered implied volatility as well as our historical volatility in developing our estimate of expected volatility. The expected life computation is based on historical exercise patterns and post-vesting termination behavior.

A summary of stock option activity for the nine months ended September 30, 2017 is presented below (dollars in thousands, except per share amounts):

	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Options outstanding at December 31, 2016	24,999,665	$ 4.91		
Granted	821,260	$ 21.60		
Exercised	(4,282,847)	$ 3.94		
Forfeited	(204,525)	$ 8.14		
Options outstanding at September 30, 2017	21,333,553	$ 5.72	4.08 years	$ 395,212
Exercisable at September 30, 2017	15,961,685	$ 4.41	3.59 years	$ 316,415

As of September 30, 2017, a total of 24,037,291 shares were available for grant under our stock option plans.

A summary of restricted stock unit (“RSU”) activity for the nine months ended September 30, 2017 is presented below (dollars in thousands, except per share amounts):

	Shares	Weighted Average Grant Date Fair Value Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
RSUs outstanding at December 31, 2016	2,469,791	$ 8.69		
Awarded	331,847	$ 22.03		
Vested and released	(348,294)	$ 4.63		
Forfeited	(111,603)	$ 10.89		
RSUs outstanding at September 30, 2017	2,341,741	$ 11.08	1.55 years	$ 56,740

NOTE 9. INCOME TAXES

Income tax expense consists of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Income tax expense	$ 3,206	$ —	$ 3,921	$ —

During the nine months ended September 30, 2017, we recorded income tax expense of $3.9 million, which primarily comprises our computed income tax expense of $5.2 million reduced by $1.2 million of excess benefits associated with equity compensation. The income tax expense for the three and nine months ended September 30, 2017 primarily relates to state taxes in jurisdictions outside of California, for which we do not have net operating loss carry-forwards due to a limited operating history.

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NOTE 10. NET INCOME (LOSS) PER SHARE

The following table sets forth a reconciliation 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,	
	2017	2016	2017	2016
Net income (loss)	$81,382	$(11,284)	$115,738	$(105,345)
Net income allocated to participating securities	(221)	—	(368)	—
Net income allocable to common stock for basic net income (loss) per share	81,161	(11,284)	115,370	(105,345)
Adjustment to net income allocated to participating securities	14	—	23	—
Net income allocable to common stock for diluted net income (loss) per share	$81,175	$(11,284)	$115,393	$(105,345)
Weighted-average shares of common stock outstanding	294,269	256,319	292,776	238,024
Dilutive securities:				
Outstanding stock options, unvested RSUs and ESPP contributions	18,671	—	18,779	—
Weighted-average shares of common stock outstanding and dilutive securities	312,940	256,319	311,555	238,024
Net income (loss) per share, basic	$0.28	$(0.04)	$0.39	$(0.44)
Net income (loss) per share, diluted	$0.26	$(0.04)	$0.37	$(0.44)

The 2014 Warrants were participating securities and the warrant holders did not have a contractual obligation to share in our losses. See “Note 7 - 2014 Warrants” for a description of the 2014 Warrants.

The following table sets forth potentially dilutive shares of common stock that are not included in the computation of diluted net income (loss) per share because to do so would be anti-dilutive (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2017	2016	2017	2016
Outstanding stock options, unvested RSUs and ESPP contributions	583	30,474	1,108	30,474
Deerfield Notes	—	33,890	—	33,890
4.25% convertible senior subordinated notes due 2019 (the “2019 Notes”)	—	413	—	413
2014 Warrants	—	1,000	—	1,000
Total potentially dilutive shares	583	65,777	1,108	65,777

The 2014 Warrants were exercised in September 2017. The Deerfield Notes were repaid in June 2017. The 2019 Notes were converted and redeemed between August and November 2016.

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NOTE 11. FAIR VALUE MEASUREMENTS

The following table sets forth the classification of our financial assets within the fair value hierarchy that were measured and recorded at fair value on a recurring basis as of September 30, 2017 and December 31, 2016. We did not have any financial liabilities measured and recorded at fair value on a recurring basis as of those dates. The amounts presented exclude cash, but include investments classified as cash equivalents (in thousands):

	September 30, 2017		
	Level 1	Level 2	Total
Money market funds	$42,797	$—	$42,797
Commercial paper	—	168,738	168,738
Corporate bonds	—	187,160	187,160
U.S. Treasury and government sponsored enterprises	—	14,644	14,644
Total financial assets	$42,797	$370,542	$413,339
	December 31, 2016		
	Level 1	Level 2	Total
Money market funds	$71,457	$—	$71,457
Commercial paper	—	165,375	165,375
Corporate bonds	—	152,407	152,407
U.S. Treasury and government sponsored enterprises	—	70,727	70,727
Total financial assets	$71,457	$388,509	$459,966

We did not have any financial assets or liabilities classified as Level 3 in the fair value hierarchy as of September 30, 2017 or December 31, 2016 and there were no transfers of financial assets or liabilities classified as Level 3 during the nine months ended September 30, 2017 or the year ended December 31, 2016.

The carrying amounts of cash, trade and other receivables, accounts payable, accrued clinical trial liabilities, accrued compensation and benefits, and other liabilities approximate their fair values and are excluded from the tables above. When available, we value investments based on quoted prices for those financial instruments, which is a Level 1 input. Our remaining investments are valued using third-party pricing sources, which use observable market prices, interest rates and yield curves observable at commonly quoted intervals of similar assets as observable inputs for pricing, which are Level 2 inputs.

NOTE 12. COMMITMENTS

Leases

On May 2, 2017, we entered into the Lease with Ascentris for an aggregate of 110,783 square feet of space in office and research facilities located at the Premises in Alameda, California. We also have the right to make certain tenant improvements to the space leased on the Premises. The Lease has an initial term of 10 years with a target commencement date of February 1, 2018, and, subject to a partial twelve-month rent abatement period, rent payments will begin upon the target commencement date. We have two five-year options to extend the Lease and a one-time option to terminate the Lease without cause on the last day of the 8th year of the initial term. We are obligated to make lease payments totaling $24.1 million over the Lease term. The Lease further provides that we are obligated to pay to Ascentris certain costs, including taxes and operating expenses. We also have a right of first offer to lease certain additional space, in the aggregate of approximately 170,000 square feet of space, as that additional space becomes available over the remainder of the initial term at 1601, 1701, 1751, and 1801 Harbor Bay Parkway, Alameda, California at a market rate determined according to the Lease.

We are deemed, for accounting purposes only, to be the owner of portions of the Premises, including two building shells, even though we are not the legal owner. See “Note 5. Property and Equipment - Build-to-Suit Lease” for a further description of the accounting for that portion of the Premises.

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On May 2, 2017, we also entered into an Agreement for Conditional Option to Amend Lease (the "Optional Amendment Agreement") with Ascentris. Under the terms of the Optional Amendment Agreement, a current tenant (the "Tenant") occupying approximately 16,343 square feet of the facility located at 1801 Harbor Bay Parkway was given the option to relocate to another building on the premises or terminate their current lease early, requiring them to relocate within six months from the termination date. Under the terms of the Optional Amendment Agreement, we would reimburse Ascentris for the first $1.5 million of costs incurred to induce the Tenant to relocate. In August 2017, the Tenant communicated to Ascentris that they were terminating their lease early. As of September 30, 2017, we have accrued $1.4 million for our anticipated reimbursement of costs to Ascentris for the Tenant's relocation. On October 16, 2017, we executed an amendment to the Lease for an additional 19,778 square feet of space located on the Premises, which includes the space vacated by the Tenant, with terms consistent with the original Lease.

As of September 30, 2017, the aggregate future minimum lease payments under our leases are as follows (in thousands):

	Operating leases	Other financing obligations [1]
Remainder of 2017	$ 1,006	$ —
Year Ending December 31,		