DEPOMED INC
Form 10-Q
August 08, 2013
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED June 30, 2013

OR

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

FOR THE TRANSITION PERIOD FROM TO

COMMISSION FILE NUMBER 001-13111

DEPOMED, INC.

(EXACT NAME OF REGISTRANT AS SPECIFIED IN ITS CHARTER)

CALIFORNIA	**94-3229046**
(STATE OR OTHER JURISDICTION OF INCORPORATION OR ORGANIZATION)	(I.R.S. EMPLOYER IDENTIFICATION NUMBER)

7999 Gateway Boulevard, Suite 300

Newark, California 94560

(ADDRESS OF PRINCIPAL EXECUTIVE OFFICES, INCLUDING ZIP CODE)

(510) 744-8000

(REGISTRANT S TELEPHONE NUMBER, INCLUDING AREA CODE)

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

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No o

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

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

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

The number of issued and outstanding shares of the Registrant s Common Stock, no par value, as of August 5, 2013 was 56,761,175.

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PART I FINANCIAL INFORMATION

ITEM 1. CONDENSED FINANCIAL STATEMENTS

DEPOMED, INC.

CONDENSED BALANCE SHEETS

(in thousands, except share amounts)

	June 30, 2013 (Unaudited)	December 31, 2012 (1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 44,934	$ 29,076
Marketable securities	24,618	37,737
Accounts receivable	6,717	3,614
Receivables from collaborative partners	8,066	10,078
Inventories	7,226	9,587
Prepaid and other current assets	5,953	5,175
Total current assets	97,514	95,267
Marketable securities, long-term	4,669	11,079
Property and equipment, net	8,169	8,237
Intangible assets, net	23,304	25,078
Other assets	324	1,992
	$ 133,980	$ 141,653
LIABILITIES AND SHAREHOLDERS EQUITY		
Current liabilities:		
Accounts payable and accrued liabilities	$ 24,357	$ 32,578
Deferred license revenue	3,041	3,273
Other current liabilities	649	830
Total current liabilities	28,047	36,681
Deferred license revenue, non-current portion	13,995	15,516
Other long-term liabilities	9,007	5,520
Commitments		
Shareholders equity:		
Preferred stock, no par value, 5,000,000 shares authorized; Series A convertible preferred stock, 25,000 shares designated, 18,158 shares issued and surrendered, and zero shares outstanding at June 30, 2013 and December 31, 2012		
Common stock, no par value, 100,000,000 shares authorized; 56,676,259 and 56,383,713 shares issued and outstanding at June 30, 2013 and December 31, 2012, respectively	215,317	211,266
Accumulated deficit	(132,363)	(127,361)
Accumulated other comprehensive gain, net of tax	(23)	31
Total shareholders equity	82,931	83,936
	$ 133,980	$ 141,653

(1) Derived from the audited financial statements included in the Company s Annual Report on Form 10-K for the year ended December 31, 2012.

See accompanying notes to Condensed Financial Statements.

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DEPOMED, INC.

CONDENSED STATEMENTS OF OPERATIONS AND COMPREHENSIVE INCOME

(in thousands, except share and per share amounts)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Revenues:				
Product sales	$ 14,106	$ 3,201	$ 23,235	$ 5,310
Royalties	15,097	9,577	29,178	18,998
License and other revenue	760	1,332	3,724	6,637
Total revenues	29,963	14,110	56,137	30,945
Costs and expenses:				
Cost of sales	1,688	1,442	3,172	1,960
Research and development expense	1,412	3,525	4,710	7,007
Selling, general and administrative expense	25,368	25,021	51,331	46,793
Amortization of intangible assets	963	105	1,924	105
Total costs and expenses	29,431	30,093	61,137	55,865
Income (loss) from operations	532	(15,983)	(5,000)	(24,920)
Other income (expense):				
Interest and other income	46	204	115	347
Interest and other expense	(40)		(156)	
Total other income (expense)	6	204	(41)	347
Net income (loss) before income taxes	538	(15,779)	(5,041)	(24,573)
Benefit from (provision for) income taxes	(60)	(1)	39	(9)
Net income (loss)	$ 478	$ (15,780)	$ (5,002)	$ (24,582)
Unrealized losses on available-for-sale securities	(35)	(9)	(54)	84
Comprehensive income (loss)	$ 443	$ (15,789)	$ (5,056)	$ (24,498)
Basic net income (loss) per common share	$ 0.01	$ (0.28)	$ (0.09)	$ (0.44)
Diluted net income (loss) per common share	$ 0.01	$ (0.28)	$ (0.09)	$ (0.44)
Shares used in computing basic net income (loss) per common share	56,562,433	55,786,617	56,511,911	55,670,598
Shares used in computing diluted net income (loss) per common share	57,142,343	55,786,617	56,511,911	55,670,598

See accompanying notes to Condensed Financial Statements.

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DEPOMED, INC.

CONDENSED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Six Months Ended June 30,	
	2013	**2012**
Operating Activities		
Net loss	$ (5,002)	$ (24,582)
Adjustments to reconcile net loss to net cash (used in) provided by operating activities:		
Depreciation and amortization	2,592	320
Amortization of investments	(307)	484
Gain on bargain purchase		(92)
Allowance for inventory obsolescence	154	696
Stock-based compensation	2,973	2,541
Changes in assets and liabilities:		
Accounts receivable	(1,091)	1,667
Inventories	2,207	(902)
Prepaid and other assets	890	(1,107)
Accounts payable and other accrued liabilities	(3,383)	2,545
Accrued compensation	(985)	(738)
Deferred revenue	(1,752)	(5,697)
Net cash used in operating activities	(3,704)	(24,865)
Investing Activities		
Purchases of property and equipment	(1,146)	(502)
Acquisition of patents	(150)	(26,436)
Purchases of marketable securities	(20,984)	(28,463)
Maturities of marketable securities	40,443	38,737
Sales of marketable securities	323	29,566
Net cash provided by investing activities	18,486	12,902
Financing Activities		
Proceeds from issuance of common stock	1,076	1,441
Net cash provided by financing activities	1,076	1,441
Net increase (decrease) in cash and cash equivalents	15,858	(10,522)
Cash and cash equivalents at beginning of period	29,076	24,043
Cash and cash equivalents at end of period	$ 44,934	$ 13,521

See accompanying notes to Condensed Financial Statements.

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DEPOMED, INC.

NOTES TO CONDENSED FINANCIAL STATEMENTS

(Unaudited)

NOTE 1. SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Depomed, Inc. (Depomed or the Company) is a specialty pharmaceutical company focused on pain and other conditions and diseases of the central nervous system. The core products of our current specialty pharmaceutical business are Gralise® (gabapentin), a once-daily product for the management of postherpetic neuralgia that we launched in October 2011, Zipsor® (diclofenac potassium) liquid filled capsules, a product for the treatment of mild to moderate acute pain that we acquired in June 2012 and Lazanda® (fentanyl) nasal spray, a product for the management of breakthrough pain in cancer patients 18 years of age and older who are already receiving and who are tolerant to opioid therapy for their underlying persistent cancer pain that we acquired in July 2013.

We also have a portfolio of royalty and milestone producing assets based on our proprietary drug delivery technologies. The cornerstone of that portion of our business is Glumetza®, a once-daily treatment for adults with type 2 diabetes that we licensed to, and is currently being commercialized by, Santarus, Inc. (Santarus) in the United States. We have license and development arrangements associated with our Acuform® gastroretentive drug delivery technology with Mallinckrodt Pharmaceuticals (Mallinckrodt), Boehringer Ingelheim International GMBH (Boehringer Ingelheim), Ironwood Pharmaceuticals, Inc. (Ironwood), Merck & Co., Inc. (Merck), Janssen Pharmaceutica N.V. and Janssen Pharmaceuticals, Inc. (Janssen).

As of June 30, 2013, the Company has one product candidate under clinical development, DM-1992 for Parkinson s disease. DM-1992 completed a Phase 2 trial for Parkinson s disease, and the Company announced a summary of the results of that trial in November 2012.

Basis of Presentation

These unaudited condensed financial statements and the related footnote information of the Company have been prepared pursuant to the requirements of the Securities and Exchange Commission (SEC) for interim reporting. As permitted under those rules and regulations, certain footnotes or other financial information that are normally required by U.S. generally accepted accounting principles have been condensed or omitted pursuant to such rules and regulations. In the opinion of the Company s management, the accompanying interim unaudited condensed financial statements include all adjustments (consisting only of normal recurring adjustments) necessary for a fair presentation of the information for the periods presented. The results for the quarter and six months ended June 30, 2013 are not necessarily indicative of results to be expected for the entire year ending December 31, 2013 or future operating periods.

The accompanying condensed financial statements and related financial information should be read in conjunction with the audited financial statements and the related notes thereto for the year ended December 31, 2012, included in the Company s Annual Report on Form 10-K filed with the SEC (the 2012 Form 10-K). The balance sheet at December 31, 2012 has been derived from the audited financial statements at that date, as filed with the 2012 Form 10-K.

Use of Estimates

The preparation of financial statements in conformity with U.S. generally accepted accounting principles requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Although management believes these estimates are based upon reasonable assumptions within the bounds of its knowledge of the Company s business and operations, actual results could differ materially from those estimates.

Revenue Recognition

The Company recognizes revenue from the sale of its products, royalties earned, and on payments received and services performed under contractual arrangements. Revenue arrangements with multiple elements are evaluated to determine whether the multiple elements met certain criteria for dividing the arrangement into separate units of accounting, including whether the delivered element(s) have stand-alone value to the Company s customer or licensee. Where there are multiple deliverables combined as a single unit of accounting, revenues are deferred and recognized over the period that we remain obligated to perform services.

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Revenue is recognized when there is persuasive evidence that an arrangement exists, delivery has occurred and title has passed, the price is fixed or determinable and the Company is reasonably assured of collecting the resulting receivable.

- Product Sales:

- Gralise: The Company began selling Gralise to wholesalers and retail pharmacies in October 2011. The Company accepts returns of unsalable product from customers within a return period of six months prior to, and 12 months following product expiration. Gralise tablets currently have a shelf-life of 24 to 36 months from date of manufacture. Given the limited history of prescriptions of Gralise and launch incentives associated with stocking Gralise, the Company was not able to reliably estimate expected returns of the product at the time of shipment prior to the fourth quarter of 2012. Accordingly, the Company deferred the recognition of revenue, and related product costs of Gralise shipments until the product was dispensed through patient prescriptions. The quantity of prescription units dispensed was estimated based on an analysis of third-party information, including third-party market research data and information obtained from wholesalers with respect to inventory levels and inventory movement. Based on the shipment and prescription trends for Gralise and based on an analysis of historical return rates of the Company s experience with products that have a similar customer base and similar return policies, the Company concluded that it had the information needed to reasonably estimate product returns for Gralise during the fourth quarter of 2012. Beginning in the fourth quarter of 2012, the Company began recognizing revenue for Gralise sales at the time of shipment to its customers.

- Zipsor: On June 21, 2012 (the acquisition date), the Company acquired all rights to Zipsor from Xanodyne Pharmaceuticals, Inc. (Xanodyne) and began distributing Zipsor to wholesalers and retail pharmacies. The Company accepts returns of unsalable product from customers within a return period of six months prior to, and 12 months following product expiration. The Company recognizes revenue for Zipsor sales at the time title transfers to its customers, which occurs at the time product is delivered to its customers. Revenue from sales of Zipsor is recorded net of estimated allowances for returns, wholesaler and retail pharmacy fees, prompt pay discounts, patient discount programs, government rebates and chargebacks.

- Glumetza: The Company sold and recorded product sales on shipments of Glumetza to wholesalers and retail pharmacies through August 2011. The Company and Santarus entered into a commercialization agreement in August 2011 under which Depomed transferred the rights to manufacture and distribute Glumetza in the United States to Santarus. Santarus commenced selling Glumetza in September 2011 and began recording product sales. See Note 4 for further information on the Santarus commercialization agreement.

Product distributed by Depomed through August 2011 is subject to rights of return six months before product expiration and up to 12 months after product expiration. The Company recognized revenue for Glumetza sales at the time title transferred to its customers, which occurred at the time product was delivered to its customers. Revenue from sales of Glumetza was recorded net of estimated allowances for returns, wholesaler and retail pharmacy fees, prompt pay discounts, patient discount programs, government rebates and chargebacks and managed care rebates.

- Product Sales Allowances - The Company recognizes product sales allowances as a reduction of product sales in the same period the related revenue is recognized. Product sales allowances are based on amounts owed or to be claimed on related sales. These estimates take into consideration the terms of the Company s agreements with customers, historical product returns, rebates or discounts taken, estimated levels of inventory in the distribution channel, the shelf life of the product, and specific known market events, such as competitive pricing and new product introductions. If actual future results vary from the Company s estimates, the Company may adjust these estimates, which could have an effect on product sales and earnings in the period of adjustment. The Company s product sales allowances include:

- Product Returns - The Company allows customers to return product for credit on returned product that is within six months before and up to 12 months after its product expiration date. The Company estimates product returns of Gralise and Zipsor. The Company also estimates returns on sales of Glumetza made by the Company through August 2011, as the Company is financially responsible for return credits on Glumetza product it shipped to customers as part of the Company s commercialization agreement with Santarus in August 2011. Under the terms of our Asset Purchase Agreement with Xanodyne, the Company also assumed financial responsibility for returns of Zipsor product previously sold by Xanodyne. See Note 11 for further information on the acquisition of Zipsor.

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The shelf life of Gralise is 24 to 36 months from the date of tablet manufacture and the shelf life of Zipsor is 36 months from the date of tablet manufacture. The shelf life of the 500mg Glumetza is 48 months from the date of tablet manufacture and the shelf life of the 1000mg Glumetza is 24 to 36 months from the date of tablet manufacture. The Company monitors actual return history on an individual product lot basis since product launch, which provides it with a basis to reasonably estimate future product returns, taking into consideration the shelf life of product, shipment and prescription trends, estimated distribution channel inventory levels, and consideration of the introduction of competitive products.

- Managed Care Rebates - The Company offers rebates under contracts with certain managed care organizations. The Company establishes an accrual equal to its estimates of future managed care rebates attributable to sales and recognizes the estimated rebates as a reduction of revenue in the same period the related revenue is recognized. The Company estimates its managed care rebates based on the terms of each agreement, estimated levels of inventory in the distribution channel, and historical and expected future utilization of product by the managed care organization.

- Wholesaler and Retail Pharmacy Discounts - The Company offers discounts to certain wholesale distributors and retail pharmacies based on contractually determined rates. The Company accrues the applicable contractual discount on shipment to wholesale distributors and retail pharmacies and recognizes the discount as a reduction of revenue in the same period the related revenue is recognized.

- Prompt Pay Discounts - The Company offers cash discounts to its customers, generally 2% of the sales price, as an incentive for prompt payment. Based on the Company s experience, the Company expects its customers to comply with the prompt payment terms to earn the cash discount. The Company accounts for cash discounts by reducing accounts receivable by the full amount of the discount and recognizes the discount as a reduction of revenue in the same period the related revenue is recognized.

- Medicaid Rebates - The Company participates in Medicaid rebate programs, which provide assistance to eligible low-income patients based on each individual state s guidelines regarding eligibility and services. Under the Medicaid rebate programs, the Company pays a rebate to each participating state, generally two to three months after the quarter in which the prescription is filled. The Company estimates and accrues Medicaid rebates based on product pricing, current rebates and changes in the level of discounts the Company offers that may affect the level of Medicaid discount, historical and estimated future percentages of product sold to Medicaid recipients and estimated levels of inventory in the distribution channel.

- Chargebacks - The Company provides discounts to authorized users of the Federal Supply Schedule (FSS) of the General Services Administration under an FSS contract with the Department of Veterans Affairs. These federal entities purchase products from wholesale distributors at a discounted price, and the wholesale distributors then charge back to the Company the difference between the current retail price and the price the federal entity paid for the product. The Company estimates and accrues chargebacks based on estimated wholesaler inventory levels, current contract prices and historical chargeback activity.

- Medicare Part D Coverage Gap - The Company participates in the Medicare Part D Coverage Gap Discount Program under which the Company provides rebates on prescriptions that fall within the donut hole coverage gap. The Company estimates and accrues rebates based on historical utilization and recognizes the rebate as a reduction of revenue in the same period the related revenue is recognized.

- Patient Discount Programs - The Company offers patient discount co-pay assistance programs in which patients receive discounts at participating retail pharmacies. The discounts are reimbursed by the Company approximately one month after the prescriptions subject to the discount are filled.

- Royalties - Royalties are recognized as earned in accordance with the contract terms when royalties from licensees can be reliably measured and collectability is reasonably assured.

Under the commercialization agreement between the Company and Santarus, the Company receives royalties on net sales of Glumetza distributed by Santarus in the United States. Santarus commenced distributing and recording product sales on shipments of Glumetza in September 2011. See Note 4 for further information on the Santarus commercialization agreement.

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Royalties received from Santarus on sales of Glumetza, from Merck on sales of Janumet XR and from Janssen on sales of NUCYNTA ER are recognized in the period earned as the royalty amounts can be estimated and collectability is reasonably assured.

- License and other arrangements - Revenue from license and collaborative arrangements are recognized when the Company has substantially completed its obligations under the terms of the arrangement and the Company s remaining involvement is inconsequential and perfunctory. If the Company has significant continuing involvement under such an arrangement, license and collaborative fees are recognized over the estimated performance period. The Company recognizes milestone payments for its research and development collaborations upon the achievement of specified milestones if (1) the milestone is substantive in nature, and the achievement of the milestone was not reasonably assured at the inception of the agreement, (2) consideration earned relates to past performance, and (3) the milestone payment is nonrefundable. A milestone is considered substantive if the consideration earned from the achievement of the milestone is consistent with the Company s performance required to achieve the milestone or consistent with the increase in value to the collaboration resulting from the Company s performance, the consideration earned relates solely to past performance, and the consideration earned is reasonable relative to all of the other deliverables and payments within the arrangement. License, milestones and collaborative fee payments received in excess of amounts earned are classified as deferred revenue until earned.

Recently Issued Accounting Standards

In February 2013, the FASB issued Accounting Standards Update No. 2013-02, Comprehensive Income (Topic 220) *Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income* (ASU 2013-02), to improve the reporting of reclassifications out of accumulated other comprehensive income. ASU 2013-02 requires an entity to report the effect of significant reclassifications out of accumulated other comprehensive income on the respective line items in net income if the amount being reclassified is required under U.S. GAAP to be reclassified in its entirety to net income. For other amounts that are not required under U.S. GAAP to be reclassified in their entirety from accumulated other comprehensive income to net income in the same reporting period, an entity is required to cross-reference other disclosures required under U.S. GAAP that provide additional detail about those amounts. ASU 2013-02 is effective for us during the first quarter of fiscal 2014 with earlier adoption permitted, which should be applied prospectively. When adopted, this standard will not have a material impact on our financial statements.

In December 2011, the FASB issued ASU 2011-11, Balance Sheet: Disclosures about Offsetting Assets and Liabilities . The differences in the requirements for offsetting assets and liabilities in the presentation of financial statements prepared in accordance with U.S. GAAP and financial statements prepared in accordance with International Financial Reporting Standards (IFRS) makes the comparability of those statements difficult. The objective of this update is to facilitate comparison between those financial statements, specifically within the scope instruments and transaction eligible for offset in the form of derivatives, sale and repurchase agreements and reverse sale and repurchase agreements, and securities borrowing and securities lending arrangements. This ASU is effective for annual reporting periods beginning on or after January 1, 2013 and interim periods within that fiscal year. The adoption of this standard did not have a material impact on our financial statements.

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NOTE 2. CASH, CASH EQUIVALENTS AND MARKETABLE SECURITIES

Securities classified as cash and cash equivalents and available-for-sale marketable securities as of June 30, 2013 and December 31, 2012 are summarized below (in thousands). Estimated fair value is based on quoted market prices for these investments.

June 30, 2013	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents:				
Cash	$ 16,677	$	$	$ 16,677
Money market funds	27,257			27,257
Corporate debt securities	1,000			1,000
U.S. government agency debt securities				
Total cash and cash equivalents	44,934			44,934
Available-for-sale securities:				
Total maturing within 1 year and included in marketable securities:				
Corporate debt securities	15,399	7	(3)	15,403
U.S. government agency debt securities	8,206	5		8,211
U.S. Treasury securities	1,004			1,004
Total maturing between 1 and 2 years and included in marketable securities:				
Corporate debt securities	4,679	1	(11)	4,669
U.S. government agency debt securities				
U.S. Treasury securities				
Total available-for-sale securities	29,288	13	(14)	29,287
Total cash, cash equivalents and marketable securities	$ 74,222	$ 13	$ (14)	$ 74,221

December 31, 2012	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Cash and cash equivalents:				
Cash	$ 11,769	$	$	$ 11,769
Money market funds	11,268			11,268
Corporate debt securities	6,039			6,039
Total cash and cash equivalents	29,076			29,076
Available-for-sale securities:				
Total maturing within 1 year and included in marketable securities:				
Corporate debt securities	21,662	31		21,693
U.S. government agency debt securities	14,027	8		14,035
U.S. Treasury securities	2,008	1		2,009
Total maturing between 1 and 2 years and included in marketable securities:				
Corporate debt securities	7,858	7	(2)	7,863
U.S. government agency debt securities	3,208	8		3,216

Total available-for-sale securities	48,763	55	(2)	$ 48,816
Total cash, cash equivalents and marketable securities	$ 77,839	$ 55	$ (2)	$ 77,892

The Company considers all highly liquid investments with a maturity at date of purchase of three months or less to be cash equivalents. The Company places its cash, cash equivalents and marketable securities with U.S. Treasury and government agency securities, and high quality securities of U.S. and international financial and commercial institutions and, to date has not experienced material losses on any of its balances. All marketable securities are classified as available-for-sale since these instruments are readily marketable. These securities are carried at fair value, which is based on readily available market information, with unrealized gains and losses included in accumulated other comprehensive gain (loss) within shareholders equity. The Company uses the specific identification method to determine the amount of realized gains or losses on sales of marketable securities. Realized gains or losses have been insignificant and are included in interest and other income in the condensed statement of operations.

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At June 30, 2013, the Company had 16 securities in an unrealized loss position. The following table shows the gross unrealized losses and fair value of the Company s investments with unrealized losses that are not deemed to be other-than-temporarily impaired, aggregated by investment category and length of time that individual securities have been in a continuous unrealized loss position, at June 30, 2013 (in thousands):

	Less than 12 months		12 months or greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate debt securities	$ 7,777	$ (14)	$	$	$ 7,777	$ (14)

The gross unrealized losses above were caused by interest rate increases. No significant facts or circumstances have arisen to indicate that there has been any deterioration in the creditworthiness of the issuers of the securities held by the Company. Based on the Company s review of these securities, including the assessment of the duration and severity of the unrealized losses and the Company s ability and intent to hold the investments until maturity, there were no material other-than-temporary impairments for these securities at June 30, 2013.

Fair value is defined as the exchange price that would be received for an asset or paid to transfer a liability (an exit price) in the principal or most advantageous market for the asset or liability in an orderly transaction between market participants on the measurement date. Valuation techniques used to measure fair value must maximize the use of observable inputs and minimize the use of unobservable inputs.

The Company utilizes the following fair value hierarchy based on three levels of inputs:

- Level 1: Quoted prices in active markets for identical assets or liabilities.

- Level 2: Inputs other than Level 1 that are observable, either directly or indirectly, such as quoted prices for similar assets or liabilities; quoted prices in markets that are not active; or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities.

- Level 3: Unobservable inputs that are supported by little or no market activity and that are significant to the fair value of the assets or liabilities.

The following tables represent the Company s fair value hierarchy for its financial assets and liabilities measured at fair value on a recurring basis as of June 30, 2013 and December 31, 2012 (in thousands):

June 30, 2013	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds	$ 27,257	$	$	$ 27,257
Corporate debt securities	1,000	20,072		21,072
Government agency debt securities		8,211		8,211

U.S. Treasury securities		1,004		1,004
Total	$ 28,257	$ 29,287	$	$ 57,544
Liabilities:				
Contingent consideration			1,498	1,498
Total	$	$	$ 1,498	$ 1,498

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December 31, 2012	Level 1	Level 2	Level 3	Total
Assets:				
Money market funds	$ 11,268	$	$	$ 11,268
U.S. corporate debt securities	6,039	29,556		35,595
U.S. Government agency debt securities		17,251		17,251
U.S. Treasury securities		2,009		2,009
Total	$ 17,307	$ 48,816	$	$ 66,123
Liabilities:				
Contingent consideration			1,342	1,342
Total	$	$	$ 1,342	$ 1,342

The fair value measurement of the contingent consideration obligations arises from the Zipsor acquisition and relates to the potential future milestone payments under the Zipsor agreement which is determined using Level 3 inputs. The key assumptions in determining the fair value are the discount rate and the probability assigned to the potential milestones being achieved. At each reporting date, the Company will re-measure the contingent consideration obligation arising from the Zipsor acquisition to its estimated fair value. Changes in the fair value of the contingent consideration obligations are recorded as a component of operating income in our condensed statement of operations and comprehensive income. For the three and six months ended June 30, 2013, accretion expense of $40,000 and $0.2 million was included within interest and other expense in the accompanying condensed statement of operations.

The table below provides a summary of the changes in fair value of all financial liabilities measured at fair value on a recurring basis using significant unobservable inputs (Level 3) for the six months ended June 30,2013 (in thousands):

	Balance at December 31, 2012	Net accretion and fair value adjustments	Balance at June 30, 2013
Liabilities:			
Contingent consideration obligations	$ 1,342	$ 156	$ 1,498

NOTE 3. NET INCOME (LOSS) PER COMMON SHARE

Basic net income (loss) per common share is calculated by dividing the net income (loss) by the weighted-average number of shares of common stock outstanding during the period. Diluted net loss per share is calculated by dividing the net income (loss) by the weighted-average number of shares of common stock outstanding during the period, plus dilutive common shares for the period determined using the treasury-stock method. For purposes of this calculation, options to purchase stock are considered to be potential common shares and are only included in the calculation of diluted net income (loss) per share when their effect is dilutive. Basic and diluted earnings per common share are calculated as follows:

(in thousands, except for per share amounts)	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
Numerator:				
Net income (loss)	$ 478	$ (15,780)	$ (5,002)	$ (24,582)

Denominator for basic net income (loss) per share	56,562	55,787	56,512	55,671
Net effect of dilutive common stock equivalents	580			
Denominator for diluted net income (loss) per share:	57,142	55,787	56,512	55,671
Basic net income (loss) per share	$ 0.01	$ (0.28)	$ (0.09)	$ (0.44)
Diluted net income (loss) per share	$ 0.01	$ (0.28)	$ (0.09)	$ (0.44)

For the three and six months ended June 30, 2013, the total number of antidilutive outstanding common stock equivalents excluded from the net income per common share computation were 5.9 million and 7.3 million, respectively. For the three and six months ended June 30, 2012, 5.5 million common stock equivalents were not included in dilutive shares because their effect is anti-dilutive.

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NOTE 4. LICENSE AND COLLABORATIVE ARRANGEMENTS

Ventiv Commercial Services, LLC

In May 2012, the Company entered into a service agreement with Ventiv Commercial Services, LLC (Ventiv), which initially provided for a sales force of 78 part-time sales representatives employed by Ventiv but dedicated to the Company. Under the agreement, the Company paid Ventiv a monthly fixed fee of $0.5 million during the initial term of the agreement, which expired in June 2013. In June 2013, the Company and Ventiv amended the agreement to reduce the contract sales force to 27 part-time and 2 full-time sales representatives. Under the terms of the amended agreement, we are required to pay Ventiv a monthly fixed fee of $0.2 million during the term of the agreement, which expires in June 2014.

Janssen Pharmaceutica N.V.

In August 2010, the Company entered into a non-exclusive license agreement with Janssen granting Janssen a license to use certain patents related to our Acuform drug delivery technology in developing fixed dose combinations of canagliflozin and extended release metformin. The Company also granted Janssen a right to reference the New Drug Application covering Glumetza in Janssen s regulatory filings covering the products. In August 2010, Janssen paid the Company a $5.0 million upfront license fee. In September 2010, the Company achieved the first development milestone under the agreement related to formulation work, which triggered a $5.0 million milestone payment which the Company received in October 2010. The Company is eligible to receive additional development milestones, as well as royalties on net sales of the products.

The Company also entered into a service agreement with Janssen under which it provided formulation work associated with the products. The formulation work under the agreement was completed in March 2011.

In February 2013, the Company completed an additional project for Janssen related to this program and recognized $2.2 million in revenue during the first quarter of 2013.

Santarus, Inc.

In August 2011, the Company entered into a commercialization agreement with Santarus granting Santarus exclusive rights to manufacture and commercialize Glumetza in the United States. The commercialization agreement supersedes the promotion agreement between the parties previously entered into in July 2008.

Under the commercialization agreement, the Company transitioned to Santarus responsibility for manufacturing, distribution, pharmacovigilance and regulatory affairs. The Company ceased shipments of Glumetza in August 2011, and Santarus began distributing and recording product sales on shipments of Glumetza in September 2011. Santarus will continue to be responsible at its expense for advertising and promotional marketing activities for Glumetza.

Santarus is required to pay the Company royalties on net product sales of Glumetza in the United States of 26.5% in 2011; 29.5% in 2012; 32.0% in 2013 and 2014; and 34.5% in 2015 and beyond, prior to generic entry of a Glumetza product. In the event of generic entry of a Glumetza product in the United States, the parties will equally share proceeds based on a gross margin split. Santarus has the exclusive right to commercialize authorized generic versions of the Glumetza products. Santarus is not required to pay additional sales milestones to the Company under the commercialization agreement. Royalty revenue from Santarus for the three and six months ended June 30, 2013 were $14.2 million and $27.5 million, respectively. Royalty revenue from Santarus for the three and six months ended June 30, 2012 was $9.4 million and $18.6 million, respectively.

The Company is financially responsible for returns of Glumetza distributed by the Company, up to the amount of the product returns reserve account for Glumetza product returns on the date immediately before Santarus began distributing Glumetza. The Company is financially responsible for Glumetza rebates and chargebacks up to the amount of its reserve accounts for those items. Santarus is responsible for all other Glumetza returns, rebates and chargebacks.

Under the commercialization agreement, the Company is responsible for managing any patent infringement lawsuits with respect to Glumetza-related patents, subject to certain consent rights in favor of Santarus, including with regard to any proposed settlements. Santarus reimburses the Company for 70% of its out-of-pocket costs, and the Company reimburses Santarus for 30% of its out-of-pocket costs, related to such lawsuits. The Company was previously responsible for managing the patent infringement lawsuit against Lupin Limited (Lupin), which was settled in February 2012, and against Sun Pharmaceutical Industries, Inc. (Sun), which was settled in January 2013.

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Pursuant to the original promotion agreement, Santarus paid the Company a $12.0 million upfront fee in July 2008. The upfront payment received was originally being amortized as revenue ratably until October 2021, which represented the estimated length of time the Company s obligations existed under the promotion agreement related to manufacturing Glumetza and paying Santarus promotion fees on gross margin of Glumetza. The commercialization agreement in August 2011 superseded the promotion agreement and removed our promotion fee obligations and contemplated removal of our manufacturing obligations. The commercialization agreement included obligations with respect to manufacturing and regulatory transition to Santarus and managing the patent infringement lawsuits against Sun and Lupin. At the time of the commercialization agreement, all of these obligations were estimated to be completed in December 2013. During the fourth quarter of 2012, events occurred related to the transfer of manufacturing with one of the contract manufacturers of Glumetza that extended the estimated completion date of Depomed s manufacturing obligations to February 2016, which is now the estimated date the Company expects its obligations will be completed under the commercialization agreement.

The Company recognized approximately $0.4 million and $0.7 million of revenue associated with this upfront license fee for the three and six months ended June 30, 2013, respectively. The Company recognized approximately $1.0 million and $2.0 million of license revenue associated with this upfront license fee for the three and six months ended June 30, 2012, respectively. The remaining deferred revenue balance is $3.7 million at June 30, 2013.

Boehringer Ingelheim International GMBH

In March 2011, the Company entered into a license and service agreement with Boehringer Ingelheim granting Boehringer Ingelheim a license to use certain patents related to the Company s Acuform drug delivery technology in development of fixed dose combinations of extended release metformin and proprietary Boehringer Ingelheim compounds in development for type 2 diabetes. Under the terms of the agreement, Boehringer Ingelheim was also granted a right of reference to the New Drug Application covering Glumetza and associated data for use in potential regulatory submission processes.

In March 2012, the Company achieved the first milestone under the agreement with respect to delivery of experimental batches of prototype formulations that meet required specifications, and received a nonrefundable $2.5 million milestone payment. As the milestone event was substantive in nature, achievement was not reasonably assured at the inception of the agreement and the milestone was related to past performance, the Company recognized the entire amount of this payment as revenue in the first quarter of 2012. The Company is also eligible to receive additional milestone payments based on regulatory filing and approval events, as well as royalties on worldwide net sales of products.

Ironwood Pharmaceuticals, Inc.

In July 2011, the Company entered into a collaboration and license agreement with Ironwood granting Ironwood a license for worldwide rights to the Company s Acuform drug delivery technology for an undisclosed Ironwood early stage development program. In March 2012, the Company achieved the first milestone under the agreement with respect to delivery of experimental batches of prototype formulations that meet required specifications, and received a nonrefundable $1.0 million milestone payment. As the nonrefundable milestone was substantive in nature, achievement of the milestone was not reasonably assured at the inception of the agreement and the milestone was related to past performance, the Company recognized the $1.0 million as revenue during the first quarter of 2012. Under the terms of the agreement, the Company may receive additional payments pending achievement of certain development and regulatory milestones, as well as royalties on product sales.

NOTE 5. STOCK-BASED COMPENSATION

The following table presents stock-based compensation expense recognized for stock options, stock awards, restricted stock units and the Company s employee stock purchase program (ESPP) in the Company s statements of operations (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Cost of sales	$ 11	$ 8	$ 21	$ 22
Research and development expense	89	149	199	346
Selling, general and administrative expense	1,462	1,026	2,753	2,173
Total	$ 1,562	$ 1,183	$ 2,973	$ 2,541

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At June 30, 2013, the Company had $11.4 million of total unrecognized compensation expense, net of estimated forfeitures, related to stock option grants and restricted stock units that will be recognized over an average vesting period of 2.5 years.

NOTE 6. INVENTORIES

Inventories consist of finished goods, raw materials and work in process and are stated at the lower of cost or market and consist of the following (in thousands):

	June 30, 2013	December 31, 2012
Raw materials	$ 1,838	$ 1,927
Work-in-process	256	1,569
Finished goods	5,982	6,787
Less: allowance for obsolescence	(850)	(696)
Total	$ 7,226	$ 9,587

Inventories relate to the manufacturing costs of the Company s Gralise and Zipsor products.

The fair value of inventories acquired related to the Zipsor acquisition in June 2012 included a step-up in the value of Zipsor inventories of $1.9 million, which was amortized to cost of sales through April 2013 as the acquired inventories were sold.

NOTE 7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES

Accounts payable and accrued liabilities consist of the following (in thousands):

	June 30, 2013	December 31, 2012
Accounts payable	$ 866	$ 2,360
Accrued compensation	4,029	5,015
Accrued rebates and sales discounts	4,309	4,250
Allowance for product returns	9,159	10,831
Accrued contract sales organization fees	969	420
Inventory and other contract manufacturing accruals	531	2,990
Other accrued liabilities	4,494	6,712
Total accounts payable and accrued liabilities	$ 24,357	$ 32,578

NOTE 8. SHAREHOLDERS EQUITY

Option Exercises

For the three and six months ended June 30, 2013 employees exercised options to purchase 68,541 and 187,781 shares of the Company s common stock with net proceeds to the Company of approximately $0.2 million and $0.6 million, respectively. For the three and six months ended June 30, 2012, employees and consultants exercised options to purchase 168,855 and 302,916 shares of the Company s common stock with net proceeds to the Company of approximately $0.5 million and $1.0 million, respectively.

Employee Stock Purchase Plan

In May 2013, the Company sold 104,765 shares under the ESPP. The shares were purchased at a weighted average purchase price of $4.30 per share with proceeds of approximately $0.5 million.

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NOTE 9. INCOME TAXES

As of December 31, 2012 and June 30, 2013, the Company had $3.6 million and $3.7 million of unrecognized tax benefits, respectively. All tax years since inception remain open to examination by the Internal Revenue Service and the California Franchise Tax Board until such time as the Company s net operating losses and credits are either utilized or expire. Interest and penalties, if any, related to unrecognized tax benefits, would be recognized as income tax expense by the Company. The Company does not have any accrued interest or penalties associated with unrecognized tax benefits. The Company does not foresee any material changes to unrecognized tax benefits within the next 12 months except as related to any new items impacting the current year operations.

NOTE 10. LEASES

In April 2012, the Company entered into an office and laboratory lease agreement to lease approximately 52,500 rentable square feet in Newark, California commencing on December 1, 2012. The Company is obligated to lease approximately 8,000 additional rentable square feet commencing no later than December 1, 2015. The lease will expire on November 30, 2022. However, the Company has the right to renew the lease for one additional five year term, provided that written notice is made to the landlord no later than 12 months prior to the lease expiration. The Company will have the one-time right to terminate the lease in its entirety effective as of November 30, 2017 by delivering written notice to the landlord on or before December 1, 2016. In the event of such termination, the Company will pay the landlord the unamortized portion of the tenant improvement allowance, specified additional allowances made by the landlord, waived base rent and leasing commissions, in each case amortized at 8% interest.

The terms of the lease include a tenant improvement allowance of up to $6.3 million covering the approximately 52,500 of space that is currently being leased. As of June 30, 2013, the Company had submitted claims for, and received $6.3 million from the landlord. The $6.3 million in submitted claims has been recorded as short- and long-term liabilities, as appropriate. The liabilities will be ratably reduced over the life of the lease which will reduce rent expense in accordance with the applicable accounting guidance.

The terms of the lease also include an additional tenant improvement allowance of up to $0.8 million covering the approximately 8,000 additional square feet of space that the Company is obligated to lease no later than December 1, 2015.

The Company was allowed to control physical access to the premises upon signing the lease. Therefore, in accordance with the applicable accounting guidance, the lease term was deemed to have commenced in April 2012. Accordingly, the rent free periods and the escalating rent payments contained within the lease are being recognized on a straight-line basis from April 2012. The Company will pay approximately $14.1 million in aggregate as rent over the term of the lease for the above premises. Deferred rent for the new lease was approximately $1.5 million as of June 30, 2013.

Rent expense was approximately $0.2 million and $0.7 million for the three and six months ended June 30, 2013. The lease on the Company s Menlo Park facility ended in January 2013. Rent expense was approximately $0.6 million and $1.0 million for the three and six months ended June 30, 2012.

NOTE 11. BUSINESS COMBINATIONS

On June 21, 2012, the Company entered into an Asset Purchase Agreement with Xanodyne, pursuant to which Depomed acquired Xanodyne s product Zipsor and related inventory for $26.4 million in cash, and assumed certain product related liabilities relating to Zipsor. In addition, the Company will make a one-time contingent payment to Xanodyne of $2.0 million in cash at the end of the first calendar year in which Depomed s net sales of Zipsor products exceed $30.0 million and an additional, one-time contingent payment to Xanodyne of $3.0 million in cash at the end of the first year in which Depomed s net sales of Zipsor products exceed $60.0 million.

In accordance with the authoritative guidance for business combinations, the Asset Purchase Agreement with Xanodyne was determined to be a business combination and was accounted for using the acquisition method of accounting. Neither separate financial statements nor pro forma results of operations have been presented because the acquisition transaction does not meet the qualitative or quantitative materiality tests under Regulation S-X.

Pursuant to the Asset Purchase Agreement, $3.0 million of the initial payment will be held in escrow for eighteen months and applied towards the indemnification obligations of Xanodyne as set forth in the Asset Purchase Agreement.

The following table presents a summary of the purchase price consideration for the Zipsor acquisition (in thousands):

Cash for Zipsor and related inventories	$	26,436
Fair Value of contingent consideration		1,303
Purchase Price	$	27,739

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The contingent consideration was recognized and measured at fair value as of the acquisition date and is included within other long-term liabilities in the accompanying balance sheet. The Company determined the acquisition date fair value of the contingent consideration obligation based on an income approach derived from Zipsor revenue estimates and a probability assessment with respect to the likelihood of achieving the level of net sales that would trigger the contingent payment. The fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement as defined in fair value measurement accounting. The key assumptions in determining the fair value are the discount rate and the probability assigned to the potential milestones being achieved. At each reporting date, the Company will re-measure the contingent consideration obligation to estimated fair value. Any changes in the fair value of contingent consideration will be recognized in operating expenses until the contingent consideration arrangement is settled.

The following table summarizes the fair values of the tangible and identifiable intangible assets acquired and liabilities assumed at the Zipsor acquisition date (in thousands):

Intangible asset - Zipsor product rights	$	27,100
Inventories		2,428
Other assets		100
Property, plant and equipment		43
Current liabilities		(1,840)
Bargain purchase		(92)
	$	27,739

The Zipsor product rights of $27.1 million have been recorded as intangible assets on the accompanying condensed balance sheet and are being amortized over the estimated useful life of the asset on a straight-line basis through July 2019. Total amortization expense for the three and six months ended June 30, 2013 were $1.0 million and $1.9 million, respectively.

The fair value of inventories acquired included a step-up in the value of Zipsor inventories of $1.9 million which was amortized to cost of sales through April 2013 as the acquired inventories were sold. The bargain purchase amount has been recorded within Interest and other income in the accompanying condensed statement of operations and comprehensive income.

NOTE 12. SUBSEQUENT EVENTS

Acquisition of Lazanda® (fentanyl) nasal spray

On July 29, 2013, the Company entered into an Asset Purchase Agreement with each of Archimedes Pharma US Inc., a Delaware corporation, Archimedes Pharma Ltd., a corporation registered under the laws of England and Wales, and Archimedes Development Ltd., a company registered under the laws of England and Wales (collectively, Archimedes), pursuant to which the Company acquired all of the U.S. and Canadian rights to Archimedes product Lazanda® (fentanyl) nasal spray and related inventory, for $4.0 million in cash. The Company also assumed certain liabilities related to Lazanda.

In addition to the initial payment, the Company will also pay royalties on its net sales of Lazanda. In 2013 and 2014, the Company will not pay royalties to Archimedes, and third party royalties assumed by the Company in connection with the acquisition will be less than 5% of the Company s net sales of Lazanda. Thereafter, the Company will pay royalties to Archimedes and third parties totaling 13% to 15% of the Company s net sales of Lazanda. In addition to the initial payment and royalties, the Company will pay to Archimedes the following one-time, cash contingent payments upon the achievement by the Company s net sales of Lazanda equal to or in excess of the following net sales milestones: (i) $1.0 million at the end of the first calendar year in which net sales of Lazanda are $20.0 million; (ii) $2.5 million at the end of the first calendar year in which net sales of Lazanda are $45.0 million; (iii) $5.0 million at the end of the first calendar year in which net sales of Lazanda are $75.0 million; and (iv) $7.5 at the end of the first calendar year in which net sales of Lazanda are $100.0 million.

NDA filing for MNK-795 accepted by FDA

In July 2013, the FDA accepted for filing a NDA from Mallinckrodt for MNK-795. MNK-795 is a controlled-release oral formulation of oxycodone and acetaminophen that has been studied for the management of moderate to severe acute pain where the use of an opioid analgesic is appropriate. MNK-795 is formulated with Depomed s Acuform® drug delivery technology. The NDA acceptance triggers a $5 million milestone payment to Depomed under a license agreement between Depomed and Mallinckrodt payable in the third quarter of 2013. The FDA granted the NDA a priority review, a designation given to drugs that, if approved, offer significant improvements in the safety or effectiveness of the treatment when compared to standard applications.

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ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

FORWARD-LOOKING INFORMATION

Statements made in this Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this Quarterly Report on Form 10-Q that are not statements of historical fact are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (the Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended. We have based these forward-looking statements on our current expectations and projections about future events. Our actual results could differ materially from those discussed in, or implied by, these forward-looking statements. Forward-looking statements are identified by words such as believe, anticipate, expect, intend, plan, will, may and other similar expressions. In addition, any statements that refer to expectations, projections or other characterizations of future events or circumstances are forward-looking statements. Forward-looking statements include, but are not necessarily limited to, those relating to:

- the commercial success and market acceptance of Gralise® (gabapentin), our once-daily product for the management of postherpetic neuralgia, Zipsor® (diclofenac potassium) liquid filled capsules, our non-steroidal anti-inflammatory drug for the treatment of mild to moderate pain in adults, and Lazanda® (fentanyl) nasal spray, our product for the management of breakthrough pain in adult, opioid-tolerant cancer patients;

- the commercial success of Glumetza® (metformin hydrochloride extended-release tablets) in the United States, and the efforts of our Glumetza commercial partner, Santarus, Inc. (Santarus);

- the results of our ongoing litigation against filers of Abbreviated New Drug Applications (each, an ANDA) to market generic Gralise in the United States and the filer of an ANDA to market generic Zipsor in the United States;

- the results of our ongoing litigation with the U.S. Food and Drug Administration (FDA) to obtain orphan drug exclusivity for Gralise in the United States;

- the outcome of our ongoing litigation against filers of ANDAs to market generic Glumetza in the United States;

- the outcome of our ongoing litigation against Purdue Pharma L.P. (Purdue) and Endo Pharmaceuticals Inc. (Endo);

- any additional patent infringement or other litigation that may be instituted related to Gralise, Zipsor, Lazanda, Glumetza or any other of our products or product candidates;

- our and our collaborative partners compliance or non-compliance with legal and regulatory requirements related to the promotion of pharmaceutical products in the United States;

- our plans to in-license, acquire or co-promote other products;

- the results of our research and development efforts;

- submission, acceptance and approval of regulatory filings;

- our need for, and ability to raise, additional capital; and

- our collaborative partners compliance or non-compliance with obligations under our collaboration agreements.

Factors that could cause actual results or conditions to differ from those anticipated by these and other forward-looking statements include those more fully described in the **RISK FACTORS** section and elsewhere in this Quarterly Report on Form 10-Q. We disclaim any intent or obligation to update or revise these forward-looking statements to reflect new events or circumstances.

ABOUT DEPOMED

Depomed is a specialty pharmaceutical company initially focused on pain and other conditions and diseases of the central nervous system. The core products of our current specialty pharmaceutical business are Gralise® (gabapentin), a once-daily product for the management of postherpetic neuralgia that we launched in October 2011, Zipsor® (diclofenac potassium) liquid filled capsules, a product for the treatment of mild to moderate acute pain that we acquired in June 2012, and Lazanda® (fentanyl) nasal spray, a product for the management of breakthrough pain in cancer patients 18 years of age and older who are already receiving and who are tolerant to opioid therapy for their underlying persistent cancer pain that we acquired in July 2013. We promote Gralise and Zipsor with a field force of 155 full-time sales representatives who are Depomed employees, as well as 29 primarily part-time sales representatives dedicated to the Company and employed by a contract sales organization. We will initially promote Lazanda with a small field force of full-time sales representatives dedicated to the Company and employed by a contract sales organization. We actively seek to expand our product portfolio through in-licensing, acquiring or obtaining co-promotion rights to commercially available products or late-stage product candidates that could be marketed and sold effectively with our existing products through our sales and marketing capability.

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We also have a portfolio of royalty and milestone producing assets based on our proprietary drug delivery technologies. The cornerstone of that portion of our business is Glumetza®, a once-daily treatment for adults with type 2 diabetes that we licensed to, and is currently being commercialized by, Santarus, Inc. (Santarus) in the United States. We have license and development arrangements associated with our Acuform® gastroretentive drug delivery technology with Mallinckrodt Pharmaceuticals (Mallinckrodt), Boehringer Ingelheim International GMBH (Boehringer Ingelheim), Ironwood Pharmaceuticals, Inc. (Ironwood), Merck & Co., Inc. (Merck), Janssen Pharmaceutica N.V. and Janssen Pharmaceuticals, Inc. (Janssen).

As of June 30, 2013, the Company has one product candidate under clinical development, DM-1992 for Parkinson s disease. DM-1992 completed a Phase 2 trial for Parkinson s disease, and the Company announced a summary of the results of that trial in November 2012.

Commercialized Products and Product Candidate Development Pipeline

The following table summarizes our and our partners commercialized products and product candidate development pipeline:

Depomed Commercialized Products

Product	Indication	Status
Gralise®	Postherpetic neuralgia	Currently sold in the United States. *Launched in October 2011*
Zipsor®	Mild to moderate acute pain	Currently sold in the United States. *Acquired by Depomed in June 2012*
Lazanda®	Breakthrough pain in opioid-tolerant patients 18 years of age and older already receiving and who are tolerant to continuous opioid therapy for underlying persistent cancer pain.	Currently sold in the United States. *Acquired by Depomed in July 2013*

Partner Commercialized Products and Product Candidates

Product / Product Candidate	Indication	Partner	Status
Glumetza®	Type 2 diabetes	United States rights held by Santarus; Canadian rights held by Valeant	Currently sold in the United States and Canada
Janumet® XR	Type 2 diabetes	Merck	License covers sales of Janumet® XR in the United States and

			certain other countries Currently sold in the United States, foreign regulatory filings in process
NUCYNTA® ER	Moderate to severe chronic pain; neuropathic pain associated with diabetic peripheral neuropathy (DPN)	Janssen	License covers sales of NUCYNTA® ER in the United States, Canada and Japan Currently sold in the United States and Canada
Canagliflozin/metformin XR combination products	Type 2 diabetes	Janssen	In development
Boehringer compounds/metformin XR combination products	Type 2 diabetes	Boehringer Ingelheim	In development
Acetaminophen/opiate combination products	Pain	Covidien	NDA for MNK-795 accepted and granted priority review by FDA in July 2013 MNK 155 in Phase 3 clinical trials
Undisclosed Ironwood compounds using Acuform® drug delivery technology	Gastrointestinal	Ironwood	Early stage development

Depomed Product Pipeline

Product	**Indication**	**Status**
DM-1992	Parkinson s disease	Phase 2 study completed in September 2012. Top-line results of Phase 2 study reported in November 2012

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PRODUCT DEVELOPMENTS AND TRANSACTIONS

Gralise (gabapentin) tablets for the Management of Postherpetic Neuralgia

In October 2011, we launched and announced the commercial availability of Gralise. Gralise product sales for the three and six months ended June 30, 2013 were $8.6 million and $14.6 million, respectively. Gralise product sales for the three and six months ended June 30, 2012 were $3.2 million and $5.0 million, respectively.

We promote Gralise through a field sales force of 155 full-time specialty sales representatives who are our employees and 29 contract sales representatives who are employed by Ventiv, our contract sales organization.

Orphan Drug Designation. In November 2010, the FDA granted Gralise Orphan Drug designation for the management of PHN based on a plausible hypothesis that Gralise is clinically superior to immediate release gabapentin due to the incidence of adverse events observed in Gralise clinical trials relative to the incidence of adverse events reported in the package insert for immediate release gabapentin. Generally, an Orphan-designated drug approved for marketing is eligible for seven years of regulatory exclusivity for the orphan-designated indication. If granted, Orphan Drug exclusivity for Gralise will run for seven years from January 28, 2011. However, the FDA has not granted Orphan Drug exclusivity for Gralise on the basis of FDA s interpretation of the statute and regulations governing Orphan Drug exclusivity. In September 2012, we filed an action in federal district court for the District of Columbia against the FDA seeking an order requiring the FDA to grant Gralise Orphan Drug exclusivity for the management of PHN. We believe Gralise is entitled to Orphan Drug exclusivity as a matter of law, and the FDA s action is not consistent with the statute or FDA s regulations related to Orphan Drugs. The lawsuit seeks a determination by the court that Gralise is protected by Orphan Drug exclusivity, and an order that FDA act accordingly. Briefing in the case was completed in March 2013 and a hearing on our summary judgment motion is scheduled for August 2013. We currently expect a decision by the end of 2013.

Zipsor (diclofenac potassium) liquid-filled capsules for Mild to Moderate Acute Pain

On June 21, 2012, we entered into an Asset Purchase Agreement with Xanodyne Pharmaceuticals, Inc. (Xanodyne), pursuant to which we acquired Xanodyne s product Zipsor and related inventory for $26.4 million in cash, and assumed certain liabilities relating to Zipsor. In addition, the agreement requires a one-time contingent payment to Xanodyne of $2.0 million in cash at the end of the first calendar year in which our net sales of Zipsor products exceed $30.0 million and an additional, one-time contingent payment to Xanodyne of $3.0 million in cash at the end of the first year in which our net sales of Zipsor products exceed $60.0 million. We also purchased Xanodyne s existing inventory and samples of Zipsor for approximately $0.5 million. We assumed responsibility for returns on product previously sold by Xanodyne with a fair value of $1.8 million as of the date of our acquisition of Zipsor. We began commercial sales of Zipsor in June 2012 and currently promote Zipsor through our field sales force. We recognized $5.6 million and $8.6 million in Zipsor revenue for the three and six months ended June 30, 2013.

Ventiv Commercial Services, LLC. In May 2012, we entered into a service agreement with Ventiv Commercial Services, LLC (Ventiv), which initially provided for a sales force of 78 part-time sales representatives employed by the Ventiv but dedicated to us. Under the agreement, we paid Ventiv a monthly fixed fee of $0.5 million during the initial term of the agreement, which expired in June 2013. In June 2013, we and Ventiv amended the agreement and reduced the contract sales force to 27 part-time and two full-time sales representatives. Under the terms of the amended agreement, we are required to pay Ventiv a monthly fixed fee of $0.2 million during the term of the agreement, which expires in

June 2014.

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Lazanda (fentanyl) nasal spray for the Management of Breakthrough pain in cancer patients, 18 years of age and older, who are already receiving and who are tolerant to opioid therapy for their underlying persistent cancer pain

On July 29, 2013, we entered into an Asset Purchase Agreement with each of Archimedes Pharma US Inc., a Delaware corporation, Archimedes Pharma Ltd., a corporation registered under the laws of England and Wales, and Archimedes Development Ltd., a company registered under the laws of England and Wales (collectively, Archimedes), pursuant to which we acquired Archimedes product Lazanda and related inventory for $4.0 million in cash, and assumed certain liabilities relating to Lazanda. In addition, the agreement requires the payment of royalties based on our net sales of Lazanda, although in 2013 and 2014, we will not pay royalties to Archimedes and third party royalties assumed by us in connection with the acquisition will be less than 5% of our net sales of Lazanda. Beginning January 2015, we will pay royalties to Archimedes and third parties totaling 13% to 15% of our net sales of Lazanda. In addition, the agreement requires the following one-time, cash contingent payments to Archimedes upon the achievement by our net sales of Lazanda equal to or in excess of the following net sales milestones: (i) $1.0 million at the end of the first calendar year in which net sales of Lazanda products are $20.0 million; (ii) $2.5 million at the end of the first calendar year in which net sales of Lazanda are $45.0 million; (iii) $5.0 million at the end of the first calendar year in which net sales of Lazanda are $75.0 million; and (iv) $7.5 at the end of the first calendar year in which net sales of Lazanda products are $100.0 million.

Publicis Touchpoint Solutions, Inc. In July 2013 and in connection with our acquisition of Lazanda, we assumed a services agreement previously entered into between Archimedes and Publicis Touchpoint Solutions, Inc. (Publicis) which provides for up to 15 full-time sales representatives employed by Publicis but dedicated to us. Under the agreement, we pay Publicis a monthly fixed fee of approximately $0.3 million during the term of the agreement, which expires in September 2013.

Glumetza for Type 2 Diabetes

Santarus. In August 2011, we entered into a commercialization agreement with Santarus granting Santarus exclusive rights to manufacture and commercialize Glumetza in the United States. The commercialization agreement supersedes the previous promotion agreement between the parties originally entered into in July 2008. Under the commercialization agreement, we granted Santarus exclusive rights to manufacture and commercialize Glumetza in the United States in return for a royalty on Glumetza net sales. We recognized $14.2 million and $27.5 million in royalty revenue for the three and six months ended June 30, 2013, respectively, under the commercialization agreement. We recognized $9.4 million and $18.6 million in royalty revenue for the three and six months ended June 30, 2012, respectively, under the commercialization agreement.

Pursuant to the commercialization agreement, we transitioned to Santarus responsibility for manufacturing, distribution, pharmacovigilance and regulatory affairs. Santarus pays us royalties on net product sales of Glumetza in the United States of 29.5% in 2012; 32.0% in 2013 and 2014; and 34.5% in 2015 and beyond prior to any future generic entry of a Glumetza product. Santarus has the exclusive right to commercialize authorized generic versions of the Glumetza products. In the event of generic entry of a Glumetza product in the territory, the parties will equally share proceeds based on a gross margin split. Santarus has the exclusive right to commercialize authorized generic versions of Glumetza.

In connection with its assumption of distribution and sales responsibility of Glumetza, Santarus purchased our existing inventory of Glumetza and bulk metformin hydrochloride at cost. We are financially responsible for returns of Glumetza distributed by us, up to the amount of our product returns reserve account for Glumetza product returns on the date immediately before Santarus began distributing Glumetza. We are also financially responsible for Glumetza rebates and chargebacks up to the amount of our reserve account for those items on the date immediately before Santarus began distributing Glumetza. Santarus is responsible for all other Glumetza returns, rebates and chargebacks.

Litigation. The settlement and license agreement we entered into with Lupin in February 2012 grants Lupin the right to begin selling a generic version of Glumetza on February 1, 2016, or earlier under certain circumstances. The settlement and license agreement we entered into with Sun in January 2013 grants Sun the right to begin selling a generic version of Glumetza on August 1, 2016, or earlier under certain circumstances. We are involved in patent litigation associated with Glumetza that is described under Legal Proceedings .

Mallinckrodt

In July 2013, the FDA accepted for filing a NDA from Mallinckrodt for MNK-795. MNK-795 is a controlled-release oral formulation of oxycodone and acetaminophen that has been studied for the management of moderate to severe acute pain where the use of an opioid analgesic is appropriate. MNK-795 is formulated with Depomed s Acuform® drug delivery technology. The NDA acceptance triggers a $5 million milestone payment to Depomed under a license agreement between Depomed and Mallinckrodt payable in the third quarter of 2013. The FDA granted the NDA a priority review, a designation given to drugs that, if approved, offer significant improvements in the safety or effectiveness of the treatment when compared to standard applications.

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Janssen Pharmaceutica N.V.

In August 2010, we entered into a non-exclusive license agreement with Janssen granting Janssen a license to certain patents related to our Acuform drug delivery technology to be used in developing fixed dose combinations of canagliflozin and extended release metformin. We also granted Janssen a right to reference the Glumetza NDA in Janssen s regulatory filings covering the products. In August 2010, Janssen paid us a $5.0 million upfront license fee. In September 2010, we achieved the first development milestone under the agreement related to formulation work, which triggered a $5.0 million milestone payment which we received in October 2010. We remain eligible to receive additional development milestones, as well as royalties on net sales of the products.

In February 2013, we completed a project for Janssen related to this program and recognized $2.2 million in revenue during the first quarter of 2013. We currently do not anticipate any further collaborative revenue for the remainder of 2013 related to this program.

Merck & Co., Inc.

We have received $12.5 million in upfront and milestone payments and will receive very low single digit royalties on Merck s net sales of Janumet XR in the United States and other licensed territories through the expiration of the licensed patents under a July 2009 license agreement with Merck. The non-exclusive license agreement grants Merck a license as well as other rights to certain of our patents directed to metformin extended release technology for Janumet XR, Merck s fixed-dose combination product for type 2 diabetes containing sitagliptin and extended release metformin that was approved by the FDA in January 2012. Merck began selling Janumet XR during the first quarter of 2012.

Boehringer Ingelheim

We have received $12.5 million in upfront and milestone payments and may receive additional development milestones, as well as royalties, pursuant to a March 2011 license and service agreement with Boehringer Ingelheim related to fixed dose combinations of extended release metformin and proprietary Boehringer Ingelheim compounds in development for type 2 diabetes. Under the agreement, we granted Boehringer Ingelheim a license to certain patents related to our Acuform drug delivery technology to be used in developing the combination products. Boehringer Ingelheim was also granted a right to reference the New Drug Application covering Glumetza in regulatory submissions for the products.

In March 2012, we received an additional $2.5 million upon delivery of experimental batches of prototype formulations that met agreed-upon specifications. The agreement provides for additional milestone payments based on regulatory filings and approval events, as well as royalties on worldwide net sales of products.

We were responsible for providing certain initial formulation work associated with the fixed dose combination products. Services performed by us under the agreement were reimbursed by Boehringer Ingelheim on an agreed-upon rate, and out-of-pocket expenses were reimbursed. We have completed all formulation work required under the agreement.

Ironwood Pharmaceuticals, Inc.

In July 2011, we entered into a collaboration and license agreement with Ironwood granting Ironwood a license for worldwide rights to certain patents and other intellectual property rights to our Acuform drug delivery technology for an undisclosed Ironwood early stage development program. In connection with the research collaboration and license agreement, we received an upfront payment of $0.9 million and were reimbursed for initial product formulation work.

In March 2012, we achieved the first milestone under the agreement upon delivery of experimental batches of prototype formulations that met agreed-upon specifications. This triggered a nonrefundable $1.0 million milestone payment which we received in May 2012. We may also receive milestone payments based on achievement of certain development and regulatory milestones, as well as royalties on product sales.

DM-1992 for Parkinson s Disease

In January 2012, we initiated a Phase 2 study to evaluate DM-1992 for the treatment of motor symptoms associated with Parkinson s disease. The trial was a randomized, active-controlled, open-label, crossover study testing DM-1992 dosed twice daily against a generic version of immediate-release carbidopa-levodopa dosed as needed. The trial enrolled 34 patients at 8 U.S. medical centers. The study assessed efficacy, safety and pharmacokinetic variables. The primary endpoint for the study was change in off time as measured by patient self-assessment and clinician assessment.

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Enrollment was completed in July 2012 and the study was completed in September 2012. In November 2012, we reported top-line results of the Phase 2 study, which we continue to evaluate as we consider partnering opportunities for DM-1992 and monitor competitive developments.

SefelsaTM for Menopausal Hot Flashes

In July 2012, we submitted a New Drug Application (NDA) for Sefelsa for the treatment of menopausal hot flashes. In May 2013, the FDA issued a complete response letter (CRL) for Sefelsa. The CRL states that the FDA cannot approve the application in its present form. Based on the letter, we currently do not intend to further invest in the product candidate.

CRITICAL ACCOUNTING POLICIES

Critical accounting policies are those that require significant judgment and/or estimates by management at the time that the financial statements are prepared such that materially different results might have been reported if other assumptions had been made. We consider certain accounting policies related to revenue recognition, accrued liabilities and stock-based compensation to be critical policies. There have been no changes to our critical accounting policies since we filed our 2012 Form 10-K with the SEC on February 22, 2013. For a description of our critical accounting policies, please refer to our 2012 Form 10-K.

RESULTS OF OPERATIONS

Three and Six Months Ended June 30, 2013 and 2012

Revenue

Total revenues are summarized in the following table (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Product sales:				
Gralise	$ 8,554	$ 3,201	$ 14,643	$ 4,950
Zipsor	5,552		8,592	
Proquin XR				360
Total product sales	14,106	3,201	23,235	5,310

Royalties:				
Santarus	14,193	9,424	27,481	18,646
Other	904	153	1,697	352
Total royalty revenue	15,097	9,577	29,178	18,998
License and Other revenue:				
Glumetza	$ 760	$ 1,387	1,520	2,775
Boehringer Ingelheim				2,617
Janssen			2,204	
Other		(55)		1,245
Total license and other revenue:	760	1,332	3,724	6,637
Total revenues	$ 29,963	$ 14,110	$ 56,137	$ 30,945

Product sales

Gralise. In October 2011, we announced the commercial availability of Gralise and began distributing Gralise to wholesalers and retail pharmacies. Until the fourth quarter of 2012, we deferred recognition of revenue on product shipments of Gralise until the right of return no longer existed, which occurred at the earlier of (a) the time Gralise units are dispensed through patient prescriptions or (b) expiration of the right of return. In the fourth quarter of 2012, we changed our revenue recognition policy for Gralise and began recognizing revenue upon shipment to our customers. The increase in Gralise product sales in 2013 is primarily a result of higher prescription demand. We currently expect Gralise product sales and prescriptions to increase from current levels for the remainder of 2013.

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Zipsor. We started recognizing sales on Zipsor at the end of June 2012. Our sales force began promoting Zipsor at the end of July 2012.

Lazanda. We anticipate we will begin recognizing sales on Lazanda during the third quarter of 2013.

Proquin XR. We ceased shipments of Proquin XR in the fourth quarter of 2010 and because of estimated significant levels of inventory at wholesalers and pharmacies in comparison to prescription demand, we deferred revenue recognition on product shipments of Proquin XR until the right of return no longer existed, which occurred at the earlier of the time Proquin XR units were dispensed through patient prescriptions or expiration of the right of return. At March 31, 2012, all rights of return expired and the remaining deferred revenue balance for Proquin XR was recognized as revenue during the first quarter of 2012.

Royalties

Santarus. We receive royalties from Santarus based on net sales of Glumetza in the United States. Royalty revenue from Santarus for the three and six months ended June 30, 2013 was $14.2 million and $27.5 million, respectively, and represents a 32.0% royalty on net sales of Glumetza. Royalty revenue from Santarus for the three and six months ended June 30, 2012 was $9.4 million and $18.6 million, respectively, and represents a 29.5% royalty on net sales of Glumetza. The increase in royalties in 2013 is primarily driven by the increase in royalty rate, higher average selling price and higher prescription demand.

Other Royalties. Merck began selling Janumet XR during the first quarter of 2012, and we began recognizing a very low single digit royalty on net product sales of Janumet XR. In August 2012, we entered into a license agreement with Janssen relating to NUCYNTA ER and began recognizing a low single digit royalty on net sales of NUCYNTA ER beginning in the third quarter of 2012.

License and Other Revenue

Glumetza. Glumetza license revenue for the three and six months ended June 30, 2013 and 2012 consisted of license revenue recognized from the $25.0 million upfront license fee received from Valeant in July 2005 and the $12.0 million upfront fee received from Santarus in July 2008.

We are recognizing the $25.0 million upfront license fee payment from Valeant as revenue ratably until October 2021, which represents the estimated length of time our obligations exist under the arrangement related to royalties we are obligated to pay Valeant on net sales of Glumetza in the United States and for our obligation to use Valeant as our sole supplier of the 1000mg Glumetza. We recognized approximately $0.4 million and $0.8 million of revenue associated with this upfront license fee for the three and six months ended June 30, 2013, respectively. The remaining deferred revenue balance is $13.3 million at June 30, 2013.

Pursuant to the promotion agreement originally entered into in July 2008, Santarus paid us a $12.0 million upfront fee. The upfront payment received was originally being amortized as revenue ratably until October 2021, which represented the estimated length of time our obligations existed under the promotion agreement related to manufacturing Glumetza and paying Santarus promotion fees on gross margin of Glumetza. The commercialization agreement in August 2011 superseded the promotion agreement and removed our promotion fee obligations and contemplated removal of our manufacturing obligations. The commercialization agreement included obligations with respect to manufacturing and regulatory transition to Santarus and managing the patent infringement lawsuits against Sun and Lupin. At the time of the commercialization agreement, all of these obligations were estimated to be completed in December 2013. During the fourth quarter of 2012, events occurred related to the transfer of manufacturing with one of the contract manufacturers of Glumetza that extended the estimated completion date of Depomed s manufacturing obligations to February 2016, which is now the estimated date we expect our obligations will be completed under the commercialization agreement.

On the effective date of the commercialization agreement, the amortization period related to remaining deferred revenue on the $12.0 million upfront fee was adjusted, and the remaining deferred revenue of $9.2 million was determined to be recognized ratably until December 2013. During the fourth quarter of 2012, the amortization period related to remaining deferred revenue on the $12.0 million upfront fee was adjusted again, and the remaining deferred revenue of $4.8 million was determined to be recognized ratably until February 2016.

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We recognized approximately $0.4 million and $0.7 million of revenue associated with this upfront license fee for the three and six months ended June 30, 2013, respectively. We recognized approximately $1.0 million and $2.0 million of revenue associated with this upfront license fee for the three and six months ended June 30, 2012, respectively. The remaining deferred revenue balance is $3.7 million at June 30, 2013.

Boehringer Ingelheim. Pursuant to our license and services agreement with Boehringer Ingelheim, Boehringer Ingelheim paid us a $10.0 million upfront license fee in March 2011, which was amortized ratably through November 2011, the estimated length of time we were obligated to perform formulation work under the agreements. As such the entire amount was recognized as license revenue in 2011.

Under the terms of the agreement, we received a nonrefundable $2.5 million milestone payment in March 2012. As the milestone event was substantive in nature, achievement was not reasonably assured at the inception of the agreement and the milestone was related to past performance, we recognized the entire amount of this payment as revenue during the first quarter of 2012.

We also provided certain initial formulation work associated with the fixed dose combination products for which we were reimbursed by Boehringer Ingelheim on an agreed-upon FTE rate per hour plus out-of-pocket expenses. We recognized approximately zero and $0.1 million of revenue associated with the reimbursement of formulation work under the service agreement during the three and six months ended June 30, 2012, respectively. We did not recognize any revenue associated with the reimbursement of formulation work in 2013.

Janssen Pharmaceutica N.V. Pursuant to our non-exclusive license agreement with Janssen, Janssen paid us a $5.0 million upfront license fee in August 2010 and an additional $5.0 million milestone payment in October 2012. We are eligible to receive additional development milestones, as well as royalties on net sales of the products.

In February 2013, we completed a project for Janssen related to this program and recognized $2.2 million in revenue during the first quarter of 2013. We currently do not anticipate any further collaborative revenue for the remainder of 2013 related to this program.

Other. Pursuant to our research collaboration and license agreement with Ironwood, Ironwood paid us a $0.9 million upfront payment in June 2011 which was amortized ratably through June 2012, the estimated length of time Depomed was obligated to perform formulation work under the agreement. We recognized approximately $0.2 million and $0.5 million of revenue associated with this upfront license fee for the three and six months ended June 30, 2012. There is no remaining deferred revenue related to this upfront payment at June 30, 2013.

In March 2012, we achieved a milestone under the agreement and Ironwood paid us the associated nonrefundable $1.0 million milestone payment in May 2012. As the nonrefundable milestone was substantive in nature, achievement of the milestone was not reasonably assured at the inception of the agreement, the milestone was related to past performance, and the collectability of the milestone is reasonably assured, we recognized the $1.0 million as revenue during the first quarter of 2012.

Under the terms of the agreement, we will assist with initial product formulation and Ironwood will be responsible for all development and commercialization of the product. The initial formulation work performed by us under the agreement will be reimbursed by Ironwood at an

agreed-upon FTE rate per hour plus out-of-pocket expenses. We recognized approximately $0.1 million of revenue associated with the reimbursement of formulation work under the agreement during the three and six months ended June 30, 2012.

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Cost of Sales

Cost of sales consists of costs of the active pharmaceutical ingredient, contract manufacturing and packaging costs, inventory write-downs, product quality testing, internal employee costs related to the manufacturing process, distribution costs and shipping costs related to our product sales of Gralise and Zipsor. Total cost of sales for the three and six months ended June 30, 2013 as compared to the prior year, was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Cost of sales	$ 1,688	$ 1,442	$ 3,172	$ 1,960
Dollar change from prior year	246		1,212	
Percentage change from prior year	17.1%		61.8%	

Cost of sales increased in 2013 as a result of the addition of Zipsor and higher Gralise product sales.

We commenced product sales of Zipsor in June 2012. The fair value of inventories acquired included a step-up in the value of Zipsor inventories of $1.9 million, which was amortized to cost of sales through April 2013 as the acquired inventories were sold. The cost of sales related to the step-up value of Zipsor for the three and six months ended June 30, 2013 was $0.2 million and $0.7 million, respectively.

Research and Development Expense

Our research and development expenses currently include salaries, clinical trial costs, consultant fees, supplies, manufacturing costs for research and development programs and allocations of corporate costs. The scope and magnitude of future research and development expenses cannot be predicted at this time for our product candidates in development, as it is not possible to determine the nature, timing and extent of clinical trials and studies, the FDA s requirements for a particular drug and the requirements and level of participation, if any, by potential partners. As potential products proceed through the development process, each step is typically more extensive, and therefore more expensive, than the previous step. Success in development therefore, generally results in increasing expenditures until actual product approval. Total research and development expense for the three and six months ended June 30, 2013 as compared to the prior year, was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2013	2012	2013	2012
Research and development expense	$ 1,412	$ 3,525	$ 4,710	$ 7,007
Dollar change from prior year	(2,113)		(2,297)	
Percentage change from prior year	-59.9%		-32.8%	

We categorize our research and development expense by project. The table below shows research and development costs for our major clinical development programs, as well as other expenses associated with all other projects in our product pipeline.

(In thousands)	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
SEFELSA	$ 9	$ 1,617	$ 1,989	$ 2,717
DM-1992	120	1,160	319	2,122
Other projects	1,283	748	2,402	2,168
Total research and development expense	$ 1,412	$ 3,525	$ 4,710	$ 7,007

The decrease in research and development expense for the three and six months ended June 30, 2013 as compared to the three and six months ended June 30, 2012 was primarily due to reduced costs related to our Sefelsa and Phase 2 trial for DM-1992 for Parkinson s disease programs.

Selling, General and Administrative Expense

Selling, general and administrative expenses primarily consist of personnel, contract personnel, marketing and promotion expenses associated with our commercial products, personnel expenses to support our administrative and operating activities, facility costs and professional expenses, such as legal fees and accounting fees. Total selling, general and administrative expense, as compared to the prior year, were as follows (in thousands):

	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
Selling, general and administrative expense	$ 25,368	$ 25,021	$ 51,331	$ 46,793
Dollar change from prior year	347		4,538	
Percentage change from prior year	1.4%		9.7%	

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The increase in selling, general and administrative expenses in 2013 primarily relates to the build out of our commercial infrastructure related to Gralise and sales and marketing expense related to Zipsor, which we acquired in June 2012. In October 2011, we began promoting Gralise through an agreement with our contract sales organization, Ventiv, which provided for 164 full-time sales representatives. In June 2012, we expanded our sales force and added an additional 78 part-time sales representatives through Ventiv. In September 2012, we established 155 full-time field sales territories and converted 142 of the Ventiv employees to Depomed employees. We did not convert the part-time sales representatives, and the conversion of the full-time sales representatives did not materially change selling, general and administrative expense. In June 2013, we reduced the contract sales organization with Ventiv from 78 part-time sales representatives to 27 part-time and 2 full-time sales representatives. We expect our selling, general and administrative expenses to slightly increase from current levels for the remainder of the year, primarily due to the acquisition of Lazanda in July 2013.

Amortization of Intangible Assets

(In thousands)	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
Amortization of intangible assets	$ 963	$ 105	$ 1,924	$ 105

The Zipsor product rights of $27.1 million have been recorded as intangible assets on the accompanying condensed balance sheet and are being amortized over the estimated useful life of the asset on a straight-line basis through July 2019. Amortization commenced on June 21, 2012, the date we acquired Zipsor. Total amortization expense for the three and six months ended June 30, 2013 was approximately $1.0 million and $1.9 million, respectively. Total amortization expense for the three and six months ended June 30, 2012 was approximately $0.1 million. The estimated amortization expense for each of the five succeeding fiscal years is expected to be $3.8 million.

Interest Income and Expense

(In thousands)	Three Months Ended June 30, 2013	2012	Six Months Ended June 30, 2013	2012
Interest and other income	$ 46	$ 204	$ 115	$ 347
Interest and other expense	(40)		(156)	
Net interest income (expense)	$ 6	$ 204	$ (41)	$ 347

Interest and other income decreased during the three and six months ended June 30, 2013 as compared to the corresponding period in 2012 as a result of lower investment balances.

The interest and other expense represent the change in the fair value of the contingent liability relating to the Zipsor acquisition.

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LIQUIDITY AND CAPITAL RESOURCES

The following table displays a summary of our cash, cash equivalents and marketable securities as of June 30, 2013 and December 31, 2012:

(In thousands)	June 30, 2013	December 31, 2012
Cash, cash equivalents and marketable securities	$ 74,221	$ 77,892

Since inception through June 30, 2013, we have financed our product development efforts and operations primarily from private and public sales of equity securities, upfront license, milestone and termination fees from collaborative and license partners, and product sales.

As of June 30, 2013, we have accumulated net losses of $132.4 million. We may incur operating losses in future years. We anticipate that our existing capital resources will permit us to meet our capital and operational requirements for at least the next two years. We base this expectation on our current operating plan, which may change as a result of many factors.

Our cash needs may also vary materially from our current expectations because of numerous factors, including:

- sales of our marketed products;
- expenditures related to our commercialization of Gralise, Zipsor and Lazanda;
- milestone and royalty revenue we receive under our collaborative development and commercialization arrangements;
- acquisitions or licenses of complementary businesses, products or technologies;
- financial terms of definitive license agreements or other commercial agreements we may enter into;
- results of research and development efforts;
- changes in the focus and direction of our business strategy and/or research and development programs; and
- results of clinical testing requirements of the FDA and comparable foreign regulatory agencies.

We will need substantial funds to:

- commercialize any products we market;
- manufacture our products and product candidates;
- acquire or license complementary businesses or products;
- conduct preclinical and clinical testing; and
- conduct research and development programs.

Our existing capital resources may not be sufficient to fund our operations until such time as we may be able to generate sufficient positive cash flows to sustain our operations. We currently do not have any other committed sources of capital. To the extent that our capital resources are insufficient to meet our future capital requirements, we will have to raise additional funds through the sale of our equity securities or from development and licensing arrangements to continue our development programs. We may be unable to raise such additional capital on favorable terms, or at all. If we raise additional capital by selling our equity or convertible debt securities, the issuance of such securities could result in dilution of our shareholders equity positions. If adequate funds are not available we may have to:

- significantly curtail commercialization of our marketed products or other operations;
- obtain funds through entering into collaboration agreements on unattractive terms; and/or
- delay, postpone or terminate clinical trials.

The inability to raise any additional capital required to fund our operations could have a material adverse effect on our company.

Cash Flows from Operating Activities

Cash used in operating activities during the six months ended June 30, 2013 was approximately $3.7 million, compared to $24.9 million during the six months ended June 30, 2012, and was primarily due to net loss for each respective period adjusted for movements in working capital, stock-based compensation and depreciation expense.

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Cash Flows from Investing Activities

Net cash provided by investing activities during the six months ended June 30, 2013 was approximately $18.5 million, which was primarily due to higher proceeds from maturities of marketable securities relative to purchases of marketable securities. Net cash provided by investing activities during the six months ended June 30, 2012 was approximately $12.9 million and consisted of a decrease in marketable securities to fund our operations offset by the acquisition of Zipsor for $26.4 million in cash in June 2012.

Cash Flows from Financing Activities

Cash provided by financing activities during the six months ended June 30, 2013 and 2012 were approximately $1.1 million and $1.4 million, respectively, and consisted of proceeds from employee option exercises.

Contractual Obligations

As of June 30, 2013, our aggregate contractual obligations are as shown in the following table (in thousands):

	1 Year	2-3 Years	4-5 Years	More than 5 Years	Total
Operating leases	$ 1,181	$ 2,542	$ 2,970	$ 7,208	$ 13,901
Contract sales organization	2,423				2,423
Purchase commitments	1,019				1,019
	$ 4,623	$ 2,542	$ 2,970	$ 7,208	$ 17,343

At June 30, 2013, we had non-cancelable purchase orders and minimum purchase obligations of approximately $1.0 million under our manufacturing agreements related to Gralise and Zipsor. The amounts disclosed only represent minimum purchase requirements.

In May 2012, the Company entered into a service agreement with Ventiv which initially provided for a sales force of 78 part-time sales representatives employed by Ventiv but dedicated to the Company. Under the agreement, the Company paid Ventiv a monthly fixed fee of $0.5 million during the initial term of the agreement, which expired in June 2013. In June 2013, the Company and Ventiv amended the agreement to reduce the contract sales force to 27 part-time and 2 full-time sales representatives. Under the terms of the amended agreement, we are required to pay Ventiv a monthly fixed fee of $0.2 million during the term of the agreement, which expires in June 2014.

In April 2012, the Company entered into an office and laboratory lease agreement to lease approximately 52,500 rentable square feet in Newark, California commencing on December 1, 2012 and an additional 8,000 rentable square feet commencing no later than December 1, 2015. The Newark lease included free rent for the first five months of the lease. Lease payments began in May 2013. The Company s Menlo Park lease

ended in January 2013. The Company will have the one-time right to terminate the lease in its entirety effective as of November 30, 2017 by delivering written notice to the landlord on or before December 1, 2016. In the event of such termination, the Company will pay the landlord the unamortized portion of the tenant improvement allowance, specified additional allowances made by the landlord, waived base rent and leasing commissions, in each case amortized at 8% interest.

The above table excludes any future royalty payments we may be required to pay on products we have licensed.

The contractual obligations reflected in the above table also exclude up to $5.0 million in contingent sales milestones we may be obligated to pay in the future under our asset purchase agreement with Xanodyne for Zipsor. We are obligated to pay Xanodyne a one-time $2.0 million milestone payment at the end of the first calendar year in which net sales of Zipsor exceed $30 million, and a one-time $3.0 million milestone payment at the end of the first calendar year in which net sales of Zipsor exceed $60 million.

The table above also excludes non-cancelable purchase orders and minimum purchase obligations of approximately $2.2 million under our supply agreement with Valeant for the supply of 1000mg Glumetza, as these obligations will be fully reimbursed by Santarus.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

There have been no significant changes in our market risk compared to the disclosures in Item 7A of our Annual Report on the 2012 Form 10-K.

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ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

An evaluation was performed under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this quarterly report. Based on that evaluation, our management, including our Chief Executive Officer and Chief Financial Officer, concluded that our disclosure controls and procedures were effective.

We review and evaluate the design and effectiveness of our disclosure controls and procedures on an ongoing basis to improve our controls and procedures over time and to correct any deficiencies that we may discover in the future. Our goal is to ensure that our senior management has timely access to all material financial and non-financial information concerning our business. While we believe the present design of our disclosure controls and procedures is effective to achieve our goal, future events affecting our business may cause us to significantly modify our disclosure controls and procedures.

Changes in Internal Controls

There were no changes in our internal controls over financial reporting during the quarter ended June 30, 2013 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

Depomed v. Watson Laboratories (Glumetza ANDA Litigation)

In April 2012, we filed a lawsuit in the United States District Court for the District of Delaware against Watson Laboratories, Inc. Florida, Actavis, Inc. (f/k/a Watson Pharmaceuticals, Inc.) and Watson Pharma, Inc. (collectively, Watson), for infringement of U.S. Patent Nos. 6,488,962 and 7,780,987, the two patents listed in the Orange Book at the commencement of the litigation for Glumetza 1000mg dosage. The complaint was amended on February 27, 2013 to add allegations of infringement of three additional patents, U.S. Patent Nos. 8,323,692 (which was subsequently listed in the Orange Book after the commencement of the litigation), and 7,736,667 and 8,329,215. The lawsuit is in response to an ANDA filed by Watson with the FDA regarding Watson s intent to market a generic version of the 1000 mg dosage strength of Glumetza prior to the expiration of the asserted patents. Valeant International Bermuda (f/k/a Valeant International (Barbados) SRL) is joined in the lawsuit as a co-plaintiff as the owner of U.S. Patent No. 7,780,987. We commenced the lawsuit within the 45 days required to automatically

stay, or bar, the FDA from approving Watson s ANDA for 30 months or until a district court decision that is adverse to the patents, whichever may occur earlier. Absent a court order, the 30-month stay is expected to expire in September 2014. Trial is scheduled for May 27, 2014.

In February 2013, we filed a complaint in the United States District Court for the District of Delaware against Watson Laboratories, Inc. Florida, Actavis, Inc., and Watson Pharma, Inc. (collectively, Watson) for infringement of the patents listed in the Orange Book for Glumetza 500mg. The lawsuit is in response to an ANDA filed by Watson with the FDA regarding Watson s intent to market a generic version of the 500mg dosage strength of Glumetza prior to the expiration of the asserted patents. We commenced the lawsuit within 45 days required to automatically stay, or bar, the FDA from approving Watson s ANDA for the 500mg dosage strength of Glumetza for 30 months or until a district court decision that is adverse to the patents, whichever may occur earlier. Absent a court order, the 30-month stay is expected to expire in August 2015.

Depomed v. Gralise ANDA Filers

In March 2012, we filed a lawsuit in the United States District Court for the District of New Jersey against Actavis Elizabeth LLC and Actavis Inc. (collectively Actavis), Watson Laboratories, Inc., Florida, Watson Pharma, Inc., and Watson Laboratories (collectively, Watson) and Incepta Pharmaceuticals (Incepta) for infringement of six U.S. patents listed in the Orange Book for the Gralise Product. The lawsuit is in response to ANDAs filed by each of Actavis, Watson and Incepta with the FDA regarding the defendants intent to market generic versions of 300mg and 600mg dosage strengths of Gralise prior to the expiration of the Orange Book patents, which include U.S. Patent Nos.: 6,340,475, 6,488,962, 6,635,280, 6,723,340, 7,438,927 and 7,731,989. We commenced the lawsuit within the 45 days required to automatically stay, or bar, the FDA from approving the ANDAs for 30 months or until a district court decision that is adverse to the asserted patents, whichever may occur earlier. Absent a court order, the 30-month stays are expected to expire in July 2014 and August 2014. In August 2012, we amended the complaint to assert U.S. Patent No. 8,192,756 and add Abon Pharmaceuticals LLC (Abon) as a defendant. In September 2012, we amended the complaint to assert U.S. Patent No. 8,252,332. Each of these patents is listed in the Orange Book. On December 21, 2012, the Court granted a joint stipulation to dismiss Watson from the case after Watson represented to Depomed that it had withdrawn its Gralise ANDA from consideration by the FDA. We may reinstitute our lawsuit should Watson resume its efforts to gain FDA approval of a generic form of Gralise. In March 2013, we amended the complaint to assert U.S. patent No. 8,333,992 against Actavis, Incepta and Abon. U.S. patent No. 8,333,992 is now listed in the Orange Book.

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In April 2012, we filed a lawsuit in the United States District Court for the District of New Jersey against Impax Laboratories (Impax), and against Par Pharmaceutical Companies, Inc. and Par Pharmaceutical, Inc. (Par) for infringement of six U.S. patents listed in the Orange Book for the Gralise product. The lawsuit is in response to ANDAs filed by each of lmpax and Par with the FDA regarding the defendants intent to market generic versions of 300mg and 600mg dosage strengths of Gralise prior to the expiration of the Orange Book patents, which includes U.S. Patent Nos.: 6,340,475, 6,488,962, 6,635,280, 6,723,340, 7,438,927 and 7,731,989. We commenced the lawsuit against Impax and Par within the 45 days required to automatically stay, or bar, the FDA from approving the ANDAs for 30 months or until a district court decision that is adverse to the asserted patents, whichever may occur earlier. Absent a court order, the 30-month stay is expected to expire in September 2014. In August 2012 and September 2012, we amended the complaint to assert respectively U.S. Patent Nos.: 8,192,756 and 8,252,332, which are now listed in the Orange Book. In October 2012, Impax withdrew its Gralise ANDA. As a result, we and Impax agreed to stipulate to this dismissal of our lawsuit against Impax for infringement of the Orange Book-listed patents. On December 17, 2012, the Court granted a joint stipulation to dismiss Par from the case after Par represented to Depomed that it no longer seeks approval of its Gralise ANDA prior to the expiration of the Orange Book-listed patents. In January 2013, the Court terminated the case. We may reinstitute our lawsuit against Par or Impax should either resume its efforts to gain FDA approval of a generic form of Gralise before expiration of the last Orange Book-listed patent.

In May 2012, we filed a lawsuit in the United States District Court for the District of New Jersey against Zydus Pharmaceuticals USA Inc. and Cadila Healthcare Limited (collectively Zydus) for infringement of six U.S. patents listed in the Orange Book for the Gralise product. The lawsuit is in response to the ANDA filed by Zydus with the FDA regarding Zydus s intent to market generic versions of 300mg and 600mg dosage strengths of Gralise prior to the expiration of the Orange Book patents, which includes U.S. Patent Nos.: 6,340,475, 6,488,962, 6,635,280, 6,723,340, 7,438,927 and 7,731,989. We commenced the lawsuit within the 45 days required to automatically stay, or bar, the FDA from approving the ANDA for 30 months or until a district court decision that is adverse to the asserted patents, whichever may occur earlier. Absent a court order, the 30-month stay is expected to expire in October and November 2014. In August 2012 and September 2012, we amended the complaint to assert respectively U.S. Patent Nos.: 8,192,756 and 8,252,332, which are now listed in the Orange Book. In March 2013, we amended the complaint to assert U.S. patent No. 8,333,992 against Zydus. U.S. Patent No. 8,333,992 is now listed in the Orange Book.

On June 13, 2012, the Court held the Case Management Conference. The Court ordered all three cases to be consolidated for purposes of all pretrial proceedings. The Markman claim construction hearing was held on June 26, 2013. Discovery is ongoing and close of fact discovery is scheduled for August 16, 2013. The Pretrial Conference is scheduled for March 13, 2014. No specific trial date has been set.

Depomed v. FDA

In November 2010, the FDA granted Gralise Orphan Drug designation for the management of PHN based on a plausible hypothesis that Gralise is clinically superior to immediate release gabapentin due to the incidence of adverse events observed in Gralise clinical trials relative to the incidence of adverse events reported in the package insert for immediate release gabapentin. Generally, an Orphan-designated drug approved for marketing is eligible for seven years of regulatory exclusivity for the orphan-designated indication. If granted, Orphan Drug exclusivity for Gralise will run for seven years from January 28, 2011. However, the FDA has not granted Orphan Drug exclusivity for Gralise based on the FDA s interpretation of the law and regulations governing Orphan Drug exclusivity. In September 2012, we filed an action in federal district court for the District of Columbia against the FDA seeking an order requiring the FDA to grant Gralise Orphan Drug exclusivity for the management of PHN. We believe Gralise is entitled to Orphan Drug exclusivity as a matter of law, and the FDA s action is not consistent with the statute or FDA s regulations governing Orphan Drugs. The lawsuit seeks a determination by the court that Gralise is protected by Orphan Drug exclusivity, and an order that FDA act accordingly. Briefing in the case was completed in March 2013 and a hearing on our summary judgment motion is scheduled for August 2013. We currently expect a decision by the end of 2013.

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Depomed v. Purdue

In January 2013, we filed a complaint in the United States District Court for the District of New Jersey against Purdue Pharma L.P. and affiliated companies (collectively, Purdue) for infringement of U.S. Patent Nos.: 6,340,475; 6,635,280; and 6,723,340, each of which is held by Depomed. The complaint alleges infringement of our patents arising from Purdue s commercialization of OxyContin® (oxycodone hydrochloride controlled-release) in the United States. On March 28, 2013, Purdue filed an answer and counterclaims, asserting non-infringement and invalidity.

Depomed v. Endo Pharmaceuticals

In April 2013, we filed a complaint in the United States District Court for the District of New Jersey against Endo Pharmaceuticals Inc. (Endo), a wholly-owned subsidiary of Endo Health Solutions Inc., for infringement of U.S. Patent Nos.: 6,340,475; 6,635,280; and 6,723,340, each of which is held by Depomed. The complaint alleges infringement of our patents arising from Endo s commercialization of OPANA® ER (oxymorphone hydrochloride extended-release) in the United States.

Depomed v. Banner Pharmacaps

On June 28, 2013, we received from Banner Pharmacaps Inc. (Banner) a Notice of Certification for U.S. Patents Nos. 6,365,180, 7,662,858, 7,884,095, 7,939,518 and 8,110,606 under 21 U.S.C. § 355 (j)(2)(A)(vii)(IV) (Zipsor® Paragraph IV Letter) certifying that Banner has submitted and the FDA has accepted for filing an Abbreviated New Drug Application (ANDA) for diclofenac potassium capsules, 25mg (Banner ANDA product). The letter states that the Banner ANDA product contains the required bioavailability or bioequivalence data to Zipsor and certifies that Banner intends to obtain FDA approval to engage in commercial manufacture, use or sale of Banner s ANDA product before the expiration of the above identified patents, which are listed for Zipsor in the Patent and Exclusivity Information Addendum of FDA s publication, *Approved Drug Products with Therapeutic Equivalence Evaluations* (commonly known as the Orange Book). U.S. Patent No. 6,365,180 expires in 2019 and U.S. Patent Nos. 7,662,858; 7,884,095; 7,939,518; and 8,110,606 expire in 2029. The Zipsor Paragraph IV letter indicates Banner has granted to Watson Laboratories Inc. (Watson) exclusive rights to Banner s proposed generic Zipsor product.

On July 26, 2013, we filed a lawsuit in the United States District Court for District of New Jersey against Banner and Watson of the patents identified above. The lawsuit was commenced within the 45 days required to automatically stay, or bar, the FDA from approving Banner s ANDA for Zipsor for 30 months or until a district court decision that is adverse to Depomed, whichever may occur earlier. Absent a court order, the 30-month stay would be expected to expire in December 2015.

General

We cannot reasonably predict the outcome of the legal proceedings described above, nor can we estimate the amount of loss, or range of loss, if any, that may result from these proceedings. As such we are not currently able to estimate the impact of the above litigation on our financial position or results of operations.

We may from time to time become party to actions, claims, suits, investigations or proceedings arising from the ordinary course of our business, including actions with respect to intellectual property claims, breach of contract claims, labor and employment claims, and other matters. Although actions, claims, suits, investigations and proceedings are inherently uncertain and their results cannot be predicted with certainty, other than the matters set forth above, we are not currently involved in any matters that we believe may have a material adverse effect on our business, results of operations or financial condition. However, regardless of the outcome, litigation can have an adverse impact on us because of associated cost and diversion of management time.

ITEM 1A. RISK FACTORS

The risk factors presented below amend and restate the risk factors previously disclosed in our 2012 Form 10-K and our Form 10-Q for the fiscal quarter ended March 31, 2013.

The following factors, along with those described above under MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS LIQUIDITY AND CAPITAL RESOURCES should be reviewed carefully, in conjunction with the other information contained in this Form 10-Q and our financial statements. These factors, among others, could cause actual results to differ materially from those currently anticipated and contained in forward-looking statements made in this Form 10-Q and presented elsewhere by our management from time to time. See Part I, Item 2 Forward-Looking Information.

If we are not able to successfully commercialize Gralise, Zipsor and Lazanda, our business will suffer.

In October 2011, we began commercial sales of Gralise. In June 2012, we acquired Zipsor, and we began commercial promotion of Zipsor in late July 2012. In July 2013, we acquired and began commercial promotion of Lazanda. As a company, we have limited experience selling and marketing pharmaceutical products. We may not be able to adequately maintain or scale the necessary sales, marketing, manufacturing, managed markets or other capabilities and infrastructure that are required to successfully commercialize Gralise, Zipsor and Lazanda. If we are unable to successfully perform these functions or execute our sales and marketing strategies for Gralise, Zipsor and Lazanda, we will not be able to maintain or increase our revenues and our business will suffer.

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If Santarus does not continue to successfully commercialize Glumetza in the United States, our business will suffer.

Pursuant to a commercialization agreement we entered into with Santarus in 2011, Santarus is primarily responsible for the commercialization of Glumetza in the United States. Our Glumetza royalty revenue depends on Santarus commercialization efforts, which could be adversely affected by any of the following factors:

- Santarus may acquire or develop alternative products;
- Santarus may pursue higher-priority programs, or change the focus of its marketing programs;
- Santarus may in the future choose to devote fewer resources to Glumetza;
- Glumetza may fail to sustain its current level of market acceptance;
- Santarus may fail to supply Glumetza 500mg from their contract manufacturers and distributors;
- Santarus may experience financial difficulties;
- Santarus may fail to comply with its obligations under our commercialization agreement;
- the outcome of our any litigation against current or future Glumetza ANDA filers; and
- the outcome of any patent infringement litigations involving our patents covering Glumetza.

Any of the preceding factors could affect Santarus commitment to the commercialization of Glumetza, which, in turn, could adversely affect our Glumetza royalty revenue. Any material reduction in our Glumetza royalties would have a material adverse effect on our business, financial condition and results of operations. We and Santarus have entered into a settlement and license agreements with each of Lupin Pharmaceuticals and Sun Pharma to resolve patent litigation involving Glumetza. The agreements grant Lupin the right to begin selling a generic version of Glumetza on February 1, 2016 and Sun the right to begin selling a generic version of Glumetza on August 1, 2016 (or earlier under certain circumstances in each case). The introduction of a generic version of Glumetza will materially and adversely affect the revenues we receive from the sales of Glumetza by Santarus.

If generic manufacturers use litigation and regulatory means to obtain approval for generic versions of our products, our business will suffer.

Under the Federal Food, Drug and Cosmetics Act (FDCA), the FDA can approve an Abbreviated New Drug Application (ANDA), for a generic version of a branded drug without the ANDA applicant undertaking the clinical testing necessary to obtain approval to market a new drug. In place of such clinical studies, an ANDA applicant usually needs only to submit data demonstrating that its product has the same active ingredient(s) and is bioequivalent to the branded product, in addition to any data necessary to establish that any difference in strength, dosage form, inactive ingredients, or delivery mechanism does not result in different safety or efficacy profiles, as compared to the reference drug.

The FDCA requires an applicant for a drug that relies, at least in part, on the patent of one of our branded drugs to notify us of their application and potential infringement of our patent rights. Upon receipt of this notice we have 45 days to bring a patent infringement suit in federal district court against the company seeking approval of a product covered by one of our patents. The discovery, trial and appeals process in such suits can take several years. If such a suit is commenced, the FDCA provides a 30-month stay on the FDA s approval of the competitor s application. Such litigation is often time-consuming and quite costly and may result in generic competition if the patents at issue are not upheld or if the generic competitor is found not to infringe such patents. If the litigation is resolved in favor of the applicant or the challenged patent expires during the 30-month stay period, the stay is lifted and the FDA may thereafter approve the application based on the standards for approval of ANDAs.

We are currently involved in patent infringement litigation against filers of three ANDAs to Gralise in connection with lawsuits consolidated in the United States District Court for the District of New Jersey, as described in greater detail under LEGAL PROCEEDINGS above. The lawsuits were filed in March 2012 and May 2012 against ANDA filers are Actavis Elizabeth LLC (Actavis), Incepta Pharmaceuticals (Incepta), and Zydus Pharmaceuticals USA and Cadila Healthcare Limited (collectively, Zydus) for infringement of nine U.S. patents listed in the Patent and Exclusivity Information Addendum of FDA s publication, *Approved Drug Products with Therapeutic Equivalence Evaluations* (commonly known as the Orange Book) for Gralise. We commenced the lawsuits within the 45 days required to automatically stay, or bar, the FDA from approving the ANDAs for 30 months or until a district court decision that is adverse to the asserted patents, whichever may occur earlier. The 30-month stays expire between July 2014 and September 2014. If the litigation is still ongoing after expiration of the applicable 30-month stay, the termination of the stay could result in the introduction of one or more products generic to Gralise prior to resolution of the litigation. Any introduction of one or more products generic to Gralise would harm our business, financial condition and results of operations.

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We are also involved in patent infringement litigation against a filer of ANDAs to Glumetza, as described in greater detail under LEGAL PROCEEDINGS above. The lawsuits were filed in April 2012 and February 2013 in the United States District Court for the District of Delaware against Watson Laboratories, Inc. Florida, Actavis, Inc. (f/k/a Watson Pharmaceuticals, Inc.) and Watson Pharma, Inc. (collectively, Watson) for infringement of the patents listed in the Orange Book for Glumetza. We commenced the lawsuit within the 45 days required to automatically bar the FDA from approving the ANDAs for 30 months or until an earlier district court decision that is adverse to the patents. Absent a court decision, the 30-month stay on the Watson ANDA is expected to expire in September 2014 as to the ANDA related to the 1000 mg dosage strength and August 2015 as to the 500mg dosage strength.

On June 28, 2013, we received from Banner Pharmacaps Inc. (Banner) a Notice of Certification for U.S. Patents Nos. 6,365,180, 7,662,858, 7,884,095, 7,939,518 and 8,110,606 under 21 U.S.C. § 355 (j)(2)(A)(vii)(IV) (Zipsor® Paragraph IV Letter) certifying that Banner has submitted and the FDA has accepted for filing an Abbreviated New Drug Application (ANDA) for diclofenac potassium capsules, 25 mg (Banner ANDA product). The letter states that the Banner ANDA product contains the required bioavailability or bioequivalence data to Zipsor and certifies that Banner intends to obtain FDA approval to engage in commercial manufacture, use or sale of Banner s ANDA product before the expiration of the above identified patents, which are listed for Zipsor in the Orange Book. We commenced the lawsuit within the 45 days required to automatically bar the FDA from approving the Banner ANDA product for 30 months or until a district court decision that is adverse to the asserted patents, whichever may occur earlier. Absent a court order, the 30-month stay is expected to expire in December 2015.

Any introduction of one or more products generic to Gralise, Glumetza, Zipsor or Lazanda would harm our business, financial condition and results of operations. The filing of the ANDAs described above, or any other ANDA or similar application in respect to any of our products could have an adverse impact on our stock price. Moreover, if the patents covering our products were not upheld in litigation or if a generic competitor is found not to infringe these patents, the resulting generic competition would have a material adverse effect on our business, results of operations and financial condition.

We depend on third parties that are single source suppliers to manufacture Gralise, Zipsor and Lazanda. If these suppliers are unable to manufacture and supply Gralise, Zipsor and Lazanda or our product candidates, our business will suffer.

Patheon is our sole supplier for Gralise pursuant to a manufacturing and supply agreement we entered into with Patheon in September 2011. Accucaps is our sole supplier for Zipsor pursuant to a manufacturing agreement we assumed in connection with our acquisition of Zipsor from Xanodyne in June 2012. DPT Lakewood, Inc. is our sole supplier for Lazanda pursuant to a manufacturing and supply agreement that we will assume in connection with our July 2013 acquisition of Lazanda. We do not have, and we do not intend to establish in the foreseeable future, internal commercial scale manufacturing capabilities. Rather, we intend to use the facilities of third parties to manufacture products for clinical trials and commercialization. Our dependence on third parties for the manufacture of our products and our product candidates may adversely affect our ability to deliver such products on a timely or competitive basis, if at all. Any failure to obtain Gralise, Zipsor or Lazanda, or active pharmaceutical ingredient, excipients or components, from our suppliers could adversely affect our business, results of operations and financial condition.

The manufacturing process for pharmaceutical products is highly regulated and regulators may shut down manufacturing facilities that they believe do not comply with regulations. We, our third-party manufacturers and our suppliers are subject to numerous regulations, including current FDA regulations governing manufacturing processes, stability testing, record keeping and quality standards. Similar regulations are in effect in other countries. Our third-party manufacturers and suppliers are independent entities who are subject to their own unique operational and financial risks which are out of our control. If we or any of these third-party manufacturers or suppliers fail to perform as required or fail to comply with the regulations of the FDA and other applicable governmental authorities, our ability to deliver our products on a timely basis or receive royalties or continue our clinical trials would be adversely affected. The manufacturing processes of our third party manufacturers and suppliers may also be found to violate the proprietary rights of others. To the extent these risks materialize and adversely affect their

performance obligations to us, and we are unable to contract for a sufficient supply of required products on acceptable terms, or if we encounter delays and difficulties in our relationships with manufacturers or suppliers, our business, results of operation and financial condition would be adversely affected.

If we are unable to successfully identify and acquire new and complementary businesses, products or technologies, our business will suffer.

Our success depends on our ability to continually enhance and broaden our product offerings in response to changing customer demands, competitive pressures and technologies, and legal and regulatory developments. An important element of our business strategy is to actively seek to acquire products or companies, and to in-license or seek co-promotion rights to products that could be sold by our sales force. Other than our contingent milestone payment obligations to Xanodyne relating to our sales of Zipsor and to Archimedes relating to our sales of Lazanda, we have no current commitments with respect to any acquisition, in-licensing or co-promotion. We do not know if we would be able to successfully complete any acquisitions, or whether we would be able to successfully integrate any acquired business, product or technology or retain any key employees. Integrating any business, product or technology we acquire could be expensive and time consuming, disrupt our ongoing business and distract our management. If we are either unable to enhance and broaden our product offerings or unable to effectively integrate any acquired businesses, products or technologies, our business would suffer. In addition, any amortization or charges resulting from the costs of acquisitions could adversely affect our operating results.

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Our collaborative arrangements may give rise to disputes over commercial terms, contract interpretation and ownership of our intellectual property and may adversely affect the commercial success of our products.

We currently have collaboration or license arrangements with Santarus, Mallinckrodt, Merck, Janssen Pharmaceuticals, Inc., Janssen Pharmaceutica NV, Boehringer Ingelheim, Ironwood and PharmaNova. In addition, we have in the past and may in the future enter into other collaborative arrangements, some of which have been based on less definitive agreements, such as memoranda of understanding, material transfer agreements, options or feasibility agreements. We may not execute definitive agreements formalizing these arrangements.

Collaborative relationships are generally complex and may give rise to disputes regarding the relative rights, obligations and revenues of the parties, including the ownership of intellectual property and associated rights and obligations, especially when the applicable collaborative provisions have not been fully negotiated and documented. Such disputes can delay collaborative research, development or commercialization of potential products, and can lead to lengthy, expensive litigation or arbitration. The terms of collaborative arrangements may also limit or preclude us from developing products or technologies developed pursuant to such collaborations. Additionally, the collaborators under these arrangements might breach the terms of their respective agreements or fail to prevent infringement of the licensed patents by third parties. Moreover, negotiating collaborative arrangements often takes considerably longer to conclude than the parties initially anticipate, which could cause us to enter into less favorable agreement terms that delay or defer recovery of our development costs and reduce the funding available to support key programs.

We may be unable to enter into future collaborative arrangements on acceptable terms, which could harm our ability to develop and commercialize our current and potential future products and technologies. Other factors relating to collaborations that may adversely affect the commercial success of our products include:

- any parallel development by a collaborative partner of competitive technologies or products;
- arrangements with collaborative partners that limit or preclude us from developing products or technologies;
- premature termination of a collaboration agreement; or
- failure by a collaborative partner to devote sufficient resources to the development and commercial sales of products using our current and potential future products and technologies.

Our collaborative arrangements do not necessarily restrict our collaborative partners from competing with us or restrict their ability to market or sell competitive products. Our current and any future collaborative partners may pursue existing or other development-stage products or alternative technologies in preference to those being developed in collaboration with us. Our collaborative partners may also terminate their collaborative relationships with us or otherwise decide not to proceed with development and commercialization of our products.

If we do not obtain Orphan Drug exclusivity for Gralise in PHN, our business could suffer.

In November 2010, the FDA granted Gralise Orphan Drug designation for the management of PHN based on a plausible hypothesis that Gralise is clinically superior to immediate release gabapentin due to the incidence of adverse events observed in Gralise clinical trials relative to the incidence of adverse events reported in the package insert for immediate release gabapentin. Generally, an Orphan-designated drug approved for marketing is eligible for seven years of regulatory exclusivity for the orphan-designated indication. If granted, Orphan Drug exclusivity for Gralise will run for seven years from January 28, 2011. However, the FDA has not granted Orphan Drug exclusivity based on the FDA s interpretation of the statute and regulations governing Orphan Drug exclusivity. In September 2012, we filed an action in federal district court for the District of Columbia against the FDA seeking an order requiring the FDA to grant Gralise Orphan Drug exclusivity for the management of PHN. We believe Gralise is entitled to Orphan Drug exclusivity as a matter of law, and the FDA s action is not consistent with the statute or FDA s regulations related to Orphan Drugs. The lawsuit seeks a determination by the court that Gralise is protected by Orphan Drug exclusivity, and an order that FDA act accordingly. Briefing in the case was completed in March 2013 and a court hearing on our summary judgment motion is scheduled for August 2013. We currently expect a decision by the end of 2013. If we do not secure orphan exclusivity in PHN for Gralise, the period of market exclusivity in the United States for Gralise may be reduced, which would adversely affect our business, results of operations and financial condition.

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Pharmaceutical marketing is subject to substantial regulation in the United States and any failure by us or our collaborative partners to comply with applicable statutes or regulations could adversely affect our business.

All marketing activities associated with Gralise, Zipsor, Lazanda and Glumetza, as well as marketing activities related to any other products for which we obtain regulatory approval, will be subject to numerous federal and state laws governing the marketing and promotion of pharmaceutical products. The FDA regulates post-approval promotional labeling and advertising to ensure that they conform to statutory and regulatory requirements. In addition to FDA restrictions, the marketing of prescription drugs is subject to laws and regulations prohibiting fraud and abuse under government healthcare programs. For example, the federal healthcare program anti-kickback statute prohibits giving things of value to induce the prescribing or purchase of products that are reimbursed by federal healthcare programs, such as Medicare and Medicaid. In addition, federal false claims laws prohibit any person from knowingly presenting, or causing to be presented, a false claim for payment to the federal government. Under this law, the federal government in recent years has brought claims against drug manufacturers alleging that certain marketing activities caused false claims for prescription drugs to be submitted to federal programs. Many states have similar statutes or regulations, which apply to items and services reimbursed under Medicaid and other state programs, or, in some states, regardless of the payer. If we, or our collaborative partners, fail to comply with applicable FDA regulations or other laws or regulations relating to the marketing of our products, we could be subject to criminal prosecution, civil penalties, seizure of products, injunction, and exclusion of our products from reimbursement under government programs, as well as other regulatory actions against our product candidates, our collaborative partners or us.

Lazanda is a controlled substance and any failure by us or our partners to comply with applicable statutes or regulations could adversely affect our business.

Lazanda is an opioid analgesic that contains fentanyl, a regulated controlled substance under the Controlled Substances Act of 1970 (CSA). The CSA establishes, among other things, certain registration, production quotas, security, recordkeeping, reporting, import, export and other requirements administered by the DEA. The DEA regulates controlled substances as Schedule I, II, III, IV or V substances, with Schedule II substances being those that present the highest risk of abuse. Fentanyl is listed by the DEA as a Schedule II substance under the CSA. The manufacture, shipment, storage, sale and use, among other things, of controlled substances that are pharmaceutical products are subject to a high degree of regulation. For example, generally all Schedule II substance prescriptions, such as prescriptions for fentanyl, must be written and signed by a physician, physically presented to a pharmacist and may not be refilled without a new prescription.

The DEA also conducts periodic inspections of certain registered establishments that handle controlled substances. Facilities that conduct research, manufacture, distribute, import or export controlled substances must be registered to perform these activities and have the security, control and inventory mechanisms required by the DEA to prevent drug loss and diversion. Failure to maintain compliance, particularly non-compliance resulting in loss or diversion, can result in regulatory action that could adversely affect our business, results of operations and financial condition. The DEA may seek civil penalties, refuse to renew necessary registrations, or initiate proceedings to restrict, suspend or revoke those registrations and in certain circumstances, violations could lead to criminal proceedings against us or our manufacturing and distribution partners, and our respective employees, officers and directors.

In addition to federal regulations, many individual states also have controlled substances laws. Although state controlled substances laws generally mirror federal law, because the states are separate jurisdictions, they may separately schedule our products. Any failure by us or our partners to obtain separate state registrations, permits or licenses in order to be able to obtain, handle, and distribute fentanyl or to meet applicable regulatory requirements could lead to enforcement and sanctions by the states in addition to those from the DEA or otherwise arising under federal law and would adversely affect our business, results of operations and financial condition.

We may incur significant liability if it is determined that we are promoting or have in the past promoted the off-label use of drugs.

Companies may not promote drugs for off-label uses that is, uses that are not described in the product s labeling and that differ from those approved by the FDA. Physicians may prescribe drug products for off-label uses, and such off-label uses are common across some medical specialties. Although the FDA and other regulatory agencies do not regulate a physician s choice of treatments, the FDCA and FDA regulations restrict communications on the subject of off-label uses of drug products by pharmaceutical companies. The Office of Inspector General of the Department of Health and Human Services (OIG), the FDA, and the Department of Justice (DOJ) all actively enforce laws and regulations prohibiting promotion of off-label uses and the promotion of products for which marketing clearance has not been obtained. If the OIG or the FDA takes the position that we are or may be out of compliance with the requirements and restrictions described above, and we are investigated for or found to have improperly promoted off-label uses, we may be subject to significant liability, including civil and administrative remedies as well as criminal sanctions. In addition, management s attention could be diverted from our business operations and our reputation could be damaged.

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If we or our marketing partners are unable to obtain acceptable prices or adequate reimbursement for our products from third-party payers, our business will suffer.

In both domestic and foreign markets, sales of our products and product candidates will depend in part on the availability of adequate reimbursement from third-party payers such as:

- government health administration authorities;
- private health insurers;
- health maintenance organizations;
- pharmacy benefit management companies; and
- other healthcare-related organizations.

If reimbursement is not available for our products or product candidates, demand for these products may be limited. Further, any delay in receiving approval for reimbursement from third-party payers could have an adverse effect on our future revenues. Third-party payers are increasingly challenging the price and cost-effectiveness of medical products and services. Significant uncertainty exists as to the reimbursement status of newly approved healthcare products, including pharmaceuticals. Our products may not be considered cost effective, and adequate third-party reimbursement may be unavailable to enable us to maintain price levels sufficient to realize an acceptable return on our investment.

Federal and state governments in the United States and foreign governments continue to propose and pass new legislation designed to contain or reduce the cost of healthcare. Existing regulations affecting pricing may also change before many of our product candidates are approved for marketing. Cost control initiatives could decrease the price that we receive for our products and any product that we may develop.

We may be unable to compete successfully in the pharmaceutical industry.

Gabapentin is currently sold by Pfizer as Neurontin® for adjunctive therapy for epileptic seizures and for postherpetic neuralgia. Pfizer s basic U.S. patents relating to Neurontin have expired, and numerous companies have received approval to market generic versions of the immediate release product. Pfizer has also developed Lyrica® (pregabalin), which has been approved for marketing in the United States for post herpetic pain, fibromyalgia, diabetic nerve pain, for adjunctive therapy for epileptic seizures and nerve pain associated with spinal cord injury. In June 2012, GlaxoSmithKline and Xenoport, Inc. received approval to market HorizantTM (gabapentin enacarbil extended-release tablets) for the management of PHN. There are other products prescribed for or under development for PHN which are now or may become competitive with Gralise.

Diclofenac, the active pharmaceutical ingredient in Zipsor, is a non-steroidal anti-inflammatory drug (NSAID) that is approved in the United States for the treatment of mild to moderate pain and inflammation, including the symptoms of arthritis. Both branded and generic versions of diclofenac are marketed in the U.S. Zipsor competes against other drugs that are widely used to treat mild to moderate pain in the acute setting. In addition, a number of other companies are developing NSAIDs in a variety of dosage forms for the treatment of mild to moderate pain and related indications. Other drugs are in clinical development to treat acute pain.

Fentanyl, an opioid analgesic, is currently sold by a number of companies for the treatment of breakthrough pain in opioid-tolerant cancer patients. Branded fentanyl products against which Lazanda currently competes include Subsys®, which is sold by Insys Therapeutics, Inc., Fentora® and Actiq®, which are sold by Cephalon, Inc., Abstral®, which is sold by Galena Biopharma, Inc. and Onsolis®, which is sold by BioDelivery Sciences International, Inc. Generic fentanyl products against which Lazanda currently competes are sold by Mallinckrodt, Inc., Par Pharmaceutical Companies, Inc. and Actavis, Inc.

Bristol-Myers Squibb is currently selling a sustained release formulation of metformin, Glucophage XR, that competes with Glumetza. A limited license that Bristol-Myers Squibb obtained from us under a November 2002 settlement agreement extends to certain current and internally-developed future compounds, which may increase the likelihood that we will face competition from Bristol-Myers Squibb in the future on products in addition to Glumetza. Several other companies have received FDA approval for and are selling an extended-release metformin product. There are a number other products prescribed for Type 2 diabetes that are competitive with Glumetza, and there are a number of products under development for the treatment of Type 2 diabetes that may become competitive with Glumetza in the future.

Competition in the pharmaceutical industry is intense. We expect competition to increase. Competing products developed in the future may prove superior to our products. Most of our principal competitors have substantially greater financial, sales, marketing, personnel and research and development resources than we do.

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We may be unable to protect our intellectual property and may be liable for infringing the intellectual property of others.

Our success will depend in part on our ability to obtain and maintain patent protection for our products and technologies, and to preserve our trade secrets. Our policy is to seek to protect our proprietary rights, by, among other methods, filing patent applications in the United States and foreign jurisdictions to cover certain aspects of our technology. We hold issued United States patents, and have patent applications pending in the United States. In addition, we are preparing patent applications relating to our expanding technology for filing in the United States and abroad. We have also applied for patents in numerous foreign countries. Some of those countries have granted our applications and other applications are still pending. Our pending patent applications may lack priority over others applications or may not result in the issuance of patents. Even if issued, our patents may not be sufficiently broad to provide protection against competitors with similar technologies and may be challenged, invalidated or circumvented, which could limit our ability to stop competitors from marketing related products or may not provide us with competitive advantages against competing products. We also rely on trade secrets and proprietary know-how, which are difficult to protect. We seek to protect such information, in part, through entering into confidentiality agreements with employees, consultants, collaborative partners and others before such persons or entities have access to our proprietary trade secrets and know-how. These confidentiality agreements may not be effective in certain cases, due to, among other things, the lack of an adequate remedy for breach of an agreement or a finding that an agreement is unenforceable. In addition, our trade secrets may otherwise become known or be independently developed by competitors.

Our ability to develop our technologies and to make commercial sales of products using our technologies also depends on not infringing others patents or other intellectual property rights. We are not aware of any intellectual property claims against us. However, the pharmaceutical industry has experienced extensive litigation regarding patents and other intellectual property rights. Patents issued to third parties relating to sustained release drug formulations or particular pharmaceutical compounds could in the future be asserted against us, although we believe that we do not infringe any valid claim of any patents. If claims concerning any of our products were to arise and it was determined that these products infringe a third party s proprietary rights, we could be subject to substantial damages for past infringement or be forced to stop or delay our activities with respect to any infringing product, unless we can obtain a license, or we may have to redesign our product so that it does not infringe upon others patent rights, which may not be possible or could require substantial funds or time. Such a license may not be available on acceptable terms, or at all. Even if we, our collaborators or our licensors were able to obtain a license, the rights may be nonexclusive, which could give our competitors access to the same intellectual property. In addition, any public announcements related to litigation or interference proceedings initiated or threatened against us, even if such claims are without merit, could cause our stock price to decline.

From time to time, we may become aware of activities by third parties that may infringe our patents. Infringement by others of our patents may reduce our market shares (if a related product is approved) and, consequently, our potential future revenues and adversely affect our patent rights if we do not take appropriate enforcement action. We may need to engage in litigation in the future to enforce any patents issued or licensed to us or to determine the scope and validity of third-party proprietary rights. For instance, in January 2013 and April 2013, we filed lawsuits against Purdue and Endo, respectively, for infringement of certain of our Acuform drug delivery technology patents and are engaged in litigation against Gralise and Glumetza ANDA filers. In these or other litigation matters, our issued or licensed patents may not be held valid by a court of competent jurisdiction. Whether or not the outcome of litigation is favorable to us, defending a lawsuit takes significant time, may be expensive and may divert management attention from other business concerns. We may also be required to participate in interference proceedings declared by the United States Patent and Trademark Office for the purpose of determining the priority of inventions in connection with our patent applications or other parties patent applications. Adverse determinations in litigation or interference proceedings could require us to seek licenses which may not be available on commercially reasonable terms, or at all, or subject us to significant liabilities to third parties. If we need but cannot obtain a license, we may be prevented from marketing the affected product.

If we are unable to obtain or maintain regulatory approval, we will be limited in our ability to commercialize our products, and our business will suffer.

The regulatory process is expensive and time consuming. Even after investing significant time and expenditures on clinical trials, we may not obtain regulatory approval of our product candidates. Data obtained from clinical trials are susceptible to varying interpretations, which could delay, limit or prevent regulatory approval, and the FDA may not agree with our methods of clinical data analysis or our conclusions regarding safety and/or efficacy. Significant clinical trial delays could impair our ability to commercialize our products and could allow our competitors to bring products to market before we do. In addition, changes in regulatory policy for product approval during the period of product development and regulatory agency review of each submitted new application may cause delays or rejections. Even if we receive regulatory approval, this approval may entail limitations on the indicated uses for which we can market a product.

For example, the active ingredients in the products utilizing our Acuform delivery technology that are being developed pursuant to our collaboration with Covidien include acetaminophen in combination with opiates. In connection with concerns that consumers may inadvertently take more than the recommended daily dose of acetaminophen, potentially causing liver damage, an FDA advisory committee has recommended that prescription products containing acetaminophen in combination with prescription analgesics (including opiates) should include black box warnings and/or be removed from the market. The FDA is evaluating the recommendations and has indicated that such an evaluation will take some time. The FDA is not required to accept advisory committee recommendations. Covidien s ability or willingness to develop and market the products subject to our collaboration may be adversely affected by actions of the FDA in response to the advisory committee recommendations.

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Further, with respect to our approved products, once regulatory approval is obtained, a marketed product and its manufacturer are subject to continual review. The discovery of previously unknown problems with a product or manufacturer may result in restrictions on the product, manufacturer or manufacturing facility, including withdrawal of the product from the market. Manufacturers of approved products are also subject to ongoing regulation and inspection, including compliance with FDA regulations governing current Good Manufacturing Practices (cGMP) or Quality System Regulation (QSR). The FDCA, the CSA and other federal and foreign statutes and regulations govern and influence the testing, manufacturing, packing, labeling, storing, record keeping, safety, approval, advertising, promotion, sale and distribution of our products. In addition, with respect to Lazanda, we and our partners are also subject to ongoing DEA regulatory obligations, including annual registration renewal, security, recordkeeping, theft and loss reporting, periodic inspection and annual quota allotments for the raw material for commercial production of our products. The failure to comply with these regulations could result in, among other things, warning letters, fines, injunctions, civil penalties, recall or seizure of products, total or partial suspension of production, non-renewal of marketing applications or authorizations or criminal prosecution, which could adversely affect our business, results of operations and financial condition.

We are also required to report adverse events associated with our products to the FDA and other regulatory authorities. Unexpected or serious health or safety concerns could result in labeling changes, recalls, market withdrawals or other regulatory actions. Recalls may be issued at our discretion or at the discretion of the FDA or other empowered regulatory agencies. For example, in June 2010, we instituted a voluntary class 2 recall of 52 lots of our 500mg Glumetza product after chemical traces of 2,4,6-tribromoanisole (TBA) were found in the product bottle. We cannot be certain that the FDA will determine that we adequately addressed the matters that led to this recall or that the FDA will not seek to impose fines or sanctions against us as a result of this recall.

We are subject to risks associated with NDAs submitted under Section 505(b)(2) of the Food, Drug and Cosmetic Act.

The products we develop generally are or will be submitted for approval under Section 505(b)(2) of the FDCA which was enacted as part of the Drug Price Competition and Patent Term Restoration Act of 1984, otherwise known as the Hatch-Waxman Act. Section 505(b)(2) permits the submission of an NDA where at least some of the information required for approval comes from studies not conducted by or for the applicant and for which the applicant has not obtained a right of reference. For instance, the NDA for Gralise relies on the FDA s prior approval of Neurontin® (gabapentin), the immediate release formulation of gabapentin initially approved by the FDA. An NDA for SEFELSA would also rely in part on the FDA s prior approval of Neurontin.

For NDAs submitted under Section 505(b)(2) of the FDCA, the patent certification and related provisions of the Hatch-Waxman Act apply. In accordance with the Hatch-Waxman Act, such NDAs may be required to include certifications, known as Paragraph IV certifications, that certify any patents listed in the FDA s Orange Book publication in respect to any product referenced in the 505(b)(2) application, are invalid, unenforceable, and/or will not be infringed by the manufacture, use, or sale of the product that is the subject of the 505(b)(2) application. Under the Hatch-Waxman Act, the holder of the NDA which the 505(b)(2) application references may file a patent infringement lawsuit after receiving notice of the Paragraph IV certification. Filing of a patent infringement lawsuit triggers a one-time automatic 30-month stay of the FDA s ability to approve the 505(b)(2) application. Accordingly, we may invest a significant amount of time and expense in the development of one or more products only to be subject to significant delay and patent litigation before such products may be commercialized, if at all. A Section 505(b)(2) application may also not be approved until any non-patent exclusivity, such as exclusivity for obtaining approval of a new chemical entity, listed in the Orange Book for the referenced product has expired. The FDA may also require us to perform one or more additional clinical studies or measurements to support the change from the approved product. The FDA may then approve the new formulation for all or only some of the indications sought by us. The FDA may also reject our future Section 505(b)(2) submissions and require us to file such submissions under Section 501(b)(1) of the FDCA, which could be considerably more expensive and time consuming. These factors, among others, may limit our ability to successfully commercialize our product candidates.

If a product liability claim against us is successful, our business will suffer.

Our business involves exposure to potential product liability risks that are inherent in the development and production of pharmaceutical products. Side effects, manufacturing defects, misuse or abuse of our products could result in patient injury or death. For example, Lazanda is a self-administered, opioid analgesic that contains fentanyl, a Schedule II controlled substance under the CSA. A patient s failure to follow instructions on the use and administration of Lazanda or the abuse of Lazanda could result in injury or death. In addition, patients using Lazanda have been diagnosed with cancer, an often fatal disease. Patient injury or death can result in product liability claims being brought against us, even if our products did not cause an injury or death. Product liability claims may be brought against us by consumers, health care providers, pharmaceutical companies or others who come into contact with our products.

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We have obtained product liability insurance for clinical trials currently underway and forecasted 2013 sales of our products, but:

- we may be unable to maintain product liability insurance on acceptable terms;
- we may be unable to obtain product liability insurance for future trials;
- we may be unable to obtain product liability insurance for future products;
- we may be unable to secure increased coverage as the commercialization of the Acuform gastric retentive technology proceeds; or
- our insurance may not provide adequate protection against potential liabilities.

Our inability to obtain or maintain adequate insurance coverage at an acceptable cost could prevent or inhibit the commercialization of our products. Defending a lawsuit could be costly and significantly divert management s attention from conducting our business. If third parties were to bring a successful product liability claim or series of claims against us for uninsured liabilities or in excess of insured liability limits, our business, results of operations and financial condition could be materially and adversely affected.

Limitations on fentanyl production in the United States could limit our ability to successfully commercialize Lazanda.

The availability and production of all Schedule II substances, including fentanyl, in the United States is limited by the DEA through a quota system that includes a national aggregate quota and individual company quotas. The DEA annually establishes an aggregate quota for total fentanyl production in the United States based on the DEA s estimate of the quantity needed to meet commercial and scientific need. The aggregate quota of fentanyl that the DEA allows to be produced in the United States annually is allocated among individual companies, which must submit applications annually to the DEA for individual production and procurement quotas. The DEA requires substantial evidence and documentation of expected legitimate medical and scientific needs before assigning quotas to individual companies. The DEA may adjust aggregate production quotas and individual production and procurement quotas from time to time during the year, although the DEA has substantial discretion in whether or not to make such adjustments. Based on a variety of factors, including public policy considerations, the DEA may set the aggregate fentanyl quota lower than the total amount requested by individual companies. Although we through our manufacturing partner are permitted to ask the DEA to increase the annual aggregate quota after it is initially established, we cannot be certain that the DEA would act favorably upon such a request. If our allocated quota of fentanyl is in sufficient to meet our commercial demand or clinical needs, our business, results of operations and financial condition could be adversely affected. In addition, any delay or refusal by the DEA in establishing the production or procurement quota or any reduction by the DEA in our allocated quota for fentanyl could adversely affect our business, results of operations and financial condition.

The FDA-mandated Risk Evaluation Mitigation Strategy (REMS) program may limit the commercial success of Lazanda.

Lazanda is subject to a FDA-mandated Risk Evaluation Mitigation Strategy (REMS) protocol that requires enrollment and participation in the REMS program to prescribe, dispense or distribute Transmucosal Immediate Release Fentanyl (TIRF) medicines, including Lazanda, for outpatient use. Many physicians, health care practitioners and pharmacies are unwilling to enroll and participate in the TIRF REMS program. As a result, there are relatively few prescribers and dispensers of TIRF products. If we are not able to successfully promote Lazanda to

participants in the TIRF REMS program, our business, results of operations and financial condition could be adversely affected.

The development of drug candidates is inherently difficult and uncertain and we cannot be certain that any of our product candidates will be approved for marketing or, if approved, will achieve market acceptance.

Clinical development is a long, expensive and uncertain process and is subject to delays and failures. Our own product candidates and those of our collaborative partners are subject to the risk that any or all of them may be found to be ineffective or unsafe, or otherwise may fail to receive necessary regulatory clearances. Positive or encouraging results of prior clinical trial are not necessarily indicative of the results obtained in later clinical trials, as was the case with the Phase 3 trial for Gralise for the management of PHN that we completed in 2007, and with the Phase 3 trials evaluating SEFELSA for menopausal hot flashes, the last of which we completed in October 2011. In addition, data obtained from pivotal clinical trials are susceptible to varying interpretations, which could delay, limit or prevent regulatory approval.

- Many other factors could delay or result in termination of our clinical trials, including:
- negative or inconclusive results;
- patient noncompliance with the protocol;
- adverse medical events or side effects among patients during the clinical trials;
- FDA inspections of our clinical operations; and
- actual or perceived lack of efficacy or safety of the product candidate.

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We are unable to predict whether any of our product candidates will receive regulatory clearances or be successfully manufactured or marketed. Further, due to the extended testing and regulatory review process required before marketing clearance can be obtained; the time frame for commercializing a product is long and uncertain. Even if these other product candidates receive regulatory clearance, our products may not achieve or maintain market acceptance. Also, DM-1992 uses the Acuform technology. If it is discovered that the Acuform technology could have adverse effects or other characteristics that indicate it is unlikely to be effective as a delivery system for drugs or therapeutics, our product development efforts and our business could be significantly harmed.

Even when or if our products obtain regulatory approval, successful commercialization requires:

- market acceptance;
- cost-effective commercial scale production; and
- reimbursement under private or governmental health plans.

Any material delay or failure in the governmental approval process and/or the successful commercialization of our potential products could adversely impact our financial position and liquidity.

Our collaborators and licensors may not adequately protect our intellectual property rights.

Our collaborators and licensors may not adequately maintain and protect our intellectual property rights. These third parties may have the first right to maintain or defend our intellectual property rights and, although we may have the right to assume the maintenance and defense of our intellectual property rights if these third parties do not, our ability to maintain and defend our intellectual property rights may be comprised by the acts or omissions of these third parties.

We depend on clinical investigators and clinical sites to enroll patients in our clinical trials and other third parties to manage the trials and to perform related data collection and analysis, and, as a result, we may face costs and delays outside of our control.

We rely on clinical investigators and clinical sites to enroll patients and other third parties to manage our trials and to perform related data collection and analysis. However, we may be unable to control the amount and timing of resources that the clinical sites that conduct the clinical testing may devote to our clinical trials. If our clinical investigators and clinical sites fail to enroll a sufficient number of patients in our clinical trials or fail to enroll them on our planned schedule, we will be unable to complete these trials or to complete them as planned, which could delay or prevent us from obtaining regulatory approvals for our product candidates.

Our agreements with clinical investigators and clinical sites for clinical testing and for trial management services place substantial responsibilities on these parties, which could result in delays in, or termination of, our clinical trials if these parties fail to perform as expected.

For example, if any of our clinical trial sites fail to comply with FDA-approved good clinical practices, we may be unable to use the data gathered at those sites. If these clinical investigators, clinical sites or other third parties do not carry out their contractual duties or obligations or fail to meet expected deadlines, or if the quality or accuracy of the clinical data they obtain is compromised due to their failure to adhere to our clinical protocols or for other reasons, our clinical trials may be extended, delayed or terminated, and we may be unable to obtain regulatory approval for, or successfully commercialize, our product candidates.

Our success is dependent in large part upon the continued services of our Chief Executive Officer and senior management with whom we do not have employment agreements.

Our success is dependent in large part upon the continued services of our President and Chief Executive Officer, James A. Schoeneck, and other members of our executive management team, and on our ability to attract and retain key management and operating personnel. We do not have agreements with Mr. Schoeneck or any of our other executive officers that provide for their continued employment with us. We may have difficulty filling open senior scientific, financial and commercial positions. Management, scientific and operating personnel are in high demand in our industry and are often subject to competing offers. The loss of the services of one or more members of management or key employees or the inability to hire additional personnel as needed could result in delays in the research, development and commercialization of our products and potential product candidates.

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Our operating results may fluctuate and affect our stock price.

The following factors will affect our operating results and may result in a material adverse effect on our stock price:

- the degree of commercial success of Gralise, Zipsor, Lazanda and Glumetza;
- announcements and results regarding clinical trial results and plans for our drug candidates;
- filings and other regulatory actions related to our product candidates;
- the outcome of our patent infringement litigation against filers of ANDAs for Gralise, Zipsor and Glumetza;
- the outcome of our patent infringement litigation against Purdue and Endo;
- developments concerning proprietary rights, including patents, infringement allegations and litigation matters;
- decisions by collaborative partners to proceed or not to proceed with subsequent phases of a collaboration or program;
- adverse events related to our products, including recalls;
- interruptions of manufacturing or supply, or other manufacture or supply difficulties;
- variations in revenues obtained from collaborative agreements, including milestone payments, royalties, license fees and other contract revenues; and
- adoption of new technologies by us or our competitors.

As a result of these factors, our stock price may continue to be volatile and investors may be unable to sell their shares at a price equal to, or above, the price paid. Additionally, any significant drops in our stock price, such as the ones we experienced following the announcement of our SEFELSA Phase 3 trial results in October 2009 and October 2011,the announcement of the vote by Reproductive Health Drugs Advisory Committee of the FDA against the approval of SEFELSA in March 2013 and the FDA s issuance of a CRL to the NDA for SEFELSA could give rise to shareholder lawsuits, which are costly and time consuming to defend against and which may adversely affect our ability to raise capital while the suits are pending, even if the suits are ultimately resolved in our favor.

We may incur operating losses in the future.

To date, we have recorded revenues from license fees, product sales, royalties, collaborative research and development arrangements and feasibility studies. For the six months ended June 30, 2013, we incurred a net loss of $5.0 million. For the year ended December 31, 2012, we incurred a net loss of $29.8 million. Collaborative milestones and settlement fees received from Abbott Products, Janssen and Merck resulted in our reaching profitability of $70.7 million and $3.9 million in 2011 and 2010, respectively. We may incur operating losses in 2013 and in future

years. Any such losses may have an adverse impact on our total assets, shareholders equity and working capital.

Our existing capital resources may not be sufficient to fund our operations until such time as we may be able to consistently generate sufficient revenues to support our operations.

We currently do not have any committed sources of capital. To the extent that our capital resources are insufficient to meet our future capital requirements, in order to continue our operations, we will have to raise additional funds through the sale of our equity securities, through debt financing, or from development and licensing arrangements. We may be unable to raise such additional capital on favorable terms, or at all. If we raise additional capital by selling our equity or convertible debt securities, the issuance of such securities could result in dilution of our shareholders equity positions. If adequate funds are not available we may have to:

- significantly curtail commercialization of our marketed products or other operations;
- delay, postpone or terminate clinical trials; and/or
- obtain funds through entering into collaboration agreements on unattractive terms.

We have implemented certain anti-takeover provisions.

Certain provisions of our articles of incorporation and the California General Corporation Law could discourage a third party from acquiring, or make it more difficult for a third party to acquire, control of our company without approval of our board of directors. These provisions could also limit the price that certain investors might be willing to pay in the future for shares of our common stock. Certain provisions allow the board of directors to authorize the issuance of preferred stock with rights superior to those of the common stock. We are also subject to the provisions of Section 1203 of the California General Corporation Law which requires a fairness opinion to be provided to our shareholders in connection with their consideration of any proposed interested party reorganization transaction.

We have adopted a shareholder rights plan, commonly known as a poison pill . The provisions described above, our poison pill and provisions of the California General Corporation Law may discourage, delay or prevent a third party from acquiring us.

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Increased costs associated with corporate governance compliance may significantly impact our results of operations.

Changing laws, regulations and standards relating to corporate governance, public disclosure and compliance practices, including the Dodd-Frank Wall Street Reform and Consumer Protection Act of 2010, the Sarbanes-Oxley Act of 2002, new SEC regulations and NASDAQ Global Market rules, are creating uncertainty for companies such as ours in understanding and complying with these laws, regulations and standards. As a result of this uncertainty and other factors, devoting the necessary resources to comply with evolving corporate governance and public disclosure standards has resulted in and may in the future result in increased general and administrative expenses and a diversion of management time and attention to compliance activities. We also expect these developments to increase our legal compliance and financial reporting costs. In addition, these developments may make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced coverage or incur substantially higher costs to obtain coverage. Moreover, we may be unable to comply with these new rules and regulations on a timely basis.

These developments could make it more difficult for us to attract and retain qualified members of our board of directors, or qualified executive officers. We are presently evaluating and monitoring regulatory developments and cannot estimate the timing or magnitude of additional costs we may incur as a result. If these costs are significant, our selling, general and administrative expenses are likely to increase.

Health care reform could increase our expenses and adversely affect the commercial success of our products.

In March 2010, President Obama signed into law the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Affordability Reconciliation Act (ACA). The ACA includes numerous provisions that affect pharmaceutical companies, some of which became effective immediately and others of which will take effect over the next several years. For example, the ACA seeks to expand healthcare coverage to the uninsured through private health insurance reforms and an expansion of Medicaid. The ACA also imposes substantial costs on pharmaceutical manufacturers, such as an increase in liability for rebates paid to Medicaid, new drug discounts that must be offered to certain enrollees in the Medicare prescription drug benefit and an annual fee imposed on all manufacturers of brand prescription drugs in the U.S. The ACA also requires increased disclosure obligations and an expansion of an existing program requiring pharmaceutical discounts to certain types of hospitals and federally subsidized clinics and contains cost-containment measures that could reduce reimbursement levels for pharmaceutical products. The ACA also includes provisions known as the Physician Payments Sunshine Act, which require manufacturers of drugs, biologics, devices and medical supplies covered under Medicare and Medicaid starting in 2013 to record any transfers of value to physicians and teaching hospitals and to report this data beginning in 2014 to the Centers for Medicare and Medicaid Services for subsequent public disclosure. Similar reporting requirements have also been enacted on the state level domestically, and an increasing number of countries worldwide either have adopted or are considering similar laws requiring transparency of interactions with health care professionals. Failure to report appropriate data may result in civil or criminal fines and/or penalties. These and other aspects of the ACA, including the regulations that may be imposed in connection with the implementation of the ACA, could increase our expenses and adversely affect our ability to successfully commercialize our products and product candidates.

If we are unable to satisfy regulatory requirements relating to internal controls, our stock price could suffer.

Section 404 of the Sarbanes-Oxley Act of 2002 requires companies to conduct a comprehensive evaluation of their internal control over financial reporting. At the end of each fiscal year, we must perform an evaluation of our internal control over financial reporting, include in our annual report the results of the evaluation, and have our external auditors publicly attest to such evaluation. If material weaknesses are found in our internal controls in the future, if we fail to complete future evaluations on time, or if our external auditors cannot attest to our future evaluations, we could fail to meet our regulatory reporting requirements and be subject to regulatory scrutiny and a loss of public confidence in

our internal controls, which could have an adverse effect on our stock price.

Business interruptions could limit our ability to operate our business.

Our operations are vulnerable to damage or interruption from computer viruses, human error, natural disasters, telecommunications failures, intentional acts of vandalism and similar events. In particular, our corporate headquarters are located in the San Francisco Bay area, which has a history of seismic activity. We have not established a formal disaster recovery plan, and our back-up operations and our business interruption insurance may not be adequate to compensate us for losses that occur. A significant business interruption could result in losses or damages incurred by us and require us to cease or curtail our operations.

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

Not applicable.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

Not applicable.

ITEM 4. MINE SAFETY DISCLOSURES

Not applicable.

ITEM 5. OTHER INFORMATION

Not applicable.

ITEM 6. EXHIBITS

(a) Exhibits

31.1	Certification pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 of James A. Schoeneck
31.2	Certification pursuant to Rule 13a-14(a) under the Securities Exchange Act of 1934 of August J. Moretti
32.1	Certification pursuant to 18 U.S.C. Section 1350 of James A. Schoeneck
32.2	Certification pursuant to 18 U.S.C. Section 1350 of August J. Moretti
101*	Interactive Data Files pursuant to Rule 405 of Regulation S-T

* Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act, are deemed not filed for purposes of Section 18 of the Exchange Act, and otherwise are not subject to liability under these sections.

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SIGNATURES

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

Date: August 8, 2013

DEPOMED, INC.

/s/ James A. Schoeneck
James A. Schoeneck
President and Chief Executive Officer

/s/ August J. Moretti
August J. Moretti
Chief Financial Officer