

DEPOMED INC  
Form 10-Q  
August 03, 2015  
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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, 2015**

**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)

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**CALIFORNIA**  
(STATE OR OTHER JURISDICTION OF  
INCORPORATION OR ORGANIZATION)

**94-3229046**  
(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  No

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

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

Large accelerated filer

Accelerated filer

Non-accelerated filer

Smaller reporting company

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

The number of issued and outstanding shares of the Registrant's Common Stock, no par value, as of July 30, 2015 was 60,311,961.

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Table of Contents**PART I FINANCIAL INFORMATION****ITEM 1. CONDENSED CONSOLIDATED FINANCIAL STATEMENTS****DEPOMED, INC.****CONDENSED CONSOLIDATED BALANCE SHEETS**

(in thousands, except share amounts)

	<b>June 30 2015 (Unaudited)</b>	<b>December 31, 2014 (1)</b>
<b>ASSETS</b>		
Current assets:		
Cash and cash equivalents	\$ 94,094	\$ 488,668
Marketable securities	23,906	70,773
Accounts receivable, net	59,750	27,008
Receivables from collaborative partners	747	1,070
Inventories	10,376	8,456
Income taxes receivable	13,891	4,030
Deferred tax assets, net	9,601	9,601
Prepaid and other current assets	19,798	8,014
Total current assets	232,163	617,620
Marketable securities, long-term	4,559	6,961
Property and equipment, net	16,013	7,055
Intangible assets, net	1,062,579	72,361
Other assets	7,445	7,068
	\$ 1,322,759	\$ 711,065
<b>LIABILITIES AND SHAREHOLDERS EQUITY</b>		
Current liabilities:		
Accounts payable and accrued liabilities	\$ 113,925	\$ 52,686
Contingent consideration liability	2,482	
Interest payable	18,156	2,683
Other current liabilities	1,098	2,130
Total current liabilities	135,661	57,499
Contingent consideration liability	12,238	14,252
Senior Notes	562,516	
Convertible Notes	236,315	229,891
Deferred tax liabilities, net, non-current	18,994	32,589
Other long-term liabilities	10,937	12,387
Commitments and contingencies (Note 12)		
Shareholders' equity:		
Preferred stock		
Common stock	252,635	239,961
Additional paid-in capital	79,067	76,809
Retained earnings	14,428	47,714
Accumulated other comprehensive loss, net of tax	(32)	(37)
Total shareholders' equity	346,098	364,447
	\$ 1,322,759	\$ 711,065

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(1) Derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2014.

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

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## DEPOMED, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(in thousands, except share and per share amounts)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
<b>Revenues:</b>				
Product sales	\$ 94,295	\$ 28,245	\$ 125,966	\$ 49,751
Royalties	209	430	742	925
License and other revenue		5,760		17,520
Non-cash PDL royalty revenue		33,297		76,081
Total revenues	94,504	67,732	126,708	144,277
<b>Costs and expenses:</b>				
Cost of sales (excluding amortization of intangible assets)	22,865	4,675	25,977	8,377
Research and development expense	4,714	1,397	6,572	3,439
Selling, general and administrative expense	57,408	32,573	91,950	65,090
Amortization of intangible assets	26,731	2,542	29,271	5,081
Total costs and expenses	111,718	41,187	153,770	81,987
(Loss) income from operations	(17,214)	26,545	(27,062)	62,290
<b>Other (expense) income:</b>				
Interest and other income	61	20	118	47
Interest expense	(22,078)	(616)	(28,100)	(1,243)
Non-cash interest expense on PDL liability		(4,903)		(10,282)
Total other expense	(22,017)	(5,499)	(27,982)	(11,478)
Net (loss) income before income taxes	(39,231)	21,046	(55,044)	50,812
Benefit from (provision for) income taxes	17,578	(8,300)	21,758	(20,128)
Net (loss) income	\$ (21,653)	\$ 12,746	\$ (33,286)	\$ 30,684
Basic net (loss) income per share	\$ (0.36)	\$ 0.22	\$ (0.56)	\$ 0.53
Diluted net (loss) income per share	\$ (0.36)	\$ 0.21	\$ (0.56)	\$ 0.51
Shares used in computing basic net (loss) income per share	59,991,934	58,105,902	59,777,594	57,827,430
Shares used in computing diluted net (loss) income per share	59,991,934	60,430,456	59,777,594	60,258,445

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



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**DEPOMED, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE (LOSS) INCOME**

**(in thousands)**

**(Unaudited)**

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
Net (loss) income	\$ (21,653)	\$ 12,746	\$ (33,286)	\$ 30,684
Unrealized gains (losses) on available-for-sale securities:				
Unrealized gains (losses) during period, net of taxes	(17)	(1)	5	(11)
Net unrealized gains (losses) on available-for-sale securities	(17)	(1)	5	(11)
Comprehensive (loss) income	\$ (21,670)	\$ 12,745	\$ (33,281)	\$ 30,673

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



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## DEPOMED, INC.

## CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(in thousands)

(Unaudited)

	Six Months Ended June 30,	
	2015	2014
<b>Operating Activities</b>		
Net (loss) income	\$ (33,286)	\$ 30,684
Adjustments to reconcile net (loss) income to net cash used in operating activities:		
Non-cash PDL royalty revenue		(76,081)
Non-cash interest expense on PDL liability		10,282
Depreciation and amortization	30,292	6,070
Accretion of debt discount	7,387	
Amortization of investments	277	200
Provision for inventory obsolescence	514	
Loss on disposal of property and equipment	45	17
Stock-based compensation	6,066	4,170
Change in fair value of contingent consideration and unfavorable contract	(2,214)	1,226
Deferred income taxes (benefit) provision	(11,337)	24,029
Excess tax benefit from stock-based compensation	(2,273)	(1,503)
Changes in assets and liabilities:		
Accounts receivable	(32,743)	2,582
Receivables from collaborative partners	322	
Inventories	9,156	2,363
Prepaid and other assets	(2,256)	(1,222)
Income taxes receivable	(9,861)	(2,373)
Accounts payable and other accrued liabilities	59,132	5,344
Interest payable	18,160	
Accrued compensation	(301)	(2,287)
Income taxes payable		(60,372)
Deferred revenue		(1,520)
Net cash provided by (used in) operating activities	37,080	(58,391)
<b>Investing Activities</b>		
Purchases of property and equipment	(1,134)	(783)
Business acquisition (Note 13)	(1,050,000)	
Purchases of marketable securities	(18,108)	(4,666)
Maturities of marketable securities	67,105	23,245
Net cash (used in) provided by investing activities	(1,002,137)	17,796
<b>Financing Activities</b>		
Proceeds from the issuance of Senior Notes	562,063	
Senior Notes issuance costs	(511)	
Proceeds from issuance of common stock	6,658	5,564
Excess tax benefit from stock-based compensation	2,273	1,502
Net cash provided by financing activities	570,483	7,066
Net decrease in cash and cash equivalents	(394,574)	(33,529)

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Cash and cash equivalents at beginning of period		488,668		244,674
Cash and cash equivalents at end of period	\$	94,094	\$	211,145

**Supplemental Disclosure of Cash Flow Information**

Cash paid during the period for:

Taxes, net of refunds	\$	40	\$	58,000
Interest		4,121		
Capitalized expenditures not paid		437		

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

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**DEPOMED, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

**(Unaudited)**

**NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES**

*Organization*

Depomed, Inc. (Depomed or the Company) is a specialty pharmaceutical company focused on pain and other central nervous system (CNS) conditions. The products that comprise the Company's current specialty pharmaceutical business are (i) NUCYNTA® ER (tapentadol extended release tablets), a product for the management of pain severe enough to require daily, around-the-clock, long term opioid treatment, including neuropathic pain associated with diabetic peripheral neuropathy (DPN) in adults, and for which alternative treatment options are inadequate, and NUCYNTA® (tapentadol), a product for the management of moderate to severe acute pain in adults, each of which the Company acquired the U.S. rights to in April 2015, (ii) Gralise® (gabapentin), a once-daily product for the management of postherpetic neuralgia (PHN) that the Company launched in October 2011, (iii) CAMBIA® (diclofenac potassium for oral solution), a product for the acute treatment of migraine attacks that the Company acquired in December 2013, (iv) Zipsor® (diclofenac potassium) liquid filled capsules, a product for the treatment of mild to moderate acute pain that the Company acquired in June 2012, and (v) 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 the Company acquired in July 2013.

The Company also has a portfolio of royalty and milestone producing license agreements based on its proprietary Acuform® gastroretentive drug delivery technology with Mallinckrodt Inc. (Mallinckrodt), Ironwood Pharmaceuticals, Inc. (Ironwood) and Janssen Pharmaceuticals, Inc. (Janssen Pharma).

On October 18, 2013, the Company sold its interests in royalty and milestone payments under its license agreements in the Type 2 diabetes therapeutic area to PDL BioPharma, Inc. (PDL) for \$240.5 million (the PDL Transaction). The interests sold include royalty and milestone payments accruing from and after October 1, 2013 from (a) Salix Pharmaceuticals, Inc. (Salix) with respect to sales of Glumetza® (metformin HCL extended-release tablets) in the United States (U.S.); (b) Merck & Co., Inc. (Merck) with respect to sales of Janumet® XR (sitagliptin and metformin HCL extended-release); (c) Janssen Pharmaceutica N.V. and Janssen Pharma (collectively, Janssen) with respect to potential future development milestones and sales of Janssen's investigational fixed-dose combination of Invokana® (canagliflozin) and extended-release metformin; (d) Boehringer Ingelheim International GMBH (Boehringer Ingelheim) with respect to potential future development milestones and sales of the investigational fixed-dose combinations of drugs and extended-release metformin subject to the Company's license agreement with Boehringer Ingelheim; and (e) LG Life Sciences Ltd. and Valeant International Bermuda SRL for

sales of extended-release metformin in Korea and Canada, respectively.

The Company has one product candidate, 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. The Company continues to evaluate clinical and regulatory strategies and commercial prospects for DM-1992.

***Basis of Presentation***

The unaudited condensed consolidated 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 (GAAP) have been condensed or omitted pursuant to such rules and regulations. In the opinion of the Company's management, the accompanying interim unaudited condensed consolidated 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 three and six months ended June 30, 2015 are not necessarily indicative of results to be expected for the entire year ending December 31, 2015 or future operating periods.

The accompanying condensed consolidated 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, 2014 included in the Company's Annual Report on Form 10-K filed with the SEC (the 2014 Form 10-K). The balance sheet at December 31, 2014 has been derived from the audited financial statements at that date, as filed with the 2014 Form 10-K.

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***Principles of Consolidation***

The condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries, Depo DR Sub, LLC (Depo DR Sub) and Depo NF Sub, LLC (Depo NF Sub). All intercompany accounts and transactions have been eliminated on consolidation.

Depo NF Sub was formed on March 26, 2015, in connection with a Note Purchase Agreement dated March 12, 2015 (Note Purchase Agreement) governing the Company's issuance of \$575.0 million aggregate principal amount of Senior Notes on April 2, 2015, for aggregate gross proceeds of approximately \$562.0 million. On April 2, 2015, the Company and Depo NF Sub entered into a Pledge and Security Agreement with the Collateral Agent pursuant to which the Company and Depo NF Sub each granted the Collateral Agent (on behalf of the Purchasers) a security interest in substantially all of their assets, other than specifically excluded assets.

Depo DR Sub was formed in October 2013 for the sole purpose of facilitating the PDL Transaction. The Company contributed to Depo DR Sub all of its rights, title and interests in each of the license agreements to receive royalty and milestone payments. Immediately following the transaction, Depo DR Sub sold to PDL, among other things, such rights to receive royalty and milestone payments, for an upfront cash purchase price of \$240.5 million.

The Company and Depo DR Sub continue to retain certain administrative duties and obligations under the specified license agreements. These include the collection of the royalty and milestone amounts due and enforcement of related provisions under the specified license agreements, among others. In addition, the Company and Depo DR Sub must prepare a quarterly distribution report relating to the specified license agreements, containing, among other items, the amount of royalty payments received by the Company, reimbursable expenses and set-offs. The Company and Depo DR Sub must also provide PDL with notice of certain communications, events or actions with respect to the specified license agreements and infringement of any underlying intellectual property.

***Use of Estimates***

The preparation of financial statements in conformity with U.S. GAAP requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Estimates are used when accounting for amounts recorded in connection with acquisitions, including initial fair value determinations of assets and liabilities as well as subsequent fair value measurements. Additionally, estimates are used in determining items such as sales discounts and returns, depreciable and amortizable lives, share-based compensation assumptions and taxes on income. 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 these estimates.

***Recognizing and Measuring Assets Acquired and Liabilities Assumed in Business Combinations at Fair Value***

The Company accounts for acquired businesses using the acquisition method of accounting, which requires that assets acquired and liabilities assumed be recorded at the date of acquisition at their respective fair values. The fair value of the consideration paid, including contingent consideration, is assigned to the underlying net assets of the acquired business based on their respective fair values. Any excess of the purchase

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price over the estimated fair values of the net assets acquired is recorded as goodwill or bargain purchase, as applicable.

Significant judgments are used in determining the estimated fair values assigned to the assets acquired and liabilities assumed and in determining estimates of useful lives of long-lived assets. Fair value determinations and useful life estimates are based on, among other factors, estimates of expected future net cash flows, estimates of appropriate discount rates used to calculate present value expected future net cash flows, the assessment of each asset's life cycle, the impact of competitive trends on each asset's life cycle and other factors. These judgments can materially impact the estimates used to allocate acquisition date fair values to assets acquired and liabilities assumed and the resulting timing and amounts charged to, or recognized in, current and future operating results. For these and other reasons, actual results may vary significantly from estimated results.

Any changes in the fair value of contingent consideration resulting from a change in the underlying inputs are recognized in operating expenses until the contingent consideration arrangement is settled. Changes in the fair value of contingent consideration resulting from the passage of time are recorded within interest expense until the contingent consideration is settled.

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***Revenue Recognition***

The Company recognizes revenue from the sale of its products, royalties earned, and payments received and services performed under contractual arrangements.

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. Revenue arrangements with multiple elements are evaluated to determine whether the multiple elements meet 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 the Company remains obligated to perform services.

- **Product Sales** The Company sells commercial products to wholesale distributors and retail pharmacies. Products sales revenue is recognized when title has transferred to the customer and the customer has assumed the risks and rewards of ownership, which typically occurs on delivery to the customer.
- **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 the 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 need to adjust these estimates, which could have an effect on product sales and earnings in the period of adjustment. The Company's sales allowances include:
  - **Product Returns** The Company allows customers to return product for credit with respect to product that is within six months before and up to 12 months after its product expiration date. The Company estimates product returns on NUCYNTA® ER and NUCYNTA®, Gralise®, CAMBIA®, Zipsor® and Lazanda®. 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 the Company shipped as part of its commercialization agreement with Salix in August 2011. Under the terms of the Zipsor® asset purchase agreement, the Company assumed financial responsibility for returns of Zipsor® product previously sold by Xanodyne Pharmaceuticals, Inc. (Xanodyne). Under the terms of the CAMBIA® asset purchase agreement, the Company also assumed financial responsibility for returns of CAMBIA® product previously sold by Nautilus. The Company did not assume financial responsibility for returns of NUCYNTA® ER and NUCYNTA® previously sold by Janssen Pharma or Lazanda® product previously sold by Archimedes Pharma US Inc. See Note 13 for further information on the acquisition of NUCYNTA® ER and NUCYNTA®, CAMBIA®, Lazanda® and Zipsor®.

The shelf life of NUCYNTA® ER and NUCYNTA® is 24 months and 36 months from the date of tablet manufacture, respectively. The shelf life of Gralise® is 24 to 36 months from the date of tablet manufacture. The shelf life of CAMBIA® is 24 to 48 months from the manufacture date. The shelf life of Zipsor® is 36 months from the date of tablet manufacture. The shelf life of Lazanda® is 24 to 36 months from the manufacture date. 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. Estimates for returns are based on historical return trends by product or by return trends of similar products, taking into consideration the shelf life of product at the time of shipment, shipment and prescription trends, estimated distribution channel inventory levels and consideration of the introduction of competitive products.

Because of the shelf life of the Company's products and its return policy of issuing credits with respect to product that is returned within six months before and up to 12 months after its product expiration date, there may be a significant period of time between when the product is shipped and when the Company issues credit on a returned product. Accordingly, the Company may have to adjust these estimates, which could have an effect on product sales and earnings in the period of adjustments.

- **Wholesaler and Retail Pharmacy Discounts** The Company offers contractually determined discounts to certain wholesale distributors and retail pharmacies that purchase directly from it. These discounts are either taken off-invoice at the time of shipment or paid to the customer on a quarterly basis one to two months after the quarter in which product was shipped to the customer.
- **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 payment terms to earn the cash discount.
- **Patient Discount Programs** The Company offers patient discount co-pay assistance programs in which patients receive certain discounts off their prescriptions at participating retail pharmacies. The discounts are reimbursed by the Company approximately one month after the prescriptions subject to the discount are filled.



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- **Medicaid Rebates** The Company participates in Medicaid rebate programs, which provide assistance to certain 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 prescriptions subject to the rebate are filled.
- **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 the 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.
- **Managed Care Rebates** The Company offers discounts under contracts with certain managed care providers. The Company generally pays managed care rebates one to three months after the quarter in which prescriptions subject to the rebate are filled.
- **Medicare Part D Coverage Gap Rebates** The Company participates in the Medicare Part D Coverage Gap Discount Program under which it provides rebates on prescriptions that fall within the "donut hole" coverage gap. The Company generally pays Medicare Part D Coverage Gap rebates two to three months after the quarter in which prescriptions subject to the rebate 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.

Royalties received from Mallinckrodt on sales of XARTEMIS XR and from Janssen Pharma on sales of NUCYNTA® ER are recognized in the period earned as the royalty amounts can be estimated and collectability is reasonably assured. The Company will no longer receive royalties from Janssen Pharma on sales of NUCYNTA® ER in the U.S. for any period after April 2, 2015, the date on which the Company acquired the U.S. rights to NUCYNTA® ER from Janssen Pharma. The Company will continue to receive royalties from Janssen Pharma on net sales of NUCYNTA® ER in Canada and Japan.

Until October 1, 2013, the Company received royalties from Salix based on net sales of Glumetza and from Merck based on net sales of Janumet® XR. The royalties were recognized in the period earned as the royalty amounts could be estimated and collectability was reasonably assured.

In October 2013, the Company sold its interests in royalty and milestone payments under its license agreements in the Type 2 diabetes therapeutic area, including the Glumetza royalty and the Janumet® XR royalty, to PDL for \$240.5 million. The Company had significant continuing involvement in the PDL transaction until September 30, 2014, primarily due to the Company's obligation to act as the intermediary for the supply of 1000 mg Glumetza to Salix, the licensee of Glumetza. Under the relevant accounting guidance, because of the Company's significant continuing involvement, the \$240.5 million payment received from PDL was accounted for as debt until September 30, 2014. As a result of debt accounting, even though the Company did not retain the related royalties and milestones under the transaction, the Company was required to record the revenue related to these royalties and milestones in its condensed consolidated statement of operations until September 30, 2014.

Effective October 1, 2014, the Company, Valeant, Salix and PDL executed an amended agreement which eliminated any and all continuing obligations on the part of the Company in the manufacture and supply of 1000 mg Glumetza tablets. Consequently, the entire outstanding balance of the liability related to the sale of future royalties and milestones of approximately \$147.0 million was recognized within Non-cash PDL royalty revenue during the fourth quarter of 2014.

- **License and Collaborative Arrangements** Revenue from license and collaborative arrangements is 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.

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*Recently Issued Accounting Standards*

In April 2015, the Financial Accounting Standards Board (FASB) issued guidance which requires debt issuance costs to be presented in the balance sheet as a direct deduction from the carrying value of the associated debt liability, consistent with the presentation of a debt discount. The guidance is effective for annual periods beginning after December 15, 2015, and interim periods thereafter, with early adoption permitted. The Company plans to adopt this guidance on January 1, 2016. The adoption of this guidance will have not have a material impact on the presentation of debt liability and debt issuance costs in the Condensed Consolidated Balance Sheet in future periods.

In August 2014, the FASB issued guidance which requires management to assess an entity's ability to continue as a going concern and to provide related disclosures in certain circumstances. Under the new guidance, disclosures are required when conditions give rise to substantial doubt about an entity's ability to continue as a going concern within one year from the financial statement issuance date. The guidance is effective for annual periods ending after December 15, 2016, and all annual and interim periods thereafter. Early application is permitted. The adoption of this guidance will not have any impact on the Company's financial position and results of operations and, at this time, the Company does not expect any impact on its disclosures.

In June 2014, the FASB issued guidance which requires that a performance target that affects vesting, and that could be achieved after the requisite service period, be treated as a performance condition. As such, the performance target should not be reflected in estimating the grant date fair value of the award. This update further clarifies that compensation cost should be recognized in the period in which it becomes probable that the performance target will be achieved and should represent the compensation cost attributable to the period(s) for which the requisite service has already been rendered. The guidance is effective for annual periods beginning after December 15, 2015, and all annual and interim periods thereafter. The Company does not anticipate that the adoption of this standard will have a material impact on its condensed consolidated financial statements.

In May 2014, the FASB issued guidance which outlines a new, single comprehensive model for entities to use in accounting for revenue arising from contracts with customers and supersedes most current revenue recognition guidance, including industry-specific guidance. This new revenue recognition model provides a five-step analysis in determining when and how revenue is recognized. The new model will require revenue recognition to depict the transfer of promised goods or services to customers in an amount that reflects the consideration a company expects to receive in exchange for those goods or services. On July 9, 2015, the FASB deferred the effective date of this standards update to fiscal years beginning after December 15, 2017, with early adoption permitted on the original effective date of fiscal years beginning after December 15, 2016. The Company is currently assessing the impact that adopting this new accounting guidance will have on its condensed consolidated financial statements and footnote disclosures and plans to adopt this guidance on January 1, 2018.

Table of Contents**NOTE 2. CASH, CASH EQUIVALENTS AND MARKETABLE SECURITIES**

All marketable securities have been designated as available for sale securities. Securities included in cash and cash equivalents and marketable securities as of June 30, 2015 and December 31, 2014 are summarized below (in thousands). Estimated fair value is based on quoted market prices for these investments.

June 30, 2015	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Cash and cash equivalents:</b>				
Cash	\$ 53,548	\$	\$	\$ 53,548
Money market funds	11,282			11,282
Commercial Paper	29,264			29,264
<b>Total cash and cash equivalents</b>	<b>\$ 94,094</b>	<b>\$</b>	<b>\$</b>	<b>\$ 94,094</b>
<b>Marketable securities:</b>				
Total maturing within 1 year and included in marketable securities:				
Corporate debt securities	\$ 23,916	\$ 1	\$ (11)	\$ 23,906
Total maturing between 1 and 2 years and included in marketable securities:				
Corporate debt securities	4,559	2	(2)	4,559
<b>Total marketable securities</b>	<b>\$ 28,475</b>	<b>\$ 3</b>	<b>\$ (13)</b>	<b>\$ 28,465</b>
<b>Total cash, cash equivalents and marketable securities</b>	<b>\$ 122,569</b>	<b>\$ 3</b>	<b>\$ (13)</b>	<b>\$ 122,559</b>
December 31, 2014	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
<b>Cash and cash equivalents:</b>				
Cash	\$ 22,452	\$	\$	\$ 22,452
Money market funds	179,923			179,923
Corporate debt securities	286,292	3	(2)	286,293
<b>Total cash and cash equivalents</b>	<b>\$ 488,667</b>	<b>\$ 3</b>	<b>\$ (2)</b>	<b>\$ 488,668</b>
<b>Marketable securities:</b>				
Total maturing within 1 year and included in marketable securities:				
Corporate debt securities	\$ 70,777	\$ 1	\$ (5)	\$ 70,773
Total maturing between 1 and 2 years and included in marketable securities:				
Corporate debt securities	6,974		(13)	6,961
<b>Total marketable securities</b>	<b>\$ 77,751</b>	<b>\$ 1</b>	<b>\$ (18)</b>	<b>\$ 77,734</b>
<b>Total cash, cash equivalents and marketable securities</b>	<b>\$ 566,418</b>	<b>\$ 4</b>	<b>\$ (20)</b>	<b>\$ 566,402</b>

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The decrease in cash, cash equivalents and marketable securities during the six months ended June 30, 2015 is primarily attributable to the payment of the purchase price for the NUCYNTA® acquisition on April 2, 2015.

The Company considers all highly liquid investments with a maturity at the date of purchase of three months or less to be cash equivalents. Cash and cash equivalents consist of cash on deposit with banks, money market instruments and corporate debt securities. The Company invests its cash in marketable securities with U.S. Treasury and government agency securities, and high quality securities of financial and commercial institutions. To date, the Company has not experienced material losses on any of its balances. 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 loss within shareholders equity on the Condensed Consolidated Balance Sheets. The Company uses the specific identification method to determine the amount of realized gains or losses on sales of marketable securities.

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Realized gains or losses have been insignificant and are included in interest and other income in the Condensed Consolidated Statement of Operations.

At June 30, 2015, the Company had 27 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, 2015 (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	\$ 17,584	\$ (14)	\$	\$	\$ 17,584	\$ (14)
Total available-for-sale	\$ 17,584	\$ (14)	\$	\$	\$ 17,584	\$ (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, 2015. For debt securities, the Company does not intend to sell the investments and it is not more likely than not that the Company will be required to sell the investments before recovery of the amortized cost.

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.



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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, 2015 and December 31, 2014 (in thousands):

June 30, 2015	Level 1	Level 2	Level 3	Total
<b>Assets:</b>				
Money market funds	\$ 11,282	\$	\$	\$ 11,282
Commercial Paper		35,416		35,416
Corporate debt securities	22,313			22,313
<b>Total</b>	<b>\$ 33,595</b>	<b>\$ 35,416</b>	<b>\$</b>	<b>\$ 69,011</b>

<b>Liabilities:</b>				
Contingent consideration- Zipsor	\$	\$	\$ 1,575	\$ 1,575
Contingent consideration- Lazanda			11,751	11,751
Contingent consideration- CAMBIA			1,394	1,394
Unfavorable contract assumed			661	661
	\$	\$	\$ 15,381	\$ 15,381

December 31, 2014	Level 1	Level 2	Level 3	Total
Money market funds	\$ 179,923	\$	\$	\$ 179,923
Commercial Paper		253,837		253,837
Corporate debt securities	110,190			110,190
<b>Total</b>	<b>\$ 290,113</b>	<b>\$ 253,837</b>	<b>\$</b>	<b>\$ 543,950</b>

<b>Liabilities:</b>				
Contingent consideration- Zipsor	\$	\$	\$ 1,800	\$ 1,800
Contingent consideration- Lazanda			11,209	11,209
Contingent consideration- CAMBIA			1,243	1,243
Unfavorable contract assumed			3,343	3,343
	\$	\$	\$ 17,595	\$ 17,595

The fair value measurement of the contingent consideration obligations arises from the Zipsor®, CAMBIA® and Lazanda® acquisitions and relates to fair value of the potential future milestone payments and royalties payable under the respective agreements which are 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 and royalties being achieved. At each reporting date, the Company re-measures the contingent consideration obligation arising from the above acquisitions to their estimated fair values. Any changes in the fair value of contingent consideration resulting from a change in the underlying inputs are recognized in operating expenses until the contingent consideration arrangement is settled. Changes in the fair value of contingent consideration resulting from the passage of time are recorded within interest expense until the contingent consideration is settled. The table below provides a summary of the changes in fair value recorded in interest expense and selling, general and administrative expense for the six months ended June 30, 2015. Changes in fair value included within interest expense in the accompanying Condensed Consolidated Statement of Operations for the three and six months ended June 30, 2015 were \$0.6 million and \$1.1 million, respectively.

The liability for the unfavorable contract assumed represents an obligation for the Company to make certain payments to a vendor upon the achievement of certain milestones by such vendor. This contract was entered into by Nautilus Neurosciences, Inc. (Nautilus) as part of a legal



settlement unrelated to the CAMBIA® acquisition. The liability of \$0.7 million recorded above, as of June 30, 2015, represents the fair value of the amounts by which the contract terms are unfavorable compared to the current pricing and a probability-weighted assessment of the likelihood that the stipulated milestones will be achieved by the third party. The contract may be terminated if the third party fails to achieve these milestones, in which case the fair value of the liability as of the date of the termination will be reversed on the Condensed Consolidated Balance Sheet and reflected in the Condensed Consolidated Statement of Operations. Any changes in the fair value of this liability resulting from a change in the underlying inputs are recognized in operating expenses until the contract is settled. Changes in the fair value of the liability resulting from the passage of time are recorded within interest expense until the contract is settled.

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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, 2015 (in thousands):

	Balance at December 31, 2014	Changes in fair value recorded in interest expense	Changes in fair value recorded in selling, general and administrative expense	Royalties Paid	Balance at June 30, 2015
<b>Liabilities:</b>					
Contingent consideration obligations- Zipsor®	\$ 1,800	\$ 124	\$ (349)		1,575
Contingent consideration obligations- Lazanda®	11,209	597	263	(318)	11,751
Contingent consideration obligations- CAMBIA®	1,243	100	51		1,394
Unfavorable contract assumed	3,343	269	(2,951)		661
Total	\$ 17,595	\$ 1,090	\$ (2,986)	\$ (318)	15,381

The Company recorded a reduction of \$1.5 million and \$3.0 million in selling, general and administrative expense during the three and six months ended June 30, 2015, respectively. The decrease in selling, general and administrative expense was primarily driven by a change in the fair value of the liability related to the unfavorable contract assumed as part of the CAMBIA® acquisition, and arose from a reduction in the probability that the vendor can achieve the milestones by the stipulated deadline. The reduction of \$1.2 million and \$3.0 million in the fair value of the unfavorable contract assumed, in the three and six months ended June 30, 2015, respectively, is a change in accounting estimate which reduced basic and diluted net loss per share by approximately (\$0.02) and (\$0.05) for the three and six months ended June 30, 2015, respectively.

The estimated fair value of the 2.50% Convertible Senior Notes Due 2021, which the Company issued on September 9, 2014 is based on a market approach. The estimated fair value was approximately \$437.1 million and \$375.2 million (par value \$345.0 million) as of June 30, 2015 and December 31, 2014, respectively, and represents a Level 2 valuation.

**NOTE 3. NET (LOSS) INCOME PER SHARE**

Basic net (loss) income per share is calculated by dividing the net (loss) income by the weighted-average number of shares of common stock outstanding during the period. Diluted net (loss) income per share is calculated by dividing the net (loss) income by the weighted-average number of shares of common stock outstanding during the period, plus potentially dilutive common shares, consisting of unexercised stock options, unvested restricted stock awards, outstanding shares under the employee stock purchase plan and convertible debt. The Company uses the treasury-stock method to compute diluted earnings per share with respect to its stock options and equivalents. The Company uses the if-converted method to compute diluted earnings per share with respect to its convertible debt. 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 (loss) income per share when their effect is dilutive. Basic and diluted earnings per common share are calculated as follows:

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(in thousands, except for per share amounts)	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
<b>Basic (loss) income per share</b>				
Net (loss) income	\$ (21,653)	\$ 12,746	\$ (33,286)	\$ 30,684
Denominator	59,992	58,106	59,778	57,827
Basic net (loss) income per share	\$ (0.36)	\$ 0.22	\$ (0.56)	\$ 0.53
<b>Diluted net (loss) income per share</b>				
Net (loss) income	\$ (21,653)	\$ 12,746	\$ (33,286)	\$ 30,684
<b>Denominator:</b>				
Denominator for basic net (loss) income per share	59,992	58,106	59,778	57,827
<b>Add effect of dilutive securities:</b>				
Stock options and equivalents		2,324		2,431
Denominator for diluted net (loss) income per share	59,992	60,430	59,778	60,258
Diluted net (loss) income per share	\$ (0.36)	\$ 0.21	\$ (0.56)	\$ 0.51

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

(in thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Convertible debt	17,931,393		17,931,393	
Stock options and equivalents	1,506,982	1,190	1,166,500	1,609
Total potentially dilutive shares	19,438,375	1,190	19,097,893	1,609

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**NOTE 4. LICENSE AND COLLABORATIVE ARRANGEMENTS**

*Janssen Pharmaceuticals, Inc.*

In August 2012, the Company entered into a license agreement with Janssen Pharma that granted Janssen Pharma a non-exclusive license to certain patents and other intellectual property rights to its Acuform® drug delivery technology for the development and commercialization of tapentadol extended release products, including NUCYNTA® ER (tapentadol extended-release tablets). The Company received a \$10.0 million upfront license fee, which was recognized as revenue in 2012, and receives low single digit royalties on net sales of NUCYNTA® ER in Canada and Japan from and after July 2, 2012 through December 31, 2021.

The Company was also previously receiving royalties on sales of NUCYNTA® ER in the U.S. until its acquisition of the U.S. rights to NUCYNTA® ER from Janssen Pharma on April 2, 2015.

*Mallinckrodt Inc. (formerly Covidien, Ltd.)*

In November 2008, the Company entered into a license agreement related to acetaminophen/opiate combination products with Mallinckrodt. The license agreement grants Mallinckrodt worldwide rights to utilize Depomed's Acuform technology for the exclusive development of up to four products containing acetaminophen in combination with opiates, two of which Mallinckrodt has elected to develop.

Since the inception of the contract, the Company has received \$27.5 million in upfront fees and milestones under the agreement. The upfront fees included a \$4.0 million upfront license fee and a \$1.5 million advance payment for formulation work the Company performed under the agreement. The milestone payments include four \$0.5 million clinical development milestones and \$5.0 million milestone payment following the FDA's July 2013 acceptance for filing of the NDA for XARTEMIS XR (oxycodone hydrochloride and acetaminophen) Extended-Release Tablets (CII), previously known as MNK-795. In March 2014, the FDA approved XARTEMIS XR for the management of acute pain severe enough to require opioid treatment and in patients for whom alternative treatment options (e.g., non-opioid analgesics) are ineffective, not tolerated or would otherwise be inadequate. The approval of the NDA triggered a \$10.0 million milestone payment to the Company, which the Company received in April 2014. This \$10.0 million milestone payment was recognized as revenue during the three months ended March 31, 2014. In May 2014, the FDA accepted for filing the NDA for MNK-155, which triggered a \$5.0 million milestone payment to the Company, which the Company received in June 2014. This \$5.0 million milestone payment was recognized as revenue during the three months ended June 30, 2014. If MNK-155 is approved by the FDA, the Company will receive a \$10.0 million milestone payment. The Company receives high single digit royalties on net sales of XARTEMIS XR, which was launched in March 2014, and will receive the same high single digit royalties on net sales of MNK-155 if that product is approved.

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***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 certain patents and other intellectual property rights to Depomed's Acuform drug delivery technology for IW-3718, an Ironwood product candidate under evaluation for refractory gastroesophageal reflux disease (GERD).

Since the inception of the contract, the Company has received \$3.4 million under the agreement, which includes an upfront payment, reimbursement of initial product formulation work and three milestones payments. The Company recognized a non-refundable milestone payment of \$1.0 million in March 2014 as a result of the initiation of clinical trials relating to IW-3718 by Ironwood. As the non-refundable milestone was both substantive in nature and related to past performance, the Company recognized the \$1.0 million as revenue in March 2014.

***Salix Pharmaceuticals, Inc. (formerly Santarus, Inc.)***

In August 2011, the Company entered into a commercialization agreement with Santarus, Inc., which was acquired by Salix in January 2014, granting Salix exclusive rights to manufacture and commercialize Glumetza in the U.S. The commercialization agreement supersedes the promotion agreement between the parties previously entered into in July 2008. Under the commercialization agreement, the Company granted Salix exclusive rights to manufacture and commercialize Glumetza in the U.S. in return for a royalty on Glumetza net sales.

Pursuant to the original promotion agreement, Salix paid the Company a \$12.0 million upfront fee in July 2008. In October 2013, the Company sold its interest in the Glumetza royalties to PDL.

Effective October 1, 2014, the Company, Valeant and Salix executed an amended agreement which eliminated any and all continuing obligations on the part of the Company in the supply of Glumetza 1000mg tablets. The execution of that agreement represented the completion of the final deliverable and, consequently, the Company recognized the remaining unamortized deferred revenue of \$1.9 million as of October 1, 2014.

The Company recognized approximately \$0.4 million and \$0.7 million of revenue associated with this upfront license fee during the three and six months ended June 30, 2014, respectively.

***Valeant Pharmaceuticals International, Inc. (formerly Biovail Laboratories, Inc.)***

In May 2002, the Company entered into a development and license agreement granting Valeant Pharmaceuticals International, Inc. (Valeant) an exclusive license in the U.S. and Canada to manufacture and market Glumetza. Under the terms of the agreement, the Company was responsible for completing the clinical development program in support of the 500mg Glumetza. In July 2005, Valeant received FDA approval to market

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Glumetza in the U.S. In accordance with the license agreement, Valeant paid a \$25.0 million license fee payment to the Company.

Until September 30, 2014, the Company was recognizing the \$25.0 million license fee payment as revenue ratably until October 2021, which represented the estimated length of time of the Company's obligations existed under the arrangement related to royalties that the Company was obligated to pay Valeant on net sales of the 500mg Glumetza in the U.S. and to use Valeant as the sole supplier of the 1000mg Glumetza. Effective October 1, 2014, the Company, Valeant and Salix executed an amended agreement which eliminated any and all continuing obligations on the part of the Company in the manufacture and supply of 1000mg Glumetza tablets. The execution of that agreement represented the completion of the final deliverable and, consequently, the Company recognized the remaining unamortized deferred revenue of \$11.3 million as of October 1, 2014. The Company recognized approximately \$0.4 million and \$0.8 million of license revenue related to the amortization of this upfront fee of \$25.0 million during the three and six months ended June 30, 2014, respectively.

Table of Contents**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 Condensed Consolidated Statements of Operations (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Cost of sales	\$ 4	\$ 1	\$ 5	\$ 13
Research and development expense	46	51	183	104
Selling, general and administrative expense	3,203	2,247	5,878	4,053
Total	\$ 3,253	\$ 2,299	\$ 6,066	\$ 4,170

At June 30, 2015, the Company had \$24.9 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 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, 2015	December 31, 2014
Raw materials	\$ 1,369	\$ 2,141
Work-in-process	1,124	1,348
Finished goods	8,414	4,984
Less: allowance for obsolescence	(531)	(17)
Total	\$ 10,376	\$ 8,456

As of June 30, 2015, the unamortized portion of the step-up in fair value related to Nucynta® inventories acquired as part of the NUCYNTA Acquisition on April 2, 2015, was \$0.8 million. The amount of the step-up in the fair value of NUCYNTA® inventories amortized to cost of sales during the three months ended June 30, 2015 was \$5.0 million.

As of June 30, 2015 and December 31, 2014, the unamortized portion of the step-up in fair value related to Lazanda® inventories acquired as part of the Lazanda® Acquisition on July 29, 2013 was \$0 and \$0.2 million, respectively. The amount of the step-up

in the fair value of Lazanda® inventories amortized to cost of sales during the three and six months ended June 30, 2015 was \$0 and \$0.2 million, respectively.



Table of Contents**NOTE 7. ACCOUNTS PAYABLE AND ACCRUED LIABILITIES**

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

	June 30, 2015	December 31, 2014
Accounts payable	\$ 1,684	\$ 1,278
Accrued compensation	6,950	7,248
Accrued rebates and sales discounts	56,585	20,695
Allowance for product returns	17,605	15,015
Inventory and other contract manufacturing accruals	3,012	360
Royalties payable	9,548	810
Sales and marketing accruals	6,625	2,497
Other accrued liabilities	11,916	4,783
Total accounts payable and accrued liabilities	\$ 113,925	\$ 52,686

**NOTE 8. LIABILITY RELATED TO SALE OF FUTURE ROYALTIES**

As noted above, in October 2013, the Company sold its interests in royalty and milestone payments under its license agreements in the Type 2 diabetes therapeutic area to PDL for \$240.5 million. Until September 30, 2014, this transaction was accounted for as debt that was amortized using the interest method over the life of the arrangement. In order to determine the amortization of the debt, the Company was required to estimate the total amount of future royalty payments to be received by PDL and payments the Company is required to make to PDL, if any, over the life of the arrangement. The sum of these amounts less the \$240.5 million proceeds the Company received was recorded as interest expense over the life of the debt. Consequently, the Company imputed interest on the unamortized portion of the debt and recorded interest expense using an estimated interest rate for an arms-length debt transaction. The Company's estimate of the interest rate under the arrangement was based on the amount of royalty and milestone payments expected to be received by PDL over the life of the arrangement. The Company's estimate of this total interest expense resulted in an effective annual interest rate of approximately 10%.

As a result of the debt accounting, even though the Company did not retain the rights to receive the related royalties and milestones under the transaction (as the amounts are remitted to PDL), the Company continued to record revenue related to these royalties and milestones until September 30, 2014. The Company recognized \$33.3 million and \$76.1 million of non-cash PDL royalty revenue for the three and six months ended June 30, 2014, respectively. The Company incurred \$4.9 million and \$10.3 million of non-cash interest expense on PDL liability for the three and six months ended June 30, 2014.

Effective October 1, 2014, the Company, Valeant, Salix and PDL executed an amended agreement which eliminated any and all continuing obligations on the part of the Company in the supply of 1000mg Glumetza tablets. Consequently, the entire outstanding balance of the liability related to the sale of future royalties and milestones of approximately \$147.0 million was recognized as non-cash PDL royalty revenue during the fourth quarter of 2014.

**NOTE 9. DEBT**

*Senior Notes*

On April 2, 2015, the Company issued \$575.0 million aggregate principal amount of senior secured notes (the Senior Notes) for aggregate gross proceeds of approximately \$562.0 million pursuant to a Note Purchase Agreement dated March 12, 2015 (Note Purchase Agreement) between the Company and Deerfield Private Design Fund III, L.P., Deerfield Partners, L.P., Deerfield International Master Fund, L.P., Deerfield Special Situations Fund, L.P., Deerfield Private Design Fund II, L.P., Deerfield Private Design International II, L.P., BioPharma Secured Investments III Holdings Cayman LP, Inteligo Bank Ltd. and Phemus Corporation (collectively, the Purchasers) and Deerfield Private Design Fund III, L.P., as collateral agent. The Company used \$550.0 million of the net proceeds received upon the sale of the Senior Notes to fund a portion of the Purchase Price paid to Janssen Pharma in connection with the NUCYNTA® acquisition. The Company incurred debt issuance costs of \$0 and \$0.5 million during the three and six months ended June 30, 2015.

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The Senior Notes will mature on April 2, 2022 (unless earlier prepaid or repurchased), are secured by substantially all of the assets of the Company and any subsidiary guarantors, and bear interest at the rate equal to the lesser of (i) 9.75% over the three month London Inter-Bank Offer Rate (LIBOR), subject to a floor of 1.0% and (ii) 11.95% (through the third anniversary of the purchase date) and 12.95% (thereafter). The interest rate is determined at the first business day of each fiscal quarter, commencing with the first such date following April 2, 2015.

The principal amount of the Senior Notes is repayable as follows (amounts in thousands):

April 2, 2018	\$	57,500
April 2, 2019		115,000
April 2, 2020		115,000
April 2, 2021		143,750
April 2, 2022		143,750
	\$	575,000

The Senior Notes can be prepaid, at the Company's option, (i) after the first anniversary of the purchase date but prior to the second anniversary, up to \$100.0 million, (ii) before the second anniversary, under certain conditions and (iii) after the second anniversary, at the Company's discretion. The Company is required to repay the outstanding Notes in full if the principal amount outstanding on its existing 2.50% Convertible Senior Notes due 2021 as of March 31, 2021, is greater than \$100.0 million. In addition, if the successor entity in a Major Transaction, as defined in the Note Purchase Agreement, does not satisfy specified qualification criteria, the Purchasers may require the Company to prepay the Senior Notes upon consummation of the Major Transaction in an amount equal to the principal amount of outstanding Notes, accrued and unpaid interest and a prepayment premium in an amount equal to what the Company would have otherwise paid in an optional prepayment described in the preceding paragraph. The Company is required to make mandatory prepayments on the Senior Notes in an amount equal to the proceeds it receives in connection with asset dispositions in excess of \$10.0 million, together with accrued and unpaid interest on the principal amount prepaid.

The Senior Notes and related indentures contain customary covenants, including, among other things, and subject to certain qualifications and exceptions, covenants that restrict the Company's ability and the ability of its subsidiaries to: incur or guarantee additional indebtedness; create or permit liens on assets; pay dividends on capital stock or redeem, repurchase or retire capital stock or subordinated indebtedness; make certain investments and other restricted payments; engage in mergers, acquisitions, consolidations and amalgamations; transfer and sell certain assets; and engage in transactions with affiliates.

Pursuant to the Note Purchase Agreement, upon the consummation of the sale of the Senior Notes on April 2, 2015, the Company and Depo NF Sub, LLC entered into a Pledge and Security Agreement with the Deerfield Private Design Fund III, L.P. (the Collateral Agent), pursuant to which the Company and Depo NF Sub each granted the Collateral Agent (on behalf of the Purchasers) a security interest in substantially all of their assets, other than specifically excluded assets.

The following is a summary of the carrying value of the Senior Notes as of June 30, 2015 (in thousands):

**June 30,  
2015**

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Principal amount of the Senior Notes	\$	575,000
Unamortized debt discount balance		(12,484)
	\$	562,516

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The debt discount and debt issuance costs will be amortized as interest expense through April 2022. The following is a summary of interest expense for the three and six months ended June 30, 2015 (in thousands):

	June 30, 2015	
	Three Months Ended	Six Months Ended
Stated coupon interest	\$ 15,281	\$ 15,281
Amortization of debt discount and debt issuance costs	471	471
Total interest expense	\$ 15,752	\$ 15,752

**Convertible Debt**

On September 9, 2014, the Company issued \$345 million aggregate principal amount of convertible notes due 2021 (the Convertible Notes) resulting in net proceeds to the Company of \$334.2 million after deducting the underwriting discount and offering expenses of \$10.4 million and \$0.4 million, respectively.

The Convertible Notes were issued pursuant to an indenture, as supplemented by a supplemental indenture between the Company and The Bank of New York Mellon Trust Company, N.A., as trustee (the Trustee), and mature on September 1, 2021, unless earlier converted, redeemed or repurchased. The Convertible Notes bear interest at the rate of 2.50% per annum, payable semi-annually in arrears on March 1 and September 1 of each year, beginning March 1, 2015.

Upon the occurrence of certain events, holders may convert their Convertible Notes prior to the close of business on the business day immediately preceding March 1, 2021. On or after March 1, 2021, until the close of business on the second trading day immediately preceding the maturity date, holders may surrender their Convertible Notes for conversion at any time. Upon conversion, the Company will pay or deliver, at its option, cash, shares of its common stock or a combination of cash and shares of its common stock. The initial conversion rate of 51.9852 shares of common stock per \$1,000 principal amount of Convertible Notes is equivalent to a conversion price of approximately \$19.24 per share of common stock. The conversion rate is subject to adjustment upon the occurrence of certain events.

In addition, upon the occurrence of certain events defined in the indenture as a fundamental change, holders of the Convertible Notes may require the Company to purchase for cash all or any portion of their Convertible Notes at a purchase price equal to 100% of the principal amount of the Convertible Notes to be purchased plus accrued and unpaid interest, if any, to, but excluding, the fundamental change purchase date.

The Convertible Notes were accounted for in accordance with ASC Subtopic 470-20, *Debt with Conversion and Other Options*. Pursuant to ASC Subtopic 470-20, since the Convertible Notes can be settled in cash, shares of common stock or a combination of cash and shares of common stock at the Company's option, the Company is required to separately account for the liability (debt) and equity (conversion option) components of the instrument. The carrying amount of the liability component of any outstanding debt instrument is computed by estimating the fair value of a similar liability without the conversion option. The amount of the equity component is then calculated by deducting the fair value of the liability component from the principal amount of the convertible debt instrument. The effective interest rate used in determining the liability component of the Convertible Notes was 9.34%. This resulted in the recognition of \$226 million as the liability component net of a \$119 million debt discount with a corresponding increase to paid-in capital representing the equity component of the Convertible Notes. The underwriting discount of \$10.4 million and offering expenses of \$0.4 million were allocated between debt issuance costs and equity issuance

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costs in proportion to the allocation of the proceeds. Debt issuance costs of \$7.1 million are included in Other assets on the Condensed Consolidated Balance Sheets as of the issuance date. Equity issuance costs of \$3.7 million related to the convertible debt offering were recorded as an offset to additional paid-in capital.

The following is a summary of the liability component of the Convertible Notes as of June 30, 2015 (in thousands):

	<b>June 30, 2015</b>	
Principal amount of the Convertible Notes	\$	345,000
Unamortized discount of the liability component		(108,685)
	\$	236,315

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The debt discount and debt issuance costs will be amortized as interest expense through September 2021. The following is a summary of interest expense for the three and six months ended June 30, 2015 (in thousands):

	June 30, 2015	
	Three Months Ended	Six Months Ended
Stated coupon interest	\$ 2,156	\$ 4,312
Amortization of debt discount and debt issuance costs	3,513	6,934
Total interest expense	\$ 5,669	\$ 11,246

The balance of unamortized debt discount and debt issuance costs was \$114.9 million of which \$108.7 million is included in Convertible Notes and \$6.2 million is included within Other assets as of June 30, 2015 on the accompanying Condensed Consolidated Balance Sheets.

**NOTE 10. SHAREHOLDERS' EQUITY***Option Exercises*

For the three and six months ended June 30, 2015, employees exercised options to purchase 354,252 and 784,724 shares of the Company's common stock, respectively, with net proceeds to the Company of approximately \$2.3 million and \$5.6 million, respectively. For the three and six months ended June 30, 2014, employees exercised options to purchase 543,680 and 968,573 shares of the Company's common stock, respectively, with net proceeds to the Company of approximately \$2.5 million and \$4.8 million, respectively.

*Common Stock*

On May 12, 2015, the shareholders of the Company approved a proposed amendment to the Company's Amended and Restated Articles of Incorporation to increase the number of authorized shares of common stock by 100,000,000 shares, from 100,000,000 shares to 200,000,000 shares.

**NOTE 11. INCOME TAXES**

The income tax provision includes federal, state and local income taxes and is based on the application of a forecasted annual income tax rate applied to the current quarter's year-to-date pre-tax income (loss). In determining the estimated annual effective income tax rate, the Company estimates the annual impact of certain factors, including projections of the Company's annual earnings, taxing jurisdictions in which the earnings

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will be generated, the Company's ability to use tax credits and net operating loss carryforwards, and available tax planning alternatives. Discrete items, including the effect of changes in tax laws, tax rates, and certain circumstances with respect to valuation allowances or other unusual or non-recurring tax adjustments, are reflected in the period in which they occur as an addition to, or reduction from, the income tax provision, rather than being included in the estimated annual effective income tax rate. The Company recorded a tax receivable of \$10.5 million for the three and six months ended June 30, 2015 based on a net operating loss carryback claim expected to be filed with the IRS with respect to the year ending December 31, 2015.

For the three and six months ended June 30, 2015 the difference between the recorded benefit for income taxes and the tax benefit based on the federal statutory rate of 35%, was primarily attributable to the impact of net non-deductible expenses and minor discrete adjustments. For the three and six months ended June 30, 2014 the difference between the recorded provision for income taxes and the tax provision based on the federal statutory rate of 35%, was primarily attributable to the impact of net non-deductible expenses and minor discrete adjustments.

As of June 30, 2015 and December 31, 2014, the Company had \$5.6 million and \$5.2 million of unrecognized tax benefits, respectively. All tax years since inception remain open to examination by the Internal Revenue Service and the state taxing jurisdictions in which the Company operates 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 has approximately \$0.4 million of accrued interest and penalties associated with unrecognized tax benefits. The Company does not foresee any material changes to unrecognized tax benefits within the next 12 months.



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The Company has non-cancelable operating leases for its office building and it is obligated to make payments under non-cancelable operating leases for automobiles used by its sales force. Future minimum lease payments under the Company's non-cancelable operating leases at June 30, 2015 were as follows (in thousands):

Year Ending December 31,	Lease Payments
2015 (remainder)	\$ 2,060
2016	4,030
2017	3,287
2018	2,371
2019	1,575
Thereafter	4,866
<b>Total</b>	<b>\$ 18,189</b>

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 will occupy approximately 8,000 additional rentable square feet commencing in July 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 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 \$11.6 million in aggregate rent over the remaining term of the lease for the above premises. Deferred rent was approximately \$1.7 million as of June 30, 2015 and \$1.7 million as of December 31, 2014.

In December 2013, the Company entered into an operating lease agreement with Enterprise FM Trust (Enterprise) for the lease of vehicles to be used by the Company's sales force. The Company began receiving vehicles in the second quarter of 2014, with the lease terms ranging from 18 to 36 months. During the three months ended June 30, 2015, the Company entered into an additional lease with Enterprise, under the existing lease terms, for use by the additional sales force hired in the three months ended June 30, 2015. The Company expects to receive the additional vehicles in the second half of 2015. The Company will pay approximately \$6.6 million in aggregate rent over the remaining term of the lease for the vehicles. Rent expense relating to the lease of cars for the three months ended June 30, 2015 and 2014 was \$0.5 million and \$0, respectively, and \$1.0 million and \$0 for the six months ended June 30, 2015 and 2014, respectively.

Rent expense relating to the office and laboratory lease agreement for the three months ended June 30, 2015 and 2014, was \$0.3 million and \$0.2 million, respectively, and \$0.7 million and \$0.3 million for the six months ended June 30, 2015 and 2014, respectively.

*Legal Matters*

**Depomed v. NUCYNTA® and NUCYNTA® ER ANDA Filers**

In July 2013, Janssen Pharma filed patent infringement lawsuits in the U.S. District Court for the District of New Jersey against Actavis Elizabeth LLC, Actavis Inc. and Actavis LLC (collectively, Actavis), as well as Alkem Laboratories Limited and Ascend Laboratories, LLC (collectively, Alkem). The patent infringement claims against Actavis and Alkem relate to their respective ANDAs seeking approval to market a generic version of NUCYNTA® ER before the expiration of U.S. Reissue Patent No. 39,593 (the 593 Patent), U.S. Patent No. 7,994,364 (the 364 Patent) and, as to Actavis only, U.S. Patent No. 8,309,060 (the 060 Patent). The lawsuit also includes patent infringement claims against Actavis and Alkem in response to their respective ANDAs seeking approval to market a generic version of NUCYNTA® before the expiration of the 593 and 364 Patents. In December 2013, Janssen Pharma filed an additional complaint in the U.S. District Court for the District of New Jersey against Alkem asserting that U.S. Patent No. 8,536,130 (the 130 Patent) relates to Alkem's ANDA seeking approval to market a generic version of NUCYNTA® ER. In August 2014, Janssen Pharma amended the complaint against Alkem to add additional dosage strengths.

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In October 2013, Janssen Pharma received a Paragraph IV Notice from Sandoz, Inc. (Sandoz) with respect to NUCYNTA® related to the 364 Patent, and a Paragraph IV Notice from Roxane Laboratories, Inc. (Roxane) with respect to NUCYNTA® related to the 364 and 593 Patents. In response to those notices, Janssen Pharma filed an additional complaint in the U.S. District Court for the District of New Jersey against Roxane and Sandoz asserting the 364 Patent against Sandoz and the 364 and 593 Patents against Roxane. In April 2014, Janssen Pharma and Sandoz entered into a joint stipulation of dismissal of the case against Sandoz, based on Sandoz's agreement not to market a generic version of NUCYNTA® products prior to the expiration of the asserted patents. In June 2014, in response to a Paragraph IV Notice from Roxane with respect to NUCYNTA® ER, Janssen Pharma filed an additional complaint in the U.S. District Court for the District of New Jersey asserting the 364, 593, and 130 Patents against Roxane.

In July 2014, in response to a Paragraph IV Notice from Watson Laboratories, Inc. (Watson) with respect to the NUCYNTA® oral solution product and the 364 and 593 Patents, Janssen Pharma filed a lawsuit in the U.S. District Court for the District of New Jersey asserting the 364 and 593 Patents against Watson.

At the time that the foregoing complaints were filed, Janssen Pharma was an exclusive U.S. licensee of the patents referred to above. On April 2, 2015, the Company acquired the U.S. rights to the NUCYNTA® ER and NUCYNTA® from Janssen Pharma. As part of the acquisition, the Company became the exclusive U.S. licensee of the patents referred to above. The Company has since been added as a plaintiff to the pending ANDA lawsuits involving NUCYNTA® ER and NUCYNTA®. No trial date has been set.

**Depomed v. Gralise® ANDA Filers**

Between March 2012 and May 2012, the Company filed lawsuits in the U.S. District Court for the District of New Jersey in response to six ANDAs filed by companies seeking to market generic versions of 300mg and 600mg dosage strengths of Gralise® prior to the expiration of the Company's patents listed in the Orange Book for Gralise®. The lawsuits were consolidated for purposes of all pretrial proceedings. The Company's lawsuits against two of the six Gralise® ANDA filers, Impax Laboratories and Watson Laboratories, have been dismissed as a result of the withdrawal of the ANDAs from consideration by the FDA. The Company's lawsuit against another ANDA filer, Par Pharmaceuticals Inc., has been dismissed because the ANDA filer no longer seeks approval of its Gralise ANDA prior to the expiration of the Company's Gralise® Orange Book-listed patents. In April 2014, the Company entered into settlement agreements with Incepta Pharmaceuticals and Abon Pharmaceuticals LLC collectively, Incepta) and with Zydus Pharmaceuticals USA Inc. and Cadila Healthcare Limited (collectively, Zydus) pursuant to which Incepta and Zydus may begin selling generic versions of Gralise® on January 1, 2024, or earlier under certain circumstances.

A bench trial involving defendants Actavis Elizabeth LLC and Actavis Inc. (collectively, Actavis) was completed on May 20, 2014 as to U.S. Patent Nos. 6,635,280; 6,488,962; 7,438,927; 7,731,989; 8,192,756; 8,252,332; and 8,333,992, which expire between September 2016 and February 2024. In August 2014, the court ruled in the Company's favor, finding that Actavis infringed all patent claims that the Company asserted and upholding the validity of the patents. On September 15, 2014, Actavis filed a notice appealing the decision to the U.S. Court of

Appeals for the Federal Circuit. On February 2, 2015, Actavis filed its opening brief with the U.S. Court of Appeals for the Federal Circuit. On April 10, 2015, Actavis and the Company entered into a settlement agreement subject to review by the U.S. Department of Justice and the Federal Trade Commission, and the entry of orders dismissing the appeal and related federal district court litigation. By the terms of this agreement, Actavis' s pending appeal is dismissed and Actavis may begin selling the generic versions of Gralise® on January 1, 2024, or earlier under certain circumstances.

**Depomed v. Purdue and Depomed v. Endo Pharmaceuticals Patent Infringement Litigation and Related *Inter Partes* Review Proceedings**

The Company has sued Purdue Pharma and Endo Pharmaceuticals for patent infringement in separate lawsuits filed in the U.S. District Court for the District of New Jersey. The lawsuits arise from Purdue' s commercialization of reformulated OxyContin® (oxycodone hydrochloride controlled-release) in the U.S. and Endo' s commercialization of OPANA® ER (oxymorphone hydrochloride extended-release) in the U.S. The Company sued Purdue in January 2013 for infringement of U.S. Patent Nos. 6,340,475 (the 475 Patent) and 6,635,280 (the 280 Patent), which expire in September 2016. The Company sued Endo in April 2013 for infringement of the 475 Patent, the 280 Patent and U.S. Patent No. 6,723,340 (the 340 Patent), which expires in October 2021. The Purdue and Endo lawsuits have been stayed pending completion of the Endo inter partes reviews described below.

In response to two petitions filed by Purdue and six petitions filed by Endo, the U.S. Patent and Trademark Office Patent Trial and Appeal Board (PTAB) has instituted inter partes reviews (each, an IPR) of certain of the claims asserted in the Company' s lawsuits against Purdue and Endo. An IPR is a proceeding that became available in September 2012 in accordance with the America Invents Act (the AIA). In an IPR, a petitioner may request that the PTAB reconsider the validity of issued patent claims on the basis of prior art in the form of printed publications and other patents. Any patent claim the PTAB determines to be unpatentable is stricken from the challenged patent. Any party may appeal final written decisions of the PTAB to the U.S. Court of Appeals for the Federal Circuit, but the PTAB' s decisions denying institution of an IPR are non-appealable. Accordingly, if the PTAB finds a challenged claim patentable, or declines to institute an IPR as to a challenged claim, the IPR petitioner is estopped from asserting in a patent infringement lawsuit that these claims are invalid on any ground the petitioner raised or reasonably could have raised in the IPR.

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In the Purdue IPRs, on July 10, 2014, the PTAB declined to institute an IPR as to two claims of the 475 patent and two claims of the 280 Patent. The PTAB instituted an IPR as to the other 15 claims of the 475 Patent and as to the other 10 claims of the 280 Patent asserted against Purdue. On October 14, 2014, Depomed submitted written responses to the Petitions, and on December 22, 2014, Purdue submitted replies. A PTAB hearing was held on March 19, 2015. On July 8, 2015, the PTAB issued final decisions confirming the patentability of all claims at issue.

Endo filed two IPR petitions for each of the 475 Patent, the 280 Patent and the 340 Patent. The PTAB declined to institute an IPR as to three of Endo's petitions. The PTAB also declined to institute an IPR as to five claims of the 475 Patent, three claims of the 280 Patent and one claim of the 340 Patent in the Endo IPRs. The PTAB instituted an IPR as to the other 13 claims of the 475 Patent, as to the other ten claims of the 280 Patent and as to the other eight claims of the 340 patent asserted against Endo. The PTAB also declined to institute an IPR as to a number of Endo's requested grounds. Discovery is complete, and oral arguments were heard on June 15, 2015. The PTAB's final written decisions in these IPRs are expected not later than September 29, 2015.

**Depomed v. Banner Pharmacaps**

On June 28, 2013, the Company received from Banner a Notice of Certification for U.S. Patent 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 ANDA for diclofenac potassium capsules, 25mg. 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. 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, the Company filed a lawsuit in the U.S. District Court for District of New Jersey against Banner and Watson for infringement 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 25 mg diclofenac 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.

On April 2, 2014, the Company filed an amended complaint to include infringement of U.S. Patent Nos. 6,287,594 and 8,623,920, which were recently added to the Orange Book listing for Zipsor® and expire in 2019 and 2029, respectively. The Court heard arguments for patent claim construction on March 3, 2015, and issued an order on March 26, 2015, in favor of the Company's construction for all disputed terms. In May of 2015, the parties entered into a settlement agreement subject to review by the U.S. Department of Justice and the Federal Trade Commission. By the terms of this agreement, Watson Laboratories Inc. may begin selling the generic version of Zipsor® on March 24, 2022, or earlier under certain circumstances. On June 4, 2015, the Court entered an order staying the case pending the regulatory approval of the settlement agreement.

*General*

The Company cannot reasonably predict the outcome of the legal proceedings described above, nor can the Company estimate the amount of loss, range of loss or other adverse consequence, if any, that may result from these proceedings. As such, the Company is not currently able to estimate the impact of the above litigation on its financial position or results of operations.

The Company may from time to time become party to actions, claims, suits, investigations or proceedings arising from the ordinary course of its 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, the Company is not currently involved in any matters that it believes may have a material adverse effect on its business, results of operations or financial condition. However, regardless of the outcome, litigation can have an adverse impact on the Company because of associated cost and diversion of management time.

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**NOTE 13. BUSINESS COMBINATIONS**

*The NUCYNTA® Acquisition*

On January 15, 2015, the Company, entered into an asset purchase agreement pursuant to which the Company acquired from Janssen and its affiliates the U.S. rights to the NUCYNTA® franchise of pharmaceutical products (the NUCYNTA® U.S. Product Rights ) as well as certain related assets for \$1.05 billion in cash (the Purchase Price ).

The NUCYNTA® franchise includes NUCYNTA® ER (tapentadol) extended release tablets indicated for the management of pain, including neuropathic pain associated with diabetic peripheral neuropathy (DPN), severe enough to require daily, around-the-clock, long-term opioid treatment, NUCYNTA® (tapentadol), an immediate release version of tapentadol, for management of moderate to severe acute pain in adults, and NUCYNTA® (tapentadol) oral solution, an approved oral form of tapentadol that has not been commercialized (collectively, the Products ).

Upon the consummation of the transaction on April 2, 2015, the Company acquired (i) rights to commercialize the Products in the United States, and (ii) certain other assets relating to the Products, including finished goods product inventory and certain manufacturing equipment. In addition, Janssen Pharma assigned to the Company all of its rights and obligations under the License Agreement (U.S.) (the License Agreement ) by and among Janssen Pharma, Janssen Research & Development, LLC and Grünenthal GmbH ( Grünenthal ) pursuant to which Janssen has a royalty-bearing license to certain Grünenthal patents and other intellectual property rights covering the commercialization of the Products in the United States.

In connection with the transaction, the Company assumed responsibility for the ongoing legal proceedings relating to certain of the Grünenthal patents licensed under the License Agreement and Janssen Pharma's clinical obligations relating to the Products and will be responsible for the associated post acquisition costs. Other than as set forth in the Asset Purchase Agreement, Janssen Pharma retained all liabilities relating to the Products associated with Janssen Pharma's commercialization of the Products prior to the consummation of the transaction.

In connection with the transaction, the Company, Janssen Pharma and certain affiliates of Janssen also entered into (i) supply agreements pursuant to which Janssen Pharma will manufacture and supply the Products to the Company until the Company, or its contract manufacturer, begins commercial production of the Products, following which the Company will manufacture and supply Janssen Pharma for its requirements for NUCYNTA® outside of the United States and (ii) a supply agreement pursuant to which an affiliate of Janssen will manufacture and supply the Company with the active pharmaceutical ingredient contained in the Products.

In connection with the consummation of the transaction, on April 2, 2015, the Company sold an aggregate of \$575.0 million principal amount of the Senior Notes for gross proceeds of approximately \$562.0 million. The Company used \$550.0 million of the net proceeds received upon the sale of the Senior Notes to fund a portion of the Purchase Price paid to Janssen Pharma.

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Pursuant to ASC Topic 805, Business Combinations, the transaction was determined to be a business combination and was accounted for using the acquisition method of accounting. The following table presents a preliminary summary of the purchase price consideration for the transaction:

(Amounts in thousands)	
Cash Paid	\$ 1,050,000
Rebates payable by Seller	(10,466)
Total Purchase Consideration	\$ 1,039,534

The rebates payable by Janssen Pharma represent a reduction to the total purchase consideration. The fair value of the rebates payable by Janssen Pharma was determined based on estimates that take into consideration the terms of agreements with customers, historical rebates taken, and the estimated amount of time it takes the product to flow through the distribution channel. The Company expects that the actual amount of rebates paid by Janssen Pharma will not be determinable until late 2015. If actual future results vary from its estimates, the Company may need to adjust these estimates, which could have an effect on the fair value of the rebates recognized in this preliminary determination of the fair values of assets acquired.



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Under the acquisition method of accounting, we have recognized net tangible and intangible assets acquired based upon their respective estimated fair values as of the acquisition date. The table below shows the preliminary fair values assigned to the assets acquired:

(Amounts in thousands)	
NUCYNTA U.S. Product Rights	\$ 1,019,489
Inventories	11,590
Manufacturing Equipment	8,455
	\$ 1,039,534

The Company incurred non-recurring transaction costs of \$9.7 million and \$12.1 million for the three and six months ended June 30, 2015 with respect to the NUCYNTA® Acquisition which have been recorded in Selling, general and administrative expense within the Company's Condensed Consolidated Statement of Operations.

*NUCYNTA® U.S. Product Rights*

The valuation of the NUCYNTA® US Product Rights was based on management's estimates, information and reasonable and supportable assumptions. This estimated fair value was determined using the income approach under the discounted cash flow method. Significant assumptions used in valuing the NUCYNTA® US Product Rights included revenue projections based on assumptions relating to pricing and reimbursement rates, market size and market penetration rates, general and administrative expenses, sales and marketing expenses, research and development expenses for clinical and regulatory support and developing an appropriate discount rate. If the Company's assumptions are not correct, there could be an impairment loss or, in the case of a change in the estimated useful life of the asset, a change in amortization expense. The NUCYNTA® US Product Rights intangible asset is amortized using the straight-line method over an estimated useful life of approximately ten years. The estimated useful life was determined based on the period of time over which the NUCYNTA® US Product Rights are expected to contribute to the Company's future cash flows. The valuation of the acquired inventories includes a step-up in fair value of \$5.9 million which is being amortized to costs of goods sold as the related inventory turns. The fair value of the acquired manufacturing equipment was estimated to approximate its net book value as of the acquisition date.

The following table represents the unaudited consolidated financial information for the Company on a pro forma basis for the three and six months ended June 30, 2015 and 2014, assuming that the NUCYNTA® Acquisition had closed on January 1, 2014. The historical financial information has been adjusted to give effect to pro forma items that are directly attributable to the acquisition and are expected to have a continuing impact on the consolidated results. These items include, among others, adjustments to record the amortization of acquired NUCYNTA® intellectual property and interest expense, debt discount and deferred financing costs associated with the Senior Notes issued in connection with the acquisition and non-recurring acquisition costs. Additionally, the following table sets forth unaudited financial information and has been compiled from historical financial statements and other information, but is not necessarily indicative of the results that actually would have been achieved had the transactions occurred on the dates indicated or that may be achieved in the future.

Amounts in thousands	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Pro forma revenues	\$ 94,504	\$ 112,366	\$ 171,665	\$ 229,543
Proforma net loss	\$ (11,953)	\$ (24,564)	\$ (36,812)	\$ (43,006)

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Pro forma net income per share-basic	\$	(0.20)	\$	(0.42)	\$	(0.62)	\$	(0.74)
Pro forma net income per share-diluted	\$	(0.20)	\$	(0.42)	\$	(0.62)	\$	(0.74)

NUCYNTA® net revenues for the three months ended June 30, 2015 were \$56.7 million. The Company does not operate NUCYNTA® as a separate business nor does it maintain the distinct and separate accounts necessary to prepare a full product profit and loss account. It is therefore, not practicable to disclose the NUCYNTA® earnings for the three months ended June 30, 2015.

***The CAMBIA® Acquisition***

On December 17, 2013, the Company entered into an asset purchase agreement with Nautilus, pursuant to which the Company acquired from Nautilus all of the rights to CAMBIA® (diclofenac potassium for oral solution), including related product inventory, and assumed from Nautilus certain liabilities relating to CAMBIA®, for an initial payment of \$48.7 million in cash and up to \$10.0 million in contingent consideration payable upon the achievement of certain specified events. In accordance with the authoritative guidance for business combinations, the transaction with Nautilus was determined to be a business combination and was accounted for using the acquisition method of accounting.

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Under the acquisition method of accounting, the Company recorded the assets acquired and liabilities assumed at their respective fair values as of the acquisition date in its condensed consolidated financial statements. The determination of estimated fair value required management to make significant estimates and assumptions. As of the acquisition date, the estimated fair value of the assets acquired was approximately \$49.7 million. The Company estimated the fair value of the contingent consideration related to this transaction at \$1.0 million, which was booked as a long-term liability on the Condensed Consolidated Balance Sheet. The Company determined this liability amount using a probability-weighted discounted cash flow model. The Company assesses the fair value of the contingent consideration quarterly, or whenever events or changes in circumstances indicate that the fair value may have changed, primarily as a result of significant changes in the Company's forecast of net sales for CAMBIA®. The fair values of the contingent consideration as of June 30, 2015 and December 31, 2014 were \$1.4 million and \$1.2 million, respectively.

***The Lazanda® Acquisition***

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 an initial payment of \$4.0 million in cash and up to \$15.0 million in contingent consideration payable upon the achievement of certain specified events. The Company also assumed certain liabilities related to Lazanda®. In accordance with the authoritative guidance for business combinations, the Lazanda® acquisition from Archimedes was determined to be a business combination and was accounted for using the acquisition method of accounting.

Under the acquisition method of accounting, the Company recorded the assets acquired and liabilities assumed at their respective fair values as of the acquisition date in its condensed consolidated financial statements. The determination of estimated fair value required management to make significant estimates and assumptions. As of the acquisition date, the estimated fair value of the assets acquired was approximately \$12.0 million. The Company estimated the fair value of the contingent consideration related to this transaction at \$8.0 million, which was booked as a long-term liability on the Condensed Consolidated Balance Sheet. The Company determined this liability amount using a probability-weighted discounted cash flow model. The Company assesses the fair value of the contingent consideration quarterly, or whenever events or changes in circumstances indicate that the fair value may have changed, primarily as a result of significant changes in the Company's forecast of net sales for Lazanda®. The fair values of the contingent consideration as of June 30, 2015 and December 31, 2014 were \$11.8 million and \$11.2 million, respectively.

***The Zipsor® Acquisition***

On June 21, 2012, the Company entered into an asset purchase agreement with Xanodyne Pharmaceuticals, Inc., a Delaware corporation (Xanodyne), pursuant to which the Company acquired Xanodyne's product Zipsor® and related inventory for \$26.4 million in cash and up to \$5.0 million in contingent consideration payable upon the achievement of certain specified events and assumed certain product-related liabilities relating to Zipsor®. In accordance with the authoritative guidance for business combinations, the Zipsor® acquisition from Xanodyne was determined to be a business combination and was accounted for using the acquisition method of accounting.

Under the acquisition method of accounting, the Company recorded the assets acquired and liabilities assumed at their respective fair values as of the acquisition date in its condensed consolidated financial statements. The determination of estimated fair value required management to make significant estimates and assumptions. As of the acquisition date, the estimated fair value of the assets acquired was approximately \$27.7 million. Zipsor® product rights of \$27.2 million were recorded as intangible assets on the accompanying Condensed Consolidated Balance Sheet and were being amortized over the estimated useful life of the asset on a straight-line basis through July 2019. On June 3, 2015, the Company entered into a settlement agreement in its ongoing patent litigation related to an Abbreviated New Drug Application (ANDA) seeking approval to market a generic version of Zipsor® (diclofenac liquid filled capsules) 25mg tablets. The settlement permits defendant Watson Laboratories Inc. to begin selling generic Zipsor on March 24, 2022, or earlier under certain circumstances. The settlement concluded all ongoing ANDA litigation related to Zipsor. In light of this settlement agreement, the Company reviewed the useful life of the Zipsor product rights and, as of June 3, 2015, extended that from the previous estimate of July 2019 to March 2022. Consequently, the Company expects that the quarterly amortization charge will be reduced from \$1.0 million to \$0.6 million, beginning with the three months ending September 30, 2015.

The Company estimated the fair value of the contingent consideration related to this transaction at \$1.3 million, which was booked as a long-term liability on the Condensed Consolidated Balance Sheet. The Company determined this liability amount using a probability-weighted discounted cash flow model. The Company assesses the fair value of the contingent consideration quarterly, or whenever events or changes in circumstances indicate that the fair value may have changed, primarily as a result of significant changes in the Company's forecast of net sales for Zipsor®. The fair values of the contingent consideration as of June 30, 2015 and December 31, 2014 were \$1.6 million and \$1.8 million, respectively.

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The gross carrying amounts and net book values of our intangible assets were as follows (in thousands):

Amounts in thousands	Remaining Useful Life (In years)	June 30, 2015			December 31, 2014		
		Gross Carrying Amount	Accumulated Amortization	Net Book Value	Gross Carrying Amount	Accumulated Amortization	Net Book Value
NUCYNTA product rights	10.0	1,019,489	(24,325)	995,164			
CAMBIA product rights	8.5	51,360	(7,915)	43,445	51,360	(5,347)	46,013
Lazanda product rights	7.0	10,480	(2,232)	8,248	10,480	(1,650)	8,830
Zipsor product rights	6.8	27,250	(11,528)	15,722	27,250	(9,732)	17,518
		1,108,579	(46,000)	1,062,579	89,090	(16,729)	72,361

Based on finite-lived intangible assets recorded as of June 30, 2015, and assuming the underlying assets will not be impaired and that the Company will not change the expected lives of the assets, future amortization expenses were estimated as follows (in thousands):

Year Ending December 31,	Estimated Amortization Expense
2015 (remainder)	\$ 54,038
2016	108,100
2017	108,100
2018	108,100
2019	108,100
Thereafter	576,141
Total	\$ 1,062,579

**NOTE 15. SUBSEQUENT EVENTS*****Horizon Pharma plc Proposal and Rights Plan***

On July 7, 2015, the Company received an unsolicited, highly conditional proposal from Horizon Pharma plc (Horizon) to acquire all of the outstanding shares of the Company in an all-stock transaction valued at \$29.25 per share (the Proposal). The Proposal is identical in all material respects to the Horizon proposal received by the Company on May 27, 2015 and reiterated on June 12, 2015 (the Prior Proposal). The Company's board of directors reviewed the Prior Proposal with the assistance of its financial advisors and its legal counsel, and unanimously concluded that the Prior Proposal did not reflect the inherent value of the Company and was not in the best interests of the Company and its shareholders. Horizon was notified of the board's decision regarding the Prior Proposal in a letter delivered to Horizon dated June 25, 2015. On July 21, 2015, the Company received a revised unsolicited, highly conditional proposal from Horizon to acquire all of

the outstanding shares of the Company in an all-stock transaction valued at \$33.00 per share (the Revised Offer). The Company's board of directors, after careful consideration and with the assistance of its independent financial and legal advisors, unanimously rejected the Revised Offer and notified Horizon about this decision on July 29, 2015.

In addition on July 12, 2015, the Company's board of directors declared a dividend of one right (Right) for each outstanding share of the Company's common stock to shareholders of record at the close of business on July 23, 2015. The description and terms of the Rights are set forth in a Rights Agreement dated as of July 12, 2015 as it may from time to time be supplemented or amended (the Rights Agreement) between the Company and Continental Stock Transfer & Trust Company, as Rights Agent. Each Right entitles the registered holder to purchase from the Company a unit consisting of one one-hundredth of a share (a Fractional Share) of Series B Junior Participating Preferred Stock at a purchase price of \$105.00 per Fractional Share, subject to adjustment. Initially, the Rights will be attached to all outstanding shares of the Company's common stock, and no separate certificates for the Rights will be distributed. The Rights will separate from the common stock and a Distribution Date will occur, with certain exceptions, upon the earlier of (i) 10 days following a public announcement that a person or group of affiliated or associated persons (an Acquiring Person) has acquired, or obtained the right to acquire, beneficial ownership of 10% or more of the outstanding shares of common stock, or (ii) 10 business days following the commencement of a tender offer or exchange offer that would result in a person's becoming an Acquiring Person. In certain circumstances, the Distribution Date may be deferred by the Company's board of directors. The Rights are not exercisable until the Distribution Date and will expire at the close of business on the date of the Company's next annual meeting of shareholders occurring after the date of the Rights Agreement, unless earlier redeemed or exchanged by the Company in accordance with the Rights Agreement.

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*Amended and Restated Bylaws*

On July 12, 2015, the Company's board of directors adopted and approved an amendment and restatement to the Company's Bylaws (the Amended Bylaws). The Amended Bylaws, among other things, provide for the establishment of a measurement record date for purposes of ascertaining shareholders eligible to call for a special meeting of shareholders and establish certain other procedures relating to the calling of a special meeting of shareholders. The Amended Bylaws also supplement the advanced notice requirements and procedures for the submission by shareholders of nominations for the board of directors and of other proposals to be presented at shareholder meetings, and provide that the exclusive forum for any shareholder to bring any: (i) derivative action, (ii) claim asserting a breach of fiduciary duty, (iii) action under the California Corporations Code or the Company's organizational documents or (iv) other action relating to the internal affairs of the Company, shall in each case be the Santa Clara County Superior Court within the State of California or, if no state court located within the State of California has jurisdiction, the federal district court for the Northern District of California. The Amended Bylaws also make certain other ministerial changes.

On August 3 2015, Horizon announced that it intends to request the Company's board of directors to set a record date to determine the shareholders eligible to request a special meeting at which Depomed shareholders will be asked to consider two principal proposals; the removal of all current Company directors, contingent on a new slate of directors being elected, and a series of amendments to the bylaws intended to reverse the changes made by the Company's board which were adopted on July 12, 2015 (collectively, the Request). Horizon also filed suit against the Company in the Superior Court of California for Santa Clara County, alleging that the Company's amendment to its bylaws and the rights plan which was put in place on July 12, 2015, violate the California Corporations Code and the board's fiduciary duties to shareholders.

On August 3 2015, the Company announced that its board will review the Request when it is received and, assuming that it is accompanied with all information required by the Company's bylaws, will fix a record date to determine shareholders entitled to request a special meeting no later than August 31, 2015. The Company also filed suit against Horizon in the Superior Court of the State of California for the County of Santa Clara alleging, among other things, Horizon's unsolicited bid to acquire the Company is predicated on the improper and unlawful use of highly confidential and proprietary information related to NUCYNTA.

**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 (the Exchange Act). 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, including statements related to the unsolicited, non-binding proposal from Horizon Pharma plc ( Horizon ) to acquire all of our outstanding shares in a stock-for-stock transaction, are forward-looking statements. Forward-looking statements include, but are not necessarily limited to, those relating to:

- the commercial success and market acceptance of our products, including NUCYNTA® ER (tapentadol extended release tablets) for the management of pain severe enough to require daily, around-the-clock, long term opioid treatment, including neuropathic pain associated with diabetic peripheral neuropathy (DPN) in adults, and for which alternate treatment options are inadequate, NUCYNTA® (tapentadol), an immediate release version of tapentadol for the management of moderate to severe acute pain in adults, Gralise® (gabapentin) for the management of postherpetic neuralgia (PHN), CAMBIA® (diclofenac potassium for oral solution) for the acute treatment of migraine attacks, Zipsor® (diclofenac potassium) for the treatment of mild to moderate pain in adults, and Lazanda® (fentanyl) nasal spray for the management of breakthrough cancer 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;
- the results of our ongoing litigation against the filers of Abbreviated New Drug Applications (each, an ANDA) to market generic versions of NUCYNTA® ER and NUCYNTA® in the United States (U.S.);
- any additional patent infringement or other litigation or proceeding that may be instituted related to NUCYNTA® ER, NUCYNTA®, Gralise®, CAMBIA®, Zipsor®, Lazanda® or any other of our products, product candidates or products we may acquire;



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- our ability to generate sufficient cash flow from our business to make payments on our indebtedness;
- our and our collaborative partners' compliance or non-compliance with legal and regulatory requirements related to the promotion of pharmaceutical products in the U.S.;
- the outcome of our ongoing patent infringement litigation against Purdue Pharma L.P. (Purdue) and Endo Pharmaceuticals Inc. (Endo);
- our compliance with the terms and conditions of the agreements governing our indebtedness;
- our plans to acquire, in-license or co-promote other products;
- the results of our research and development efforts;
- submission, acceptance and approval of regulatory filings;
- our 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. Except as required by law, we assume no obligation to update any forward-looking statement publicly, or to revise any forward-looking statement to reflect events or developments occurring after the date of this Quarterly Report on Form 10-Q, even if new information becomes available in the future. Thus, you should not assume that our silence over time means that actual events are bearing out as expressed or implied in any such forward-looking statement.

**ABOUT DEPOMED**

Depomed is a specialty pharmaceutical company focused on pain and other central nervous system (CNS) conditions. The products that comprise our current specialty pharmaceutical business are (i) NUCYNTA® ER (tapentadol extended release tablets), a product for the management of pain severe enough to require daily, around-the-clock, long term opioid treatment, including neuropathic pain associated with diabetic peripheral neuropathy (DPN) in adults, and for which alternate treatment options are inadequate, and NUCYNTA® (tapentadol), a product for management of moderate to severe acute pain in adults, each of which we acquired the U.S rights to in April 2015 (collectively, the NUCYNTA® Acquisition), (ii) Gralise® (gabapentin), a once-daily product for the management of postherpetic neuralgia (PHN) that we launched in October 2011, (iii) CAMBIA® (diclofenac potassium for oral solution), a non-steroidal anti-inflammatory drug for the acute treatment of migraine attacks that we acquired in December 2013, (iv) Zipsor® (diclofenac potassium) liquid filled capsules, a non-steroidal anti-inflammatory drug for the treatment of mild to moderate acute pain that we acquired in June 2012, and (v) 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 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. In conjunction with the acquisition of Nucynta on April 2, 2015, we increased the size of our total sales force from approximately 188 full-time sales representatives to approximately 300 full-time sales representatives.

We also have a portfolio of royalty and milestone producing license agreements based on our proprietary Acuform® gastroretentive drug delivery technology with Mallinckrodt Inc. (Mallinckrodt), Ironwood Pharmaceuticals, Inc. (Ironwood) and Janssen Pharmaceuticals, Inc. (Janssen Pharma).

In October 2013, we sold our interests in royalty and milestone payments under our license agreements in the Type 2 diabetes therapeutic area to PDL BioPharma, Inc. (PDL) for \$240.5 million (the PDL Transaction). The interests sold include royalty and milestone payments accruing from and after October 1, 2013 from: (a) Salix Pharmaceuticals, Inc. (Salix) with respect to sales of Glumetza® (metformin HCL extended-release tablets) in the U.S.; (b) Merck & Co. Inc. (Merck) with respect to sales of Janumet® XR (sitagliptin and metformin HCL extended-release); (c) Janssen Pharmaceutica N.V. and Janssen Pharma (collectively, Janssen) with respect to potential future development milestones and sales of Janssen's investigational fixed-dose combination of Invokana® (canagliflozin) and extended-release metformin; (d) Boehringer Ingelheim International GMBH (Boehringer Ingelheim) with respect to potential future development milestones and sales of the investigational fixed-dose combinations of drugs and extended-release metformin subject to our license agreement with Boehringer Ingelheim; and (e) LG Life Sciences Ltd. and Valeant International Bermuda SRL for sales of extended-release metformin in Korea and Canada, respectively.

As of June 30, 2015, we have one product candidate, DM-1992 for Parkinson's disease. DM-1992 completed a Phase 2 trial for Parkinson's disease, and we announced a summary of the results of that trial in November 2012. We continue to evaluate partnering opportunities for DM-1992 and monitor competitive developments.

Table of Contents**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*

<b>Product</b>	<b>Indication</b>	<b>Status</b>
NUCYNTA® ER	Pain severe enough to require daily, around-the-clock, long term opioid treatment, including neuropathic pain associated with DPN in adults, and for which alternate treatment options are inadequate	Currently sold in the U.S. <i>Acquired in April 2015</i>
NUCYNTA®	Moderate to severe acute pain in adults	Currently sold in the U.S. <i>Acquired in April 2015</i>
Gralise®	Management of PHN	Currently sold in the U.S. <i>Launched in October 2011</i>
CAMBIA®	Acute treatment of migraine attacks in adults 18 years of age or older	Currently sold in the U.S. <i>Acquired in December 2013</i>
Zipsor®	Mild to moderate acute pain	Currently sold in the U.S. <i>Acquired in June 2012</i>
Lazanda®	Breakthrough pain in cancer patients 18 years of age and older who are already receiving and who are tolerant to continuous opioid therapy for their underlying persistent cancer pain	Currently sold in the U.S. <i>Acquired in July 2013</i>

Table of Contents*Partner Commercialized Products and Product Candidates*

<b>Product / Product Candidate</b>	<b>Indication</b>	<b>Partner</b>	<b>Status</b>
XARTEMIS XR (oxycodone hydrochloride and acetaminophen)	Management of acute pain severe enough to require opioid treatment and in patients for whom alternative treatment options are ineffective, not tolerated or would otherwise be inadequate	Mallinckrodt	Approved by the FDA and launched in March 2014
MNK-155	Pain	Mallinckrodt	NDA accepted for filing by the FDA in May 2014; complete response letter received in April 2015  Foreign regulatory filings in process
NUCYNTA® ER	Pain severe enough to require, daily, around-the-clock, long term opioid treatment, including neuropathic pain associated with DPN in adults, and for which alternate treatment options are inadequate	Janssen Pharma	License covers sales of NUCYNTA® ER in Canada and Japan
IW-3718 Refractory gastroesophageal reflux disease (GERD) program using Acuform®	Refractory GERD	Ironwood	In clinical development

**Commercialized Products***NUCYNTA® ER (Tapentadol Extended Release Tablets) for management of pain, including DPN*

NUCYNTA® ER is an extended release version of tapentadol that is indicated for the management of pain severe enough to require daily, around-the-clock, long term opioid treatment, including neuropathic pain associated with DPN in adults, and for which alternate treatment options are inadequate. We acquired the U.S. rights to NUCYNTA® ER from Janssen Pharma and began shipping and recognizing product sales on NUCYNTA® ER in April 2015. We began commercial promotion of NUCYNTA® ER in June 2015.



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***NUCYNTA® (Tapentadol) for management of moderate to severe acute pain***

NUCYNTA® is an immediate release version of tapentadol that is indicated for the management of moderate to severe acute pain in adults. We acquired the U.S. rights to NUCYNTA from Janssen Pharma and began shipping and recognizing product sales on NUCYNTA in April 2015. We began commercial promotion of NUCYNTA® in June 2015.

***Gralise® (Gabapentin) tablets for the management of PHN***

Gralise® is our proprietary, once-daily formulation of gabapentin indicated for the management of PHN. We made Gralise® commercially available in October 2011, following its FDA approval in January 2011 and our reacquisition of the product in March 2011 from Abbott Products, Inc., our former licensee.

***CAMBIA® (Diclofenac Potassium for Oral Solution) for the acute treatment of migraine attacks in adults 18 years of age or older***

CAMBIA® is a non-steroidal anti-inflammatory drug (NSAID) indicated for the acute treatment of migraine attacks with or without aura in adults 18 years of age or older. We acquired CAMBIA® and related product inventory on December 17, 2013 from Nautilus Neurosciences, Inc. (Nautilus). We also assumed certain annual third party royalty obligations totaling not more than 11% of CAMBIA® net sales.

We began shipping and recognizing product sales on CAMBIA® in December 2013. We began commercial promotion of CAMBIA® in February 2014.

***Zipsor® (Diclofenac Potassium) liquid-filled capsules for mild to moderate acute pain***

Zipsor® is a NSAID indicated for relief of mild to moderate acute pain in adults. Zipsor® uses proprietary ProSorb® delivery technology to deliver a finely dispersed, rapidly absorbed formulation of diclofenac. We acquired Zipsor® in June 2012 from Xanodyne Pharmaceuticals, Inc. (Xanodyne).

We began shipping and recognizing product sales on Zipsor® at the end of June 2012. We began commercial promotion of Zipsor® in July 2012.

*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*

Lazanda® nasal spray is an intranasal fentanyl drug used to manage breakthrough pain in cancer patients 18 years of age or older who are already receiving and who are tolerant to opioid therapy for their underlying persistent cancer pain. We acquired Lazanda® and certain related product inventory on July 29, 2013, from Archimedes Pharma US Inc., Archimedes Pharma Ltd., and Archimedes Development Ltd. (collectively, Archimedes).

We began shipping and recognizing product sales on Lazanda® in August 2013. We began commercial promotion of Lazanda® in October 2013.

#### *Segment Information*

The Company operates in one operating segment and has operations solely in the U.S. To date, all of the Company's revenues from product sales are related to sales in the U.S. The Company has recognized license and royalty revenue from license agreements in the territories of the U.S., Canada and Korea.

#### **License and Development Arrangements**

##### *Janssen Pharmaceuticals, Inc. NUCYNTA® ER*

In August 2012, we entered into a license agreement with Janssen Pharma that grants Janssen Pharma a non-exclusive license to certain patents and other intellectual property rights to our Acuform drug delivery technology for the development and commercialization of tapentadol extended release products, including NUCYNTA® ER (tapentadol extended-release tablets). We received a \$10.0 million upfront license fee and receive low single digit royalties on net sales of NUCYNTA® ER in the U.S., Canada, and Japan from and after July 2, 2012 through December 31, 2021. We will not receive any royalties from Janssen Pharma on net sales of NUCYNTA® ER in the U.S. for any period after April 2, 2015, the date on which we acquired the U.S. rights to NUCYNTA® ER from Janssen Pharma. We will continue to receive royalties from Janssen Pharma on net sales of NUCYNTA® ER in Canada and Japan.

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***Mallinckrodt (Formerly Covidien) Acetaminophen/Opiate Combination Products***

In November 2008, we entered into a license agreement related to acetaminophen/opiate combination products with Mallinckrodt. The license agreement grants Mallinckrodt worldwide rights to utilize our Acuform technology for the exclusive development of up to four products containing acetaminophen in combination with opiates, two of which Mallinckrodt has elected to develop.

We have received \$27.5 million in upfront fees and milestones under the agreement. The upfront fees included a \$4.0 million upfront license fee and a \$1.5 million advance payment for formulation work we performed under the agreement. The milestone payments include four \$0.5 million clinical development milestones, a \$5.0 million milestone following the FDA's July 2013 acceptance for filing of the NDA for XARTEMIS XR (oxycodone hydrochloride and acetaminophen) Extended-Release Tablets (CII), previously known as MNK-795, a \$10.0 million milestone on FDA approval of XARTEMIS XR, and a \$5.0 million milestone following the FDA's May 2014 acceptance for filing of the NDA for MNK-155.

In March 2014, the FDA approved XARTEMIS XR for the management of acute pain severe enough to require opioid treatment and in patients for whom alternative treatment options (e.g., non-opioid analgesics) are ineffective, not tolerated or would otherwise be inadequate. The approval of the NDA triggered a \$10.0 million milestone payment to us, which we recognized in the first quarter of 2014 and received in April 2014. In May 2014, the FDA accepted for filing the NDA for MNK-155. The acceptance for filing of the NDA triggered a \$5.0 million milestone payment to us which we recognized in the second quarter of 2014 and received in June 2014. We receive high single digit royalties on net sales of XARTEMIS XR, which was launched in March 2014, and we will receive the same high single digit royalty on net sales of MNK-155 if it is approved.

***Ironwood Pharmaceuticals, Inc. IW-3718 for Refractory GERD***

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 IW-3718, an Ironwood product candidate under evaluation for refractory GERD.

Since the inception of the contract, we have received \$3.4 million under the agreement, which includes an upfront payment, reimbursement of initial product formulation work and three milestone payments, including a milestone payment of \$1.0 million in March 2014 as a result of the initiation of clinical trials relating to IW-3718 by Ironwood. As the non-refundable milestone was both substantive in nature and related to past performance, we recognized the \$1.0 million as revenue in March 2014.

**Licensing and Development Agreement Royalties Sold to PDL in October 2013**

In October 2013, we sold to PDL our milestone and royalty interests in our license agreements in the type 2 diabetes therapeutic area (and any replacements for the agreements) for \$240.5 million. The material agreements included in the sale are described above. From and after October 1, 2013, PDL will receive all royalty and milestone payments due under the agreements until PDL has received payments equal to \$481 million, after which we and PDL will share evenly all net payments received.



We had significant continuing involvement in the PDL transaction until September 30, 2014, primarily due to our obligation to act as the intermediary for the supply of 1000mg Glumetza to Salix Pharmaceuticals (formerly Santarus Inc.), the licensee of Glumetza. Under the relevant accounting guidance, because of our significant continuing involvement, the \$240.5 million payment received from PDL was accounted for as debt until September 30, 2014. As a result of the debt accounting, even though we did not retain the related royalties and milestones under the transaction, we were required to record revenue related to these royalties and milestones until September 30, 2014.

Effective October 1, 2014, the Company, Valeant, Salix and PDL executed an amended agreement which eliminated any and all continuing obligations on our part in the supply of 1000mg Glumetza tablets. Consequently, the entire outstanding balance of the liability related to the sale of future royalties and milestones of approximately \$147.0 million was recognized within Non-cash PDL royalty revenue during the fourth quarter of 2014.

*Salix Pharmaceuticals, Inc. (formerly Santarus, Inc.)* **Glumetza®**

In August 2011, we entered into a commercialization agreement with Salix granting Salix exclusive rights to manufacture and commercialize Glumetza in the U.S. The commercialization agreement supersedes the previous promotion agreement between the parties originally entered into in July 2008. Under the commercialization agreement, we granted Salix exclusive rights to manufacture and commercialize Glumetza in the U.S. in return for a royalty on Glumetza net sales.

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Salix pays royalties on Glumetza net product sales in the U.S. as follows: 26.5% in 2011; 29.5% in 2012; 32.0% in 2013 and 2014; and 34.5% in 2015 and beyond, prior to a generic entry of a Glumetza product. In the event of a generic entry of a Glumetza product in the U.S., the parties will thereafter equally share Glumetza proceeds based on a gross margin split.

In October 2013, the Company sold its interest in the Glumetza royalties to PDL. Pursuant to the original promotion agreement, Salix paid us 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 our obligations existed under the promotion agreement related to manufacturing Glumetza and paying Salix 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 its manufacturing obligations. The commercialization agreement included obligations with respect to manufacturing and regulatory transition to Salix and managing the patent infringement lawsuits against Sun Pharmaceutical Industries, Inc. (Sun) and Lupin Limited (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 our manufacturing obligations with respect to 1000-mg Glumetza to February 2016, which is the estimated date we expected our obligations would be completed under the commercialization agreement. We recognized approximately \$0.4 million of revenue associated with this upfront license fee during the three months ended March 31, 2014.

Effective October 1, 2014, the Company, Valeant and Salix executed an amended agreement which eliminated any and all continuing obligations on our part in the supply of Glumetza 1000mg tablets. The execution of that agreement represented the completion of the final deliverable and, consequently, we recognized the remaining unamortized deferred revenue of \$1.9 million as of October 1, 2014.

***Valeant Pharmaceuticals International, Inc. (formerly Biovail Laboratories, Inc.)***

In May 2002, we entered into a development and license agreement granting Valeant Pharmaceuticals International, Inc. (Valeant) an exclusive license in the U.S. and Canada to manufacture and market Glumetza. Under the terms of the agreement, we were responsible for completing the clinical development program in support of the 500mg Glumetza. In July 2005, Valeant received FDA approval to market Glumetza in the U.S. In accordance with the license agreement, Valeant paid a \$25.0 million license fee payment to the Company.

Until September 30, 2014, we were recognizing the \$25.0 million license fee payment as revenue ratably until October 2021, which represented the estimated length of time our obligations existed under the arrangement related to royalties that we were obligated to pay Valeant on net sales of the 500mg Glumetza in the U.S. and to use Valeant as the sole supplier of the 1000mg Glumetza.

Effective October 1, 2014, the Company, Valeant and Salix executed an amended agreement which eliminated any and all continuing obligations on the part of the Company in the manufacture and supply of 1000mg Glumetza tablets. The execution of that agreement represented the completion of the final deliverable and, consequently, we recognized the remaining unamortized deferred revenue of \$11.3 million as of October 1, 2014. We recognized approximately \$0.4 million and \$0.8 million of license revenue related to the amortization of this upfront fee of \$25.0 million during the three and six months ended June 30, 2014, respectively.

**Product Candidate**

*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 thirty-four patients at eight U.S. 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.

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. We continue to evaluate clinical and regulatory strategies and commercial prospects for DM-1992.

Table of Contents**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 use of estimates to be critical policies. These estimates form the basis for making judgments about the carrying value of assets and liabilities. There have been no changes to our critical accounting policies since we filed our Annual Report on Form 10-K filed with the SEC on February 26, 2015 (the 2014 Form 10-K). The description of our critical accounting policies is incorporated herein by reference to our 2014 Form 10-K.

**RESULTS OF OPERATIONS**

*Three and Six Months Ended June 30, 2015 and 2014.*

**Revenue**

Total revenues by products and licensees are summarized in the following table (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
<b>Product sales:</b>				
Nucynta products	\$ 56,653	\$	\$ 56,653	\$
Gralise	20,927	15,111	38,201	25,970
Cambia	6,848	4,958	12,213	9,582
Zipsor	6,014	6,822	11,861	12,165
Lazanda	3,853	1,354	7,038	2,034
Total product sales	94,295	28,245	125,966	49,751
Royalties	209	430	742	925
Non-cash PDL royalty revenue		33,297		76,081
<b>License and Other revenue:</b>				
Glumetza		760		1,520
Mallinckrodt		5,000		15,000
Other				1,000
Total license and other revenue:		5,760		17,520
Total revenues	\$ 94,504	\$ 67,732	\$ 126,708	\$ 144,277

**Product Sales**

NUCYNTA®. We consummated the acquisition of the NUCYNTA® franchise on April 2, 2015 and began shipments on April 6, 2015. Until June 2015, we retained the contract sales force that had been promoting NUCYNTA® for Janssen, and we re-launched NUCYNTA® with our increased sales force in mid-June 2015. In conjunction with the acquisition, Janssen is responsible for certain rebates in an amount estimated to be \$10.5 million, which was treated as a reduction in the purchase consideration for NUCYNTA®. Accordingly, the NUCYNTA® product net sales of \$56.7 million reflect the deduction of these rebates during the second quarter. In future periods, we will be responsible for such product rebates. We expect NUCYNTA® sales and prescriptions to increase from current levels for the remainder of 2015.

Gralise®. In October 2011, we announced the commercial availability of Gralise® and began distributing Gralise® to wholesalers and retail pharmacies. The increase in Gralise® product sales in the first six months of 2015 relative to the comparable period in 2014 is a result of higher prescription demand and price increases. We expect Gralise® product sales and prescriptions to increase from current levels for the remainder of 2015.

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CAMBIA®. We began shipping and recognizing product sales on CAMBIA® in December 2013. We began commercial promotion of CAMBIA® in February 2014. The increase in CAMBIA® product sales in the first six months of 2015 relative to the comparable period in 2014 is a result of higher prescription demand and price increases. We expect CAMBIA® product sales and prescriptions to increase from current levels for the remainder of 2015.

Zipsor®. We began shipping and recognizing product sales on Zipsor® at the end of June 2012. We began commercial promotion of Zipsor® in July 2012. The decrease in Zipsor® product sales in the first six months of 2015 relative to the comparable period in 2014 is primarily the result of lower prescription demand. We expect Zipsor® product sales to approximate current levels for the remainder of 2015.

Lazanda®. We began shipping and recognizing product sales on Lazanda® in August 2013. We began commercial promotion of Lazanda® in October 2013. The increase in Lazanda® product sales in the first six months of 2015 relative to the comparable period in 2014 is primarily a result of higher prescription demand, and to a lesser extent, price increases. We expect Lazanda® product sales and prescriptions to increase from current levels for the remainder of 2015.

***Royalties***

Other Royalties. Other royalties for the three and six months ended June 30, 2015 and 2014 primarily includes royalties from Janssen Pharma on net sales of NUCYNTA® ER and royalties from Mallinckrodt on net sales of XARTEMISTM XR, which was launched in March 2014. We will continue to receive royalties from Janssen Pharma on net sales of NUCYNTA® ER in Canada and Japan.

***Non-Cash PDL Royalty Revenue***

In October 2013, as noted above, we sold our interests in royalty and milestone payments under our license agreements in the Type 2 diabetes therapeutic area to PDL for \$240.5 million. Until September 30, 2014, this transaction was accounted for as debt that was amortized using the interest method over the life of the arrangement. As a result of the debt accounting, even though we did not retain the rights to receive the related royalties and milestones under the transaction (as the amounts are remitted to PDL), we continued to record revenue related to these royalties and milestones until September 30, 2014. We recognized \$33.3 million and \$76.1 million of non-cash PDL royalty revenue during the three and six months ended June 30, 2014.

Effective October 1, 2014, the Company, Valeant, Salix and PDL executed an amended agreement which eliminated any and all continuing obligations on our part in the supply of 1000mg Glumetza tablets. Consequently, the entire outstanding balance of the liability related to the sale of future royalties and milestones of approximately \$147.0 million was recognized within Non-cash PDL royalty revenue during the fourth quarter of 2014.

*License and Other Revenue*

Glumetza. Glumetza license revenue for the three and six months ended June 30, 2014 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 Salix in July 2008.

We were 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 U.S. and for our obligation to use Valeant as our sole supplier of the 1000mg Glumetza.

We were recognizing the \$12.0 million upfront license payment from Salix as revenue ratably until February 2016, which is the estimated date we expect our obligations will be completed under the commercialization agreement.

Effective October 1, 2014, the Company, Valeant and Salix executed an amended agreement which eliminated any and all continuing obligations on the part of the Company in the supply of Glumetza 1000mg tablets. The execution of that agreement represented the completion of the final deliverable and consequently, we recognized the remaining unamortized deferred revenue of \$13.2 million during the fourth quarter of 2014.

Mallinckrodt (formerly Covidien). In March 2014, the FDA approved Mallinckrodt's NDA for XARTEMIS XR. The approval of the NDA triggered a \$10.0 million nonrefundable milestone payment to us under our license agreement with Mallinckrodt, which we received in April 2014. In May 2014, the FDA accepted for filing the NDA for MNK-155. The acceptance for filing triggered a \$5.0 million nonrefundable milestone payment to us under our license agreement with Mallinckrodt, which we received in July 2014. As the nonrefundable milestones were both substantive in nature and related to past performance, achievement was not reasonably assured at the inception of the agreement and the collectability of the milestones was reasonably assured, we recognized the entire \$10.0 million milestone payment related to XARTEMIS approval as revenue in the first quarter of 2014 and we recognized the entire \$5.0 million milestone payment related to FDA acceptance for filing of the NDA for MNK-155 in the second quarter of 2014.

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*Ironwood.* In March 2014, we recognized \$1.0 million in revenue relating to a milestone earned under our license agreement with Ironwood related to Ironwood's IW-3718 product candidate for refractory GERD commencing clinical trials. As we had no continuing involvement in this arrangement, we recognized the \$1.0 million as revenue in March 2014.

**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. Total cost of sales for the three and six months ended June 30, 2015, as compared to the corresponding periods in the prior year, was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Cost of sales	\$ 22,865	\$ 4,675	\$ 25,977	\$ 8,377
Dollar change from prior year	18,190		17,600	
Percentage change from prior year	389.1%		210.1%	

The increase in cost of sales for the three and six months ended June 30, 2015, as compared to the same period in 2014 was primarily due to the NUCYNTA® Acquisition. We began selling NUCYNTA® in April 2015. The fair value of inventories acquired included a step-up in the value of NUCYNTA® inventories of \$5.9 million which is being amortized to cost of sales as the acquired inventories are sold. The cost of sales related to the step-up value of NUCYNTA® was \$5.0 million for the three and six months ended June 30, 2015. In addition, cost of sales for NUCYNTA® includes a royalty on net sales payable to Grünenthal GmbH (Grünenthal). We have assumed the license agreement with Grünenthal GmbH (Grünenthal) regarding NUCYNTA® and NUCYNTA® ER and will owe royalties to Grünenthal which will be accounted for as a portion of cost of sales for these products.

We began selling CAMBIA® in December 2013. The fair value of inventories acquired included a step-up in the value of CAMBIA® inventories of \$3.7 million which was amortized to cost of sales as the acquired inventories were sold. The cost of sales related to the step-up value of CAMBIA® was \$1.7 million and \$3.1 million for the three and six months ended June 30, 2014, respectively. We began selling Lazanda in August 2013. The fair value of inventories acquired included a step-up in the value of Lazanda inventories of \$0.6 million which was being amortized to cost of sales as the acquired inventories were sold. The cost of sales related to the step-up value of Lazanda was \$0.1 million for the three and six months ended June 30, 2014, respectively.

We expect cost of sales to increase for the remainder of 2015, as we expect product sales to increase from current levels.



**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. Therefore, success in development generally results in increasing expenditures until actual product approval. Total research and development expense for the three and six months ended June 30, 2015, as compared to the prior year, was as follows (in thousands):

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2015</b>	<b>2014</b>	<b>2015</b>	<b>2014</b>
Research and development expense	\$ 4,714	\$ 1,397	\$ 6,572	\$ 3,439
Dollar change from prior year	3,317		3,133	
Percentage change from prior year	237.4%		91.1%	

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Research and development expense for the three months ended June 30, 2015 increased substantially over second quarter 2014 primarily as a result of our assumption of responsibility for certain pediatric studies relating to NUCYNTA®.

We expect research and development expense for the remainder of 2015 to increase from current levels, primarily due to our assumption of the responsibility for certain post marketing regulatory requirements and pediatric studies in connection with the NUCYNTA® Acquisition. In addition, we also commenced pediatric studies relating to CAMBIA® during the year.

**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. Total selling, general and administrative expense for the three and six months ended June 30, 2015, as compared to the prior year, was as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Selling, general and administrative expense	\$ 57,408	\$ 32,573	\$ 91,950	\$ 65,090
Dollar change from prior year	24,835		26,860	
Percentage change from prior year	76.2%		41.3%	

The increase in selling, general and administrative expense for the three and six months ended June 30, 2015, as compared to the same period in 2014, was primarily due to expenses incurred with respect to the NUCYNTA® Acquisition. These expenses included non-recurring transaction costs of \$9.7 million and \$12.1 million for the three and six months ended June 30, 2015. In addition, we incurred costs relating to maintenance of a contractual sales force during the period prior to our re-launch in June, the hiring of additional field sales persons, additional personnel to support the increased sales force, and marketing expenditures associated with our re-launch of NUCYNTA® ER and NUCYNTA®. We also incurred higher expenses due to the increased Lazanda® sales force. The increased selling, general and administrative expense was off-set by a reduction of \$1.2 million resulting from the change in the fair value of the liability related to unfavorable contract assumed as part of the CAMBIA® acquisition.

We expect selling, general and administrative expense for the remainder of 2015 to decrease from the levels incurred in the three months ended June 30, 2015.

**Amortization of Intangible Assets**

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(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Amortization of intangible assets- Zipsor	\$ 831	\$ 965	\$ 1,796	\$ 1,929
Amortization of intangible assets- Lazanda	291	292	582	583
Amortization of intangible assets- CAMBIA	1,284	1,285	2,568	2,569
Amortization of intangible assets- NUCYNTA	24,325		24,325	
	\$ 26,731	\$ 2,542	\$ 29,271	\$ 5,081

The Zipsor® product rights of \$27.2 million have been recorded as intangible assets on the accompanying Condensed Consolidated Balance Sheet and were being amortized over the estimated useful life of the asset on a straight-line basis through July 2019. On June 3, 2015, the Company entered into a settlement agreement in its ongoing patent litigation related to an Abbreviated New Drug Application (ANDA) seeking approval to market a generic version of Zipsor® (diclofenac liquid filled capsules) 25mg tablets. The settlement permits defendant Watson Laboratories Inc. to begin selling generic Zipsor on March 24, 2022, or earlier under certain circumstances. The settlement concluded all ongoing ANDA litigation related to Zipsor. In light of this settlement agreement, the Company reviewed the useful life of the Zipsor product rights and, as of June 3, 2015, extended that from the previous estimate of July 2019 to March 2022. Consequently, the Company expects that the amortization charge for future quarters will be \$0.4 million lower than in previous quarters. Total amortization expense relating to Zipsor product rights for the three and six months ended June 30, 2015 was \$0.8 million and \$1.8 million, respectively, compared to \$1.0 million and \$1.9 million for the three and six months ended June 30, 2014, respectively. The estimated amortization expense for the remainder of 2015 is expected to be \$1.2 million.

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The CAMBIA® product rights of \$51.4 million have been recorded as intangible assets on the accompanying Condensed Consolidated Balance Sheet and are being amortized over the estimated useful life of the asset on a straight-line basis through December 2023. Amortization commenced on December 17, 2013, the date on which we acquired CAMBIA®. Total amortization expense for each of the three months ended June 30, 2015 and 2014 was approximately \$1.3 million and \$2.6 million for each of the six months ended June 30, 2015. The estimated amortization expense for the remainder of 2015 is expected to be \$2.6 million.

The Lazanda® product rights of \$10.5 million have been recorded as intangible assets on the accompanying Condensed Consolidated Balance Sheet and are being amortized over the estimated useful life of the asset on a straight-line basis through August 2022. Amortization commenced on July 29, 2013, the date on which we acquired Lazanda®. Total amortization expense for each of the three and six months ended June 30, 2015 and 2014 was approximately \$0.3 million and \$0.6 million, respectively. The estimated amortization expense for the remainder of 2015 is expected to be \$0.6 million.

The NUCYNTA® product rights of approximately, \$1.0 billion that we acquired on April 2, 2015, have been recorded as intangible assets on the accompanying Condensed Consolidated Balance Sheet and are being amortized using the straight line method over the estimated useful life of approximately ten years. Amortization commenced on the acquisition date and the total amortization expense for each of the three and six months ended June 30, 2015 was approximately \$24.3 million. The estimated amortization expense for the remainder of 2015 is expected to be \$49.8 million.

**Interest Income and Expense**

(In thousands)	Three Months Ended June 30,		Six Months Ended June 30,	
	2015	2014	2015	2014
Interest and other income	\$ 61	\$ 20	\$ 118	\$ 47
Change in fair value of contingent consideration and unfavorable contract				
Interest expense	(22,078)	(616)	(28,100)	(1,243)
Non-cash interest expense on PDL liability		(4,903)		(10,282)
Net interest income (expense)	\$ (22,017)	\$ (5,499)	\$ (27,982)	\$ (11,478)

The increase in net interest expense for the three and six months ended June 30, 2015, as compared to the corresponding periods in the prior year, is primarily related to interest expense relating to the Company's issuance of \$575.0 million aggregate principal amount of senior secured notes issued in April, 2015 (the Senior Notes) and the 2.5% Convertible Senior Notes Due 2021 that were issued on September 9, 2014 (the Convertible Notes). The interest expense is comprised of:

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(In thousands)	Three Months Ended June 30,		Six Months Ended June 30	
	2015	2014	2015	2014
Interest payable on the Notes	\$ 15,281	\$	\$ 15,281	\$
Interest payable on the Convertible debt	2,156		4,313	
Amortization of debt discounts and debt issuance costs relating to the Notes and Convertible debt	3,995		7,416	
Changes in fair value of contingent consideration	646	616	1,090	1,243
Total interest expense	\$ 22,078	\$ 616	\$ 28,100	\$ 1,243

*The Senior Notes*

On April 2, 2015, the Company issued \$575.0 million aggregate principal amount of senior secured notes (the Senior Notes) for aggregate gross proceeds of approximately \$562.0 million pursuant to a Note Purchase Agreement dated March 12, 2015 (Note Purchase Agreement) between the Company and Deerfield Private Design Fund III, L.P., Deerfield Partners, L.P., Deerfield International Master Fund, L.P., Deerfield Special Situations Fund, L.P., Deerfield Private Design Fund II, L.P., Deerfield Private Design International II, L.P., BioPharma Secured Investments III Holdings Cayman LP, Inteligo Bank Ltd. and Phemus Corporation (collectively, the Purchasers) and Deerfield Private Design Fund III, L.P., as collateral agent. The Company used \$550.0 million of the net proceeds received upon the sale of the Senior Notes to fund a portion of the purchase price paid to Janssen Pharma. In connection with our acquisition of the NUCYNTA® franchise on April 2, 2015.

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The Senior Notes will mature in seven years (unless earlier prepaid or repurchased), are secured by substantially all of the assets of the Company and any subsidiary guarantors, and bear interest at the rate equal to the lesser of (i) 9.75% over the three month London Inter-Bank Offer Rate (LIBOR), subject to a floor of 1.0% and (ii) 11.95% (through the third anniversary of the purchase date) and 12.95% (thereafter). The interest rate is determined at the first business day of each fiscal quarter, commencing with the first such date following April 2, 2015. The Senior Notes can be prepaid, at the Company's option, (i) after the first anniversary of the purchase date but prior to the second anniversary, up to \$100.0 million, (ii) before the second anniversary, under certain conditions and (iii) after the second anniversary, at the Company's discretion.

*Convertible Notes*

In September, 2014, the Company issued the Convertible Debt resulting in net proceeds of \$334.2 million after deducting the underwriting discount and offering expenses of \$10.4 million and \$0.4 million, respectively. The interest rate for the Convertible Notes is fixed at 2.50% per annum and is payable semi-annually in arrears on March 1 and September 1 of each year, commencing on March 1, 2015.

In accordance with accounting guidance on embedded conversion features, we valued and bifurcated the conversion option associated with the Convertible Notes from the respective host debt instrument and recorded the conversion option of \$111.9 million for the Convertible Notes in Shareholders' Equity on our Condensed Consolidated Balance Sheets. The resulting debt discounts on the Convertible Notes are being amortized to interest expense at an effective interest rate of 9.34% over the contractual term of the Convertible Notes.

*Non-cash interest expense on PDL liability*

The decrease in non-cash interest expense on PDL liability for the three and six months ended June 30, 2015, as compared to the corresponding period in 2014, is attributable to the royalty sale transaction that we completed in October 2013. Until September 30, 2014, we accounted the royalty sale transaction as debt and accounted for the non-cash interest expense on PDL liability. Effective October 1, 2014, the Company, Valeant, Salix and PDL executed an amended agreement which eliminated any and all continuing obligations on the part of the Company in the supply of 1000mg Glumetza tablets. As a result, we have not recorded any non-cash interest expense on PDL liability after September 30, 2014.

**Income Tax (Benefit) Provision**

At the end of 2014, we adjusted our partial valuation allowance that has an impact on the comparison of the three and six months ended June 30, 2015 benefit from income taxes when compared to the provision for income taxes for the corresponding period of 2014. For the three and six months ended June 30, 2015, we recorded a benefit from income taxes of \$17.6 million and \$21.8 million, respectively, compared to a provision for income taxes of \$8.3 million and \$20.1 million for the three and six months ended June 30, 2014. The benefit from income taxes in the three and six months ended June 30, 2015 as compared to the provision from income taxes for the same period in 2014 is primarily attributable to a decrease in income before taxes. We paid approximately \$0.04 million in income taxes for the three and six months ended June 30, 2015 compared to \$1.5 million and \$58.8 million for the three and six months ended June 30, 2014. The Company recorded a tax receivable of \$10.5 million for the three and six months ended June 30, 2015 based on a net operating loss carryback claim expected to be filed with the IRS

with respect to the year ending December 31, 2015.

### **Non-GAAP Financial Measures**

To supplement our financial results presented on a U.S. generally accepted accounting principles, or GAAP, basis, we have included information about Non-GAAP financial measures used by us may be calculated differently from, and therefore may not be comparable to, non-GAAP measures used by other companies. The Company includes information about non-GAAP adjusted earnings (loss), non-GAAP adjusted earnings (loss) per share and non-GAAP adjusted EBITDA, non-GAAP financial measures, as useful operating metrics for the six month periods ended June 30, 2015 and 2014 and its full year 2015 financial outlook. The Company believes that the presentation of these non-GAAP financial measures, when viewed with our results under GAAP and the accompanying reconciliations, provides supplementary information to investors. The Company uses these non-GAAP financial measures in connection with its own planning and forecasting purposes and for measuring the Company's performance. These non-GAAP financial measures should be considered in addition to, and not a substitute for, or superior to, net income or other financial measures calculated in accordance with GAAP. Non-GAAP adjusted earnings (loss) and non-GAAP adjusted earnings (loss) per share are not based on any standardized methodology prescribed by GAAP and represent GAAP net income (loss) and GAAP earnings (loss) per share adjusted to exclude (1) non-cash PDL royalty revenue, net of related costs, (2) non-cash interest expense on the liability related to the sale of future royalties and milestones to PDL, (3) amortization related to product acquisitions, (4) stock-based compensation expense, (5) non-cash interest expense related to debt, and to adjust (6) the income tax provision to reflect the estimated amounts payable or receivable in cash. Non-GAAP adjusted EBITDA is not based on any standardized methodology prescribed by GAAP and represents GAAP net income (loss) adjusted to exclude (1) non-cash PDL royalty revenue, net of related costs, (2) interest income (3) interest expense, (4) amortization related to product acquisitions, (5) stock-based compensation expense, (6) depreciation, (7) taxes and (8) transaction costs associated with product acquisitions. Non-GAAP financial measures used by the Company may be calculated differently from, and therefore may not be comparable to, non-GAAP measures used by other companies.

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The following table reconciles the Company's GAAP net income to non-GAAP adjusted income for the three and six months ended June 30, 2015 and 2014, respectively (in thousands, except per share amount):

	Three Months Ended June 30,			Six Months Ended June 30,		
	2015	2014		2015	2014	
	(unaudited)			(unaudited)		
GAAP net income (loss)	\$ (21,653)	\$ 12,746	\$	\$ (33,286)	\$ 30,684	\$
Non-cash PDL royalties, net of related costs		(32,865)			(75,210)	
Non-cash interest expense on PDL liability		4,903			10,282	
Non-cash interest expense on debt	3,984			7,405		
Amortization related to product acquisitions	41,458	4,933		43,044	9,489	
Stock based compensation	3,249	2,299		6,061	4,170	
Non-cash income tax adjustment	(7,036)	8,300		(11,216)	20,128	
Non-GAAP adjusted earnings (loss)	\$ 20,002	\$ 316	\$	\$ 12,008	\$ (457)	\$
Non-GAAP adjusted earnings (loss) per share (1)	\$ 0.27	\$ 0.01	\$	\$ 0.19	\$ (0.01)	\$

(1) The Company uses the if-converted method to compute diluted earnings per share with respect to its convertible debt. There was no add-back of interest expense or additional dilutive shares related to the convertible debt for the six months ended June 30, 2015 and the three and six months ended June 30, 2014, as the effect is anti-dilutive.

The following table reconciles the Company's GAAP net income (loss) to non-GAAP adjusted EBITDA for the three and six months ended June 30, 2015 and 2014 (in thousands):

	Three Months Ended June 30,			Six Months Ended June 30,		
	2015	2014		2015	2014	
	(unaudited)			(unaudited)		
GAAP net income (loss)	\$ (21,653)	\$ 12,746	\$	\$ (33,286)	\$ 30,684	\$
Non-cash PDL royalties, net of related costs		(32,865)			(75,210)	
Amortization related to product acquisitions	41,458	4,933		43,044	9,489	
Stock based compensation	3,249	2,299		6,061	4,170	
Interest income (other)	(61)	(13)		(118)	(31)	
Interest expense	21,432	4,903		27,010	10,282	
Depreciation	432	479		853	1,000	
Provision (benefit) from income taxes	(17,578)	8,300		(21,758)	20,128	
Transaction costs	9,685			12,117		
Non-GAAP Adjusted EBITDA	\$ 36,964	\$ 782	\$	\$ 33,923	\$ 512	\$



Table of Contents**LIQUIDITY AND CAPITAL RESOURCES**

(In thousands)	June 30, 2015	December 31, 2014
Cash, cash equivalents and marketable securities	\$ 122,559	\$ 566,402

The decrease in cash, cash equivalents and marketable securities during the six months ended June 30, 2015 is primarily attributable to the NUCYNTA® acquisition. We placed \$500.0 million into escrow during the three months ended March 31, 2015 which was applied to the purchase price at closing on April 2, 2015. The balance of the purchase price was financed from the proceeds of the Senior Notes.

During the second quarter of 2015, our cash, cash equivalents and marketable securities increased by approximately \$55.0 million as compared to the three months ended March 31, 2015. During the quarter we borrowed \$575.0 million pursuant to the Senior Notes to finance the acquisition of the NUCYNTA acquisition and to pay fees incurred in connection with the acquisition and other one-time fees discussed under Selling General and Administrative Expenses above. In July 2015, we paid quarterly interest on the Senior Notes in the amount of approximately \$15.3 million.

We may incur operating losses in future years. We believe that our existing cash balances and cash we expect to generate from operations will be sufficient to fund our operations, and to meet our existing obligations for the foreseeable future, including our obligations under the Convertible Notes and the Senior Notes. We based this expectation on our current operating plan and the anticipated impact of the NUCYNTA® acquisition, which may change as a result of many factors.

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

- acquisitions or licenses of complementary businesses, products, technologies or companies;
- sales of our marketed products;
- expenditures related to our commercialization of NUCYNTA® ER, NUCYNTA®, Gralise®, CAMBIA®, Zipsor®, and Lazanda®;
- milestone and royalty revenue we receive under our collaborative development and commercialization arrangements;
- interest and principal payments on our current and future indebtedness;
- financial terms of definitive license agreements or other commercial agreements we may enter into;

- 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.

The following table summarizes our cash flow activities (in thousands):

	Six Months Ended June 30,	
	2015	2014
Cash provided by (used in) operating activities	\$ 37,080	\$ (58,391)
Cash (used in) provided by investing activities	(1,002,137)	17,796
Cash provided by financing activities	570,483	7,066

#### Cash Flows from Operating Activities

Cash provided by (used in) operating activities during the six months ended June 30, 2015 and 2014 were approximately \$37.1 million and \$58.4 million, respectively. Cash provided by operating activities during the six months ended June 30, 2015 was due to net loss adjusted for non-cash items of \$28.8 million and movements in working capital of \$41.6 million. Cash used in operating activities during the six months ended June 30, 2014 was primarily related to income tax payments totaling approximately \$58.8 million related to the year ended December 31, 2013.

#### Cash Flows from Investing Activities

Cash used in investing activities during the six months ended June 30, 2015 was approximately, \$1.0 billion compared to cash provided by investing activities of \$17.8 million in the corresponding period in the prior year. Cash used in investing activities during the six months ended June 30, 2015 primarily relates to the \$1.05 billion in cash paid for the NUCYNTA® acquisition on April 2, 2015 off-set by a net cash inflow from the maturities of marketable securities. Cash used in investing activities during the six months ended June 30, 2014 was primarily driven by higher maturities of marketable securities relative to purchases of marketable securities.

Table of Contents**Cash Flows from Financing Activities**

Cash provided by financing activities during the six months ended June 30, 2015 and 2014 was approximately \$570.5 million and \$7.1 million, respectively, and consisted primarily of proceeds from employee option exercises and excess tax benefits from stock-based compensation.

**Contractual Obligations**

As of June 30, 2015, our aggregate contractual obligations as shown in the following table were as follows (in thousands):

	1 Year	2-3 Years	4-5 Years	More than 5 Years	Total
Senior Notes - principal	\$	\$ 57,500	\$ 230,000	\$ 287,500	\$ 575,000
Senior Notes - interest	61,641	123,625	98,900	46,402	330,568
Convertible Debt - principal				345,000	345,000
Convertible Debt - interest	8,625	17,250	17,250	12,938	56,063
Operating leases(1)	4,140	6,573	3,418	4,058	18,189
Purchase commitments	19,731				19,731
	\$ 94,137	\$ 204,948	\$ 349,568	\$ 695,898	\$ 1,344,551

(1) Amounts represent payments under a non-cancelable office and laboratory lease and under an operating lease for vehicles used by our sales force.

At June 30, 2015, we had non-cancelable purchase orders and minimum purchase obligations of approximately \$19.7 million under our manufacturing agreements related to NUCYNTA®, Galise®, Zipsor®, Lazanda® and CAMBIA®. The amounts disclosed only represent minimum purchase requirements. Actual purchases are expected to exceed these amounts.

In April 2012, we entered into an office and laboratory lease agreement to lease approximately 52,500 rentable square feet in Newark, California commencing on December 1, 2012. We leased an additional 8,000 rentable square feet commencing in July 2015. The Newark lease included free rent for the first five months of the lease. Lease payments began in May 2013. We 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, we 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.

**Off-Balance Sheet Arrangements**

None.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

There have been no material changes in the sources and effects of our market risk compared to the disclosures in Item 7A of our Annual Report on the 2014 Form 10-K.

*Interest Rate Risk.* We are subject to interest rate fluctuation exposure through our borrowings under the Senior Secured Credit Facility and our investment in money market accounts which bear a variable interest rate. Borrowings under the Senior Secured Credit Facility bear interest at a rate equal to the three month LIBOR plus 9.75% per annum, subject to a 1.0% LIBOR floor and certain thresholds. Since current LIBOR rates are below the 1.0% LIBOR floor, the interest rate on our borrowings under the Senior Secured Credit Facility has been 10.75% per annum. An increase in the LIBOR of 100 basis points above the current three-month LIBOR rates would increase our interest expense by \$5.8 million per year.

The goals of our investment policy are associated with the preservation of capital, fulfillment of liquidity needs and fiduciary control of cash. To achieve our goal of maximizing income without assuming significant market risk, we maintain our excess cash and cash equivalents in money market funds. Because of the short-term maturities of our cash equivalents, we do not believe that a decrease in interest rates would have any material negative impact on the fair value of our cash equivalents.

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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, 2015 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. NUCYNTA® and NUCYNTA® ER ANDA Filers**

In July 2013, Janssen Pharma filed patent infringement lawsuits in the U.S. District Court for the District of New Jersey against Actavis Elizabeth LLC, Actavis Inc. and Actavis LLC (collectively, Actavis), as well as Alkem Laboratories Limited and Ascend Laboratories, LLC (collectively, Alkem). The patent infringement claims against Actavis and Alkem relate to their respective ANDAs seeking approval to market a generic version of NUCYNTA® ER before the expiration of U.S. Reissue Patent No. 39,593 (the 593 Patent), U.S. Patent No. 7,994,364 (the 364 Patent) and, as to Actavis only, U.S. Patent No. 8,309,060 (the 060 Patent). The lawsuit also includes patent infringement claims against Actavis and Alkem in response to their respective ANDAs seeking approval to market a generic version of NUCYNTA® before the expiration of the 593 and 364 Patents. In

December 2013, Janssen Pharma filed an additional complaint in the U.S. District Court for the District of New Jersey against Alkem asserting that U.S. Patent No. 8,536,130 (the 130 Patent) relates to Alkem's ANDA seeking approval to market a generic version of NUCYNTA® ER. In August 2014, Janssen Pharma amended the complaint against Alkem to add additional dosage strengths.

In October 2013, Janssen Pharma received a Paragraph IV Notice from Sandoz, Inc. (Sandoz) with respect to NUCYNTA® related to the 364 Patent, and a Paragraph IV Notice from Roxane Laboratories, Inc. (Roxane) with respect to NUCYNTA® related to the 364 and 593 Patents. In response to those notices, Janssen Pharma filed an additional complaint in the U.S. District Court for the District of New Jersey against Roxane and Sandoz asserting the 364 Patent against Sandoz and the 364 and 593 Patents against Roxane. In April 2014, Janssen Pharma and Sandoz entered into a joint stipulation of dismissal of the case against Sandoz, based on Sandoz's agreement not to market a generic version of NUCYNTA® products prior to the expiration of the asserted patents. In June 2014, in response to a Paragraph IV Notice from Roxane with respect to NUCYNTA® ER, Janssen Pharma filed an additional complaint in the U.S. District Court for the District of New Jersey asserting the 364, 593, and 130 Patents against Roxane.

In July 2014, in response to a Paragraph IV Notice from Watson Laboratories, Inc. (Watson) with respect to the NUCYNTA® oral solution product and the 364 and 593 Patents, Janssen Pharma filed a lawsuit in the U.S. District Court for the District of New Jersey asserting the 364 and 593 Patents against Watson.

At the time that the foregoing complaints were filed, Janssen Pharma was an exclusive U.S. licensee of the patents referred to above. On April 2, 2015, the Company acquired the U.S. rights to the NUCYNTA® ER and NUCYNTA® from Janssen Pharma. As part of the acquisition, the Company became the exclusive U.S. licensee of the patents referred to above. The Company has since been added as a plaintiff to the pending ANDA lawsuits involving NUCYNTA® ER and NUCYNTA®. No trial date has been set.

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**Depomed v. Gralise® ANDA Filers**

Between March 2012 and May 2012, the Company filed lawsuits in the U.S. District Court for the District of New Jersey in response to six ANDAs filed by companies seeking to market generic versions of 300mg and 600mg dosage strengths of Gralise® prior to the expiration of the Company's patents listed in the Orange Book for Gralise®. The lawsuits were consolidated for purposes of all pretrial proceedings. The Company's lawsuits against two of the six Gralise® ANDA filers, Impax Laboratories and Watson Laboratories, have been dismissed as a result of the withdrawal of the ANDAs from consideration by the FDA. The Company's lawsuit against another ANDA filer, Par Pharmaceuticals Inc., has been dismissed because the ANDA filer no longer seeks approval of its Gralise ANDA prior to the expiration of the Company's Gralise® Orange Book-listed patents. In April 2014, the Company entered into settlement agreements with Incepta Pharmaceuticals and Abon Pharmaceuticals LLC collectively, Incepta) and with Zydus Pharmaceuticals USA Inc. and Cadila Healthcare Limited (collectively, Zydus) pursuant to which Incepta and Zydus may begin selling generic versions of Gralise® on January 1, 2024, or earlier under certain circumstances.

A bench trial involving defendants Actavis Elizabeth LLC and Actavis Inc. (collectively, Actavis) was completed on May 20, 2014 as to U.S. Patent Nos. 6,635,280; 6,488,962; 7,438,927; 7,731,989; 8,192,756; 8,252,332; and 8,333,992, which expire between September 2016 and February 2024. In August 2014, the court ruled in the Company's favor, finding that Actavis infringed all patent claims that the Company asserted and upholding the validity of the patents. On September 15, 2014, Actavis filed a notice appealing the decision to the U.S. Court of Appeals for the Federal Circuit. On February 2, 2015, Actavis filed its opening brief with the U.S. Court of Appeals for the Federal Circuit. On April 10, 2015, Actavis and the Company entered into a settlement agreement subject to review by the U.S. Department of Justice and the Federal Trade Commission, and the entry of orders dismissing the appeal and related federal district court litigation. By the terms of this agreement, Actavis's pending appeal is dismissed and Actavis may begin selling the generic versions of Gralise® on January 1, 2024, or earlier under certain circumstances.

**Depomed v. FDA**

In November 2010, the FDA granted Gralise® Orphan Drug designation for the management of PHN, but did not recognize Orphan drug exclusivity for Gralise® in January 2011 when Gralise® was approved for marketing in the U.S. In September 2012, the Company 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. Briefing in the case was completed in March 2013 and a hearing on the summary judgment motion was held in August 2013. In September 2014, the court issued an order granting the Company's request for summary judgment, and ordering the FDA to grant Orphan Drug exclusivity for Gralise® for the management of PHN, which the FDA did formally in October 2014. On November 3, 2014, the FDA filed a notice appealing the order to the U.S. Court of Appeals for the Federal Circuit. On November 5, 2014, the government dismissed its appeal.

**Depomed v. Purdue and Depomed v. Endo Pharmaceuticals Patent Infringement Litigation and Related *Inter Partes* Review Proceedings**

The Company has sued Purdue Pharma and Endo Pharmaceuticals for patent infringement in separate lawsuits filed in the U.S. District Court for the District of New Jersey. The lawsuits arise from Purdue's commercialization of reformulated OxyContin® (oxycodone hydrochloride controlled-release) in the U.S. and Endo's commercialization of OPANA® ER (oxymorphone hydrochloride extended-release) in the U.S. The Company sued Purdue in January 2013 for infringement of U.S. Patent Nos. 6,340,475 (the 475 Patent) and 6,635,280 (the 280 Patent), which expire in September 2016. The Company sued Endo in April 2013 for infringement of the 475 Patent, the 280 Patent and U.S. Patent No. 6,723,340 (the 340 Patent), which expires in October 2021. The Purdue and Endo lawsuits have been stayed pending completion of the Endo inter partes reviews described below.

In response to two petitions filed by Purdue and six petitions filed by Endo, the U.S. Patent and Trademark Office Patent Trial and Appeal Board (PTAB) has instituted inter partes reviews (each, an IPR) of certain of the claims asserted in the Company's lawsuits against Purdue and Endo. An IPR is a proceeding that became available in September 2012 in accordance with the America Invents Act (the AIA). In an IPR, a petitioner may request that the PTAB reconsider the validity of issued patent claims on the basis of prior art in the form of printed publications and other patents. Any patent claim the PTAB determines to be unpatentable is stricken from the challenged patent. Any party may appeal final written decisions of the PTAB to the U.S. Court of Appeals for the Federal Circuit, but the PTAB's decisions denying institution of an IPR are non-appealable. Accordingly, if the PTAB finds a challenged claim patentable, or declines to institute an IPR as to a challenged claim, the IPR petitioner is estopped from asserting in a patent infringement lawsuit that these claims are invalid on any ground the petitioner raised or reasonably could have raised in the IPR.

In the Purdue IPRs, on July 10, 2014, the PTAB declined to institute an IPR as to two claims of the 475 patent and two claims of the 280 Patent. The PTAB instituted an IPR as to the other 15 claims of the 475 Patent and as to the other 10 claims of the 280 Patent asserted against Purdue. On October 14, 2014, Depomed submitted written responses to the Petitions, and on December 22, 2014, Purdue submitted replies. A PTAB hearing was held on March 19, 2015. On July 8, 2015, the PTAB issued final decisions confirming the patentability of all claims at issue.



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Endo filed two IPR petitions for each of the 475 Patent, the 280 Patent and the 340 Patent. The PTAB declined to institute an IPR as to three of Endo's petitions. The PTAB also declined to institute an IPR as to five claims of the 475 Patent, three claims of the 280 Patent and one claim of the 340 Patent in the Endo IPRs. The PTAB instituted an IPR as to the other 13 claims of the 475 Patent, as to the other ten claims of the 280 Patent and as to the other eight claims of the 340 patent asserted against Endo. The PTAB also declined to institute an IPR as to a number of Endo's requested grounds. Discovery is complete, and oral arguments were heard on June 15, 2015. The PTAB's final written decisions in these IPRs are expected not later than September 29, 2015.

**Depomed v. Banner Pharmacaps**

On June 28, 2013, the Company received from Banner a Notice of Certification for U.S. Patent 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 ANDA for diclofenac potassium capsules, 25mg. 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. 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, the Company filed a lawsuit in the U.S. District Court for District of New Jersey against Banner and Watson for infringement 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 25 mg diclofenac 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.

On April 2, 2014, the Company filed an amended complaint to include infringement of U.S. Patent Nos. 6,287,594 and 8,623,920, which were recently added to the Orange Book listing for Zipsor® and expire in 2019 and 2029, respectively. The Court heard arguments for patent claim construction on March 3, 2015, and issued an order on March 26, 2015, in favor of the Company's construction for all disputed terms. In May of 2015, the parties entered into a settlement agreement subject to review by the U.S. Department of Justice and the Federal Trade Commission. By the terms of this agreement, Watson may begin selling the generic version of Zipsor® on March 24, 2022, or earlier under certain circumstances. On June 4, 2015, the Court entered an order staying the case pending the regulatory approval of the settlement agreement.

**General**

The Company cannot reasonably predict the outcome of the legal proceedings described above, nor can the Company estimate the amount of loss, range of loss or other adverse consequence, if any, that may result from these proceedings. As such, the Company is not currently able to estimate the impact of the above litigation on its financial position or results of operations.

The Company may from time to time become party to actions, claims, suits, investigations or proceedings arising from the ordinary course of its 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, the Company is not currently involved in any matters that it believes may have a material adverse effect on its business, results of operations or financial condition. However, regardless of the outcome, litigation can have an adverse impact on the Company 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 2014 Form 10-K and our quarterly report on Form 10-Q for the three month period ended March 31, 2015.

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**.

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***If we do not successfully commercialize NUCYNTA® ER, NUCYNTA®, Gralise®, CAMBIA®, Zipsor® and Lazanda®, our business, financial condition and results of operations will suffer.***

In April 2015, we acquired and began commercial promotion of NUCYNTA® ER and NUCYNTA®. In October 2011, we began commercial sales of Gralise®. In June 2012, we acquired Zipsor® and began commercial promotion of Zipsor® in July 2012. In July 2013, we acquired Lazanda® and began commercial promotion of Lazanda® in October 2013. In December 2013, we acquired CAMBIA® and began commercial promotion of CAMBIA® in February 2014. As a Company, we have a limited history of selling and marketing pharmaceutical products. In addition to the risks discussed elsewhere in this section, our ability to successfully commercialize and generate revenues from NUCYNTA® ER, NUCYNTA®, Gralise®, CAMBIA®, Zipsor® and Lazanda® depends on a number of factors, including, but not limited to, our ability to:

- develop and execute our sales and marketing strategies for our products;
- achieve, maintain and grow market acceptance of our products;
- obtain and maintain adequate coverage, reimbursement and pricing from managed care, government and other third-party payers;
- maintain, manage or scale the necessary sales, marketing, manufacturing, managed markets, and other capabilities and infrastructure that are required to successfully integrate and commercialize our products;
- maintain and extend intellectual property protection for our products; and
- comply with applicable legal and regulatory requirements.

If we are unable to successfully achieve or perform these functions, we will not be able to maintain or increase our revenues from NUCYNTA® ER, NUCYNTA®, Gralise®, CAMBIA®, Zipsor® and Lazanda®, our business, financial condition and results of operations will suffer.

***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 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.

As described in greater detail under LEGAL PROCEEDINGS above, in August 2014, we received a favorable ruling in our patent litigation against Actavis relating to Gralise®. The lawsuit was filed in March 2012 against Actavis for infringement of certain 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®. A bench trial was completed on May 20, 2014 and in August 2014 the court ruled in our favor, finding that Actavis infringed all asserted claims of all seven patents asserted in trial and upholding the validity of the patents, which expire between September 2016 and February 2024. On September 15, 2014, Actavis filed a notice appealing the decision to the U.S. Court of Appeals for the Federal Circuit. On February 2, 2015, Actavis filed its opening brief with the U.S. Court of Appeals for the Federal Circuit. On April 10, 2015, Actavis and the Company entered into a settlement agreement subject to review by the U.S. Department of Justice and the Federal Trade Commission, and the entry of orders dismissing the appeal and related federal district court litigation. By the terms of this agreement, Actavis's pending appeal is dismissed and Actavis may begin selling generic versions of Gralise® on January 1, 2024, or earlier under certain circumstances.

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As described in greater detail under LEGAL PROCEEDINGS above, on June 28, 2013, we received from Banner a Notice of Certification for U.S. Patent 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) certifying that Banner has submitted and the FDA has accepted for filing an ANDA for 25mg diclofenac potassium capsules, (Banner ANDA Product). Banner has granted exclusive rights to the Banner ANDA Product to Watson Laboratories Inc., a subsidiary of Actavis plc. 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. The letter indicates Banner has granted to Watson Laboratories Inc. (Watson) exclusive rights to Banner's proposed generic Zipsor® product. 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 would be expected to expire in December 2015. In May of 2015, Watson and the Company entered into a settlement agreement, subject to review by the U.S. Department of Justice and the Federal Trade Commission, pursuant to which Watson may begin selling the generic version of Zipsor® on March 24, 2022, or earlier under certain circumstances. On June 4, 2015, the court entered an order staying the case pending the regulatory approval of the settlement agreement.

As described in greater detail under LEGAL PROCEEDINGS above, on June 13, 2013 and August 11, 2013, Janssen Pharma received from Actavis, a notice of certification for U.S. Patent Nos. RE 39,593, 7,994,364, and 8,309,060 under 21 U.S.C. § 355 (j)(2)(A)(vii)(IV) certifying that Actavis has submitted and the FDA has accepted for filing an ANDA for NUCYNTA® 50mg, 75mg and 100mg tapentadol HCl tablets and NUCYNTA® ER 50mg, 100mg, 150mg, 200mg and 250mg tapentadol HCl tablets (Actavis ANDA Products). On June 20, 2013 and July 1, 2013, Janssen Pharma received from Alkem a notice of certification for U.S. Patent Nos. RE 39,593 and 7,994,364 under 21 U.S.C. § 355 (j)(2)(A)(vii)(IV) certifying that Alkem has submitted and the FDA has accepted for filing an ANDA for NUCYNTA® 50mg, 75mg and 100mg tapentadol HCl tablets and NUCYNTA® ER 50mg, 100mg, 150mg, 200mg and 250mg tapentadol HCl tablets (Alkem ANDA Products). On October 8, 2013 and May 9, 2014, Janssen Pharma received from Roxane a notice of certification for U.S. Patent Nos. RE 39,593 and 7,994,364 under 21 U.S.C. § 355 (j)(2)(A)(vii)(IV) certifying that Roxane has submitted and the FDA has accepted for filing an ANDA for NUCYNTA® 50mg, 75mg and 100mg tapentadol HCl tablets and NUCYNTA® ER 50mg, 100mg, 150mg, 200mg and 250mg tapentadol HCl tablets (Roxane ANDA Products). The letters collectively state that the Actavis, Alkem and Roxane ANDA Products, respectively, contain the required bioavailability or bioequivalence data to NUCYNTA® 50mg, 75mg and 100mg tapentadol HCl tablets and NUCYNTA® ER 50mg, 100mg, 150mg, 200mg and 250mg tapentadol HCl tablets and collectively certifies that Actavis, Alkem and Roxane, respectively, intend to obtain FDA approval to engage in commercial manufacture, use or sale of Actavis, Alkem and Roxane's ANDA products, respectively, before the expiration of the above identified patents, which are listed for NUCYNTA® 50mg, 75mg and 100mg tapentadol HCl tablets and NUCYNTA® ER 50mg, 100mg, 150mg, 200mg and 250mg tapentadol HCl tablets in the Orange Book. Janssen Pharma commenced the lawsuits within the 45 days required to automatically bar the FDA from approving the Actavis, Alkem and Roxane's ANDA products 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 May 20, 2016. In connection with our acquisition of NUCYNTA® ER and NUCYNTA® from Janssen Pharma, we assumed responsibility for managing these lawsuits.

Any introduction of one or more products generic to NUCYNTA® ER, NUCYNTA®, Gralise®, CAMBIA®, Zipsor® or Lazanda®, whether as a result of an ANDA or otherwise, 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, financial condition, and results of operations.

*If we are unable to negotiate acceptable pricing or obtain adequate reimbursement for our products from third-party payers, our business will suffer.*

Sales of our products depend significantly on the availability of acceptable pricing and adequate reimbursement from third-party payers such as:

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

If reimbursement is not available for our products or product candidates, demand for our 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 frequently require that pharmaceutical companies negotiate agreements that provide discounts or rebates from list prices. We have agreed to provide such discounts and rebates to certain third-party payers. We expect increasing pressure to offer larger discounts or discounts to a greater number of third-party payers to maintain acceptable reimbursement levels for and access to our products for patients at co-pay levels that are reasonable and customary. In addition, if our competitors reduce the prices of their products, or otherwise demonstrate that they are better or more cost effective than our products, this may result in a

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greater level of reimbursement for their products relative to our products, which would reduce sales of our products and harm our results of operations. The process for determining whether a third-party payer will provide coverage for a product may be separate from the process for setting the price or reimbursement rate that such third-party payer will pay for the product once coverage is approved. Third-party payers may limit coverage to specific products on an approved list, or formulary, which might not include all of the approved products for a particular indication, including one or more of our products. Any third-party payer decision not to approve pricing for, or provide adequate coverage and reimbursement of, our products, including by limiting or denying reimbursement for new products or excluding products that were previously eligible for reimbursement, would limit the market acceptance and commercial prospects of our products and harm our business, financial condition and results of operations.

There have been, and there will continue to be, legislative and regulatory proposals to change the healthcare system in ways that could impact our ability to commercialize our products profitably. We anticipate that the federal and state legislatures and the private sector will continue to consider and may adopt and implement healthcare policies, such as the ACA, intended to curb rising healthcare costs. These cost containment measures include: controls on government-funded reimbursement for drugs; new or increased requirements to pay prescription drug rebates to government health care programs; controls on healthcare providers; challenges to the pricing of drugs or limits or prohibitions on reimbursement for specific products through other means; requirements to try less expensive products or generics before a more expensive branded product; and public funding for cost effectiveness research, which may be used by government and private third-party payers to make coverage and payment decisions. These and other cost containment measures could decrease the price that we receive for our products and any product that we may develop or acquire, which would harm our business, financial condition and results of operations.

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

Tapentadol, the active pharmaceutical ingredient in NUCYNTA® ER and NUCYNTA®, is a proprietary opioid analgesic that we market exclusively in the U.S. NUCYNTA® ER and NUCYNTA® compete with a number of branded and generic products that are widely used to treat moderate to severe chronic pain, including neuropathic pain associated with DPN, and acute pain, respectively. These products include OxyContin® (oxycodone hydrochloride extended-release tablets), which is marketed by Purdue Pharma L.P., and OPANA® ER (oxymorphone hydrochloride), which is marketed by Endo Pharmaceuticals, Inc., each of which are approved for marketing in the U.S. for the management of pain severe enough to require daily, around-the-clock, long-term opioid treatment and for which alternative treatment options are inadequate. Each of OxyContin® and OPANA® ER have achieved significant levels of market acceptance. There are also a number of branded and generic opioids, including oxymorphone, fentanyl, morphine, buprenorphine and hydromorphone, which have received approval and are marketed in the U.S. for the treatment of moderate to severe pain, including chronic and acute pain. Lyrica® (pregabalin), which is marketed by Pfizer, Inc. (Pfizer), has been approved for marketing in the U.S. for the treatment of neuropathic pain associated with DPN. Branded and generic versions of duloxetine and lidocaine have also been approved for marketing in the U.S. for the treatment of neuropathic pain associated with DPN. There are a number of other products and treatments prescribed for, or under development, for the management of chronic and acute pain, including neuropathic pain associated with DPN, which are now or may become competitive with NUCYNTA® ER and NUCYNTA®.

Gabapentin is currently sold by Pfizer as Neurontin® for adjunctive therapy for epileptic seizures and for PHN. 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. In addition to receiving approval for marketing to treat neuropathic pain associated with DPN, Lyrica® (pregabalin), has also been approved for marketing in the U.S. for the treatment of post

herpetic pain, fibromyalgia, adjunctive therapy, epileptic seizures, and nerve pain associated with spinal cord injury and has captured a significant portion of the market. In December 2014, Pfizer announced positive Phase 3 clinical trial results for its controlled release formulation of Lyrica® as a treatment for PHN. In June 2012, GlaxoSmithKline and Xenoport, Inc. received approval to market Horizant (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 an NSAID that is approved in the U.S. for the treatment of mild to moderate pain in adults, 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.

An alternate formulation of diclofenac is the active ingredient in CAMBIA® that is approved in the U.S. for the acute treatment of migraine in adults. CAMBIA® competes with a number of triptans which are used to treat migraine and certain other headaches. Currently, seven triptans are available and sold in the U.S. (almotriptan, eletriptan, frovatriptan, naratriptan, rizatriptan, sumatriptan and zolmitriptan), as well as a fixed-dose combination product containing sumatriptan plus naproxen. There are other products prescribed for or under development for the treatment of migraines which are now or may become competitive with CAMBIA®.



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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. (BDSI). Generic fentanyl products against which Lazanda® currently competes are sold by Mallinckrodt, Par and Actavis.

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

***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 use 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 use 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 use, 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.

***Pharmaceutical marketing is subject to substantial regulation in the U.S. 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 NUCYNTA® ER, NUCYNTA®, Gralise®, CAMBIA®, Zipsor® and Lazanda®, as well as marketing activities related to any other products which we may acquire, or 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, in recent years, the federal government 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 that apply to items and services reimbursed under Medicaid and other state programs, and, in some states, such statutes or regulations apply 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, injunctions, 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.

*Acquisition of new and complementary businesses, products, and technologies is a key element of our corporate strategy. If we are unable to successfully identify and acquire such businesses, products or technologies, our business and prospects will be limited.*

Since June 2012, we have acquired NUCYNTA® ER, NUCYNTA®, CAMBIA®, Zipsor® and Lazanda®. 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. We cannot be certain that we will be able to successfully identify, pursue and complete any further acquisitions or whether we would be able to successfully integrate any acquired business, product or technology or retain any key employees. If we are unable to enhance and broaden our product offerings, our business and prospects will be limited.

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***If we are unable to successfully integrate any business, product or technology we may acquire, our business, financial condition and operating results will suffer.***

Integrating any business, product or technology we acquire, including NUCYNTA® ER and NUCYNTA®, is expensive, time consuming and can disrupt and adversely affect our ongoing business, including product sales, and distract our management.

Our ability to successfully integrate any business, product or technology we acquire depends on a number of factors, including, but not limited to, our ability to:

- minimize the disruption and distraction of our management and other employees, including our sales force, in connection with the integration of any acquired business, product or technology;
- maintain and increase sales of our existing products;
- establish or manage the transition of the manufacture and supply of any acquired product, including the necessary active pharmaceutical ingredients, excipients and components;
- identify and add the necessary sales, marketing, manufacturing, regulatory and other related personnel, capabilities and infrastructure that are required to successfully integrate any acquired business, product or technology;
- manage the transition and migration of all commercial, financial, legal, clinical, regulatory and other pertinent information relating to any acquired business, product or technology;
- comply with legal, regulatory and contractual requirements applicable to any acquired business, product or technology;
- obtain and maintain adequate coverage, reimbursement and pricing from managed care, government and other third-party payers with respect to any acquired product; and
- maintain and extend intellectual property protection for any acquired product or technology.

If we are unable to perform the above functions or otherwise effectively integrate any acquired businesses, products or technologies, our business, financial condition and operating results will suffer.

***If we engage in strategic transactions that fail to achieve the anticipated results and synergies, our business will suffer.***

We may seek to engage in strategic transactions with third parties, such as product or company acquisitions, strategic partnerships, joint ventures, divestitures or business combinations. We may face significant competition in seeking potential strategic partners and transactions, and the negotiation process for acquiring any product or engaging in strategic transactions can be time-consuming and complex. Engaging in strategic transactions, such as our acquisition of the U.S. rights to NUCYNTA® ER and NUCYNTA®, may require us to incur non-recurring and other charges, increase our near and long-term expenditures, pose integration challenges and fail to achieve the anticipated results or synergies or distract our management and business, which may harm our business.

As part of an effort to acquire a product or company or to enter into other strategic transactions, we conduct business, legal and financial due diligence with the goal of identifying, evaluating and assessing material risks involved in the transaction. Despite our efforts, we ultimately may be unsuccessful in ascertaining, evaluating and accurately assessing all such risks and, as a result, might not realize the intended advantages of

the transaction. We may also assume liabilities and legal risks in connection with a transaction, including those relating to activities of the seller prior to the consummation of the transaction and contracts that we assume. Failure to realize the expected benefits from acquisitions or strategic transactions that we may consummate, or that we have completed, such the acquisition of the U.S. rights to NUCYNTA® ER and NUCYNTA®, whether as a result of identified or unidentified risks, integration difficulties, regulatory setbacks, governmental investigations, litigation or other events, could adversely affect our business, results of operations and financial condition.

*We depend on third parties that are single source suppliers to manufacture our products. If these suppliers are unable to manufacture and supply our products, or there is insufficient availability of our products or the raw materials necessary to manufacture our products, our business will suffer.*

An affiliate of Janssen Pharma is our sole supplier of NUCYNTA® ER and NUCYNTA® pursuant to a manufacturing supply agreement we entered into with such entity in April 2015. Patheon Puerto Rico Inc. (Patheon) is our sole supplier for Gralise® pursuant to a manufacturing and supply agreement we entered into with Patheon in September 2011. Accucaps Industries Limited is our sole supplier for Zipsor® pursuant to a manufacturing agreement we assumed in connection with our acquisition of Zipsor® in June 2012. DPT Lakewood Inc. is our sole supplier for Lazanda® pursuant to a manufacturing and supply agreement that we assumed in connection with our acquisition of Lazanda® in July 2013. MiPharm, S.p.A is our sole supplier for CAMBIA® pursuant to a manufacturing and supply agreement that we assumed in connection with our acquisition of CAMBIA® in December 2013. We have one qualified supplier for the active pharmaceutical ingredient in each of NUCYNTA® ER, NUCYNTA®, CAMBIA®, Zipsor®

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and Lazanda® and two qualified suppliers for the active pharmaceutical ingredient in Gralise®. 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 commercialization and clinical trials. Our dependence on third parties for the manufacture of our products and our product candidates may adversely affect our ability to obtain such products on a timely or competitive basis, if at all. Any failure to obtain sufficient supplies of NUCYNTA® ER, NUCYNTA®, Gralise®, CAMBIA®, Zipsor® or Lazanda®, or the necessary active pharmaceutical ingredients, excipients or components from our suppliers would 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 adequate supplies of our products to our customers on a timely basis, or to continue our clinical trials could 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 such third-party manufacturers' 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 could be adversely affected.

***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 U.S. and foreign jurisdictions to cover certain aspects of our technology. We hold issued U.S. patents and have patent applications pending in the U.S. In addition, we are pursuing patent applications relating to our technologies in the U.S. 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 other 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 other patents or intellectual property rights. We are not aware of any such 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 such third party's 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 to enforce any patents issued or licensed to us or to determine the scope and validity of third-party proprietary rights. For instance, we are engaged in litigation against three NUCYNTA® ER and NUCYNTA® ANDA filers, and one NUCYNTA® oral solution ANDA filer. Also, 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. In response to our lawsuits, Purdue and Endo are challenging the validity of the patents we asserted in *inter partes* review proceedings before the PTAB at the U.S. Patent and Trademark Office. In these or other

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proceedings, our issued or licensed patents may not be held valid by a court of competent jurisdiction or the PTAB. Whether or not the outcome of litigation or the PTAB proceeding is favorable to us, the litigation and the proceedings takes significant time, may be expensive, and may divert management attention from other business concerns. We may also be required to participate in derivation proceedings or other post-grant proceedings declared by the U.S. Patent and Trademark Office for the purposes of, respectively, determining the priority of inventions in connection with our patent applications or determining validity of claims in our issued patents. Adverse determinations in litigation or proceedings at the U.S. Patent and Trademark Office would adversely affect our business, results of operations and financial condition and 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.

***Our failure to generate sufficient cash flow from our business to make payments on our debt would adversely affect our business, financial condition and results of operations.***

We have incurred significant indebtedness in the aggregate principal amount of \$920.0 million under our Senior Notes and our Convertible Notes. Our ability to make scheduled payments of the principal of, to pay interest on, or to refinance, the Convertible Notes, the Senior Notes and any additional debt obligations we may incur, depends on our future performance, which is subject to economic, financial, competitive and other factors that may be beyond our control. Our business may not generate cash flow from operations in the future sufficient to service our debt and to make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as selling assets, restructuring debt or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance our indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on commercially reasonable or acceptable terms, which could result in a default on our obligations, including the Convertible Notes and the Senior Notes.

In addition, our significant indebtedness, combined with our other financial obligations and contractual commitments, could have other important consequences to our business. For example, it could:

- make it more difficult for us to meet our payment and other obligations under the Convertible Notes, the Senior Secured Notes or our other indebtedness;
- result in an event of default if we fail to comply with the financial and other covenants contained in the Note Purchase Agreement, which event of default could result in all of our debt becoming immediately due and payable;
- make us more vulnerable to adverse changes in general economic, industry and competitive conditions and adverse changes in government regulation;
- subject us to the risk of increased sensitivity to interest rate increases on our indebtedness with variable interest rates, including the Senior Notes;
- require the dedication of a substantial portion of our cash flow from operations to service our indebtedness, thereby reducing the amount of our cash flow available for other purposes, including working capital, clinical trials, research and development, capital expenditures and other general corporate purposes;
- prevent us from raising funds necessary to repurchase the Convertible Notes in the event we are required to do so following a fundamental change, as specified in the indenture governing the Convertible Notes, to repurchase

the Senior Notes in the event we are required to do so following a major transaction or as required in the event that the principal amount outstanding under the Convertible Notes as of March 31, 2021 is greater than \$100.0 million, as specified in the Note Purchase Agreement or to settle conversions of the Convertible Notes in cash;

- result in dilution to our existing shareholders as a result of the conversion of the Convertible Notes into shares of common stock;
- limit our flexibility in planning for, or reacting to, changes in our business and our industry;
- put us at a disadvantage compared to our competitors who have less debt; and
- limit our ability to borrow additional amounts for working capital and other general corporate purposes, including funding possible acquisitions of, or investments in, additional products, technologies, and companies.

Any of these factors could adversely affect our business, financial condition and results of operations. In addition, if we incur additional indebtedness, the risks related to our business and our ability to service or repay our indebtedness would increase.



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

The ACA includes numerous provisions that affect pharmaceutical companies, some of which became effective immediately upon President Obama signing the law, and others of which are scheduled to 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 to record any transfers of value to physicians and teaching hospitals and to report this data 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.

***Changes in laws and regulations may adversely affect our business.***

The manufacture, marketing, sale, promotion and distribution of our products are subject to comprehensive government regulation. Changes in laws and regulations applicable to the pharmaceutical industry could potentially affect our business. For example, federal, state and local governments have recently given increased attention to the public health issue of opioid abuse. At the federal level, the White House Office of National Drug Control Policy continues to coordinate efforts between the FDA, U.S. Drug Enforcement Agency (DEA) and other agencies to address this issue. The DEA continues to increase its efforts to hold manufacturers, distributors, prescribers and pharmacies accountable through various enforcement actions as well as the implementation of compliance practices for controlled substances. In addition, many state legislatures are considering various bills intended to reduce opioid abuse, for example by establishing prescription drug monitoring programs and mandating prescriber education. These and other changes in laws and regulations could adversely affect our business, financial condition and results of operations.

***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.

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 Controlled Substances Act of 1970 (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.

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

The products we develop or acquire 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 a 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, the immediate release formulation of gabapentin initially approved by the FDA.

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 production and commercialization of pharmaceutical products. Side effects, manufacturing defects, misuse or abuse of any of our products could result in patient injury or death. For instance, 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, 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 our anticipated 2015 sales of our products and clinical trials currently underway, 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 our Acuform gastric retentive technology expands; 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 adversely affected.

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

We currently have collaboration or license arrangements with a number of companies, including Mallinckrodt, Janssen Pharma, Salix and Ironwood. 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 collaborative partners under these arrangements might breach the terms of their respective agreements or fail to maintain, protect or prevent infringement of the licensed patents or our other intellectual property rights 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. Any failure by our collaborative partners to abide by the terms of their respective agreements with us, including their failure to accurately calculate, report or pay any royalties payable to us, may adversely affect our results of operations.

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.

***Any failure by us or our partners to comply with applicable statutes or regulations relating to controlled substances could adversely affect our business.***

Each of NUCYNTA® ER and NUCYNTA® are opioid analgesics that contain tapentadol. Lazanda® is an opioid analgesic that contains fentanyl. Tapentadol and fentanyl are regulated controlled substances under the 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. Each of tapentadol and fentanyl are 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.

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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.

***Limitations on the production of Schedule II substances in the U.S. could limit our ability to successfully commercialize NUCYNTA® ER, NUCYNTA® and Lazanda®.***

The availability and production of all Schedule II substances, including tapentadol and fentanyl, is limited by the DEA through a quota system that includes a national aggregate quota, production quotas for individual manufacturers and procurement quotas that authorize the procurement of specific quantities of Schedule II controlled substances for use in drug manufacturing. The DEA annually establishes an aggregate quota for total tapentadol and total fentanyl production in the U.S. based on the DEA's estimate of the quantity needed to meet commercial and scientific need. The aggregate quota of tapentadol and fentanyl that the DEA allows to be produced in the U.S. annually is allocated among applicable individual drug manufacturers, which must submit applications annually to the DEA for individual production quotas. In turn, the manufacturers of NUCYNTA® ER, NUCYNTA® and Lazanda® have to obtain a procurement quota to source tapentadol and fentanyl for the production of NUCYNTA® ER, NUCYNTA® and Lazanda®, respectively. The DEA requires substantial evidence and documentation of expected legitimate medical and scientific needs before assigning quotas for these activities. 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 quota lower for tapentadol or fentanyl than the total amount requested by individual manufacturers. Although through our manufacturing partner we are permitted to ask the DEA to increase our manufacturer's procurement quota after it is initially established, we cannot be certain that the DEA would act favorably upon such a request. In addition, our manufacturers obtain a procurement quota for tapentadol or fentanyl for all tapentadol or fentanyl products manufactured at their facility, which is allocated to NUCYNTA® ER, NUCYNTA® and Lazanda®, as applicable, at the manufacturer's discretion. If the available quota of tapentadol or fentanyl is insufficient 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 or our manufacturer in establishing the production or procurement quota or any reduction by the DEA or our manufacturer in the allocated quota for tapentadol or fentanyl could adversely affect our business, results of operations and financial condition.

***The FDA-mandated Risk Evaluation and Mitigation Strategy program may limit the commercial success of NUCYNTA® ER and Lazanda®.***

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

promote NUCYNTA® ER and Lazanda® to participants in the applicable REMS program, our business, results of operations and financial condition could be adversely affected.

*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.



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*The market price of our common stock historically has been volatile. Our results of operations may fluctuate and affect our stock price.*

The trading price of our common stock has been, and is likely to continue to be, volatile and could be subject to wide fluctuations in response to various factors, some of which are beyond our control. From September 30, 2013 through June 30, 2015, our stock price has ranged from \$6.95 to \$28.16 per share. In addition, our stock price increased significantly since we disclosed in a press release on July 7, 2015 that we received and, our Board of Directors rejected, an unsolicited, highly conditional, non-binding proposal from Horizon Pharma plc (Horizon) to acquire all of the outstanding shares of the Company in an all-stock transaction valued at \$29.25 per share. This announcement caused the price of our common stock to increase significantly, from \$20.62 per share at the close of market on the last trading day before the announcement, to \$28.62 per share at the close of market on the first trading day following the announcement. Horizon may, among other things, continue to pursue the proposal with our shareholders, may make an improved proposal, reduce its proposal or withdraw its proposal. On August 3, 2015, each of Horizon and the Company filed lawsuits against the other party in connection with Horizon's proposal. The price of our common stock could be unusually volatile during this period, and if the market perceives that no transaction may occur, or that a transaction may occur at a price less than the current trading price, the price per share of our common stock could decrease, including back to preannouncement levels or even lower.

Factors affecting our operating results and that could adversely affect our stock price include:

- the degree of commercial success and market acceptance of NUCYNTA® ER, NUCYNTA®, Gralise®, CAMBIA®, Zipsor® and Lazanda®;
- filings and other regulatory or governmental actions or proceedings related to our products and product candidates and those of our collaborative partners;
- the outcome of our patent infringement litigation against the filers of ANDAs for NUCYNTA® ER and NUCYNTA®;
- the outcome of our patent infringement litigation against the filer of an ANDA for Zipsor®;
- developments concerning proprietary rights, including patents, infringement allegations, inter party review proceedings and litigation matters, including those recently filed in connection with Horizon's proposal.
- our ability to generate sufficient cash flow from our business to make payments on our indebtedness;
- our and our collaborative partners' compliance or non-compliance with legal and regulatory requirements and with obligations under our collaborative agreements;
- our plans to acquire, in-license or co-promote other products, or acquire or combine with other companies, and our degree of success in realizing the intended advantages of, and mitigating any risks associated with, any such transaction;
- 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;
- adoption of new technologies by us or our competitors;
- the outcome of our patent infringement litigation against Purdue and Endo;
- our compliance with the terms and conditions of the agreements governing our indebtedness;
- decisions by collaborative partners to proceed or not to proceed with subsequent phases of a collaboration or program;
- sales of large blocks of our common stock or the dilutive effect of our Convertible Notes; and
- variations in our operating results, earnings per share, cash flows from operating activities, deferred revenue, and other financial metrics and non-financial metrics, and how those results compare to analyst expectations.

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. Any significant drops in our stock price 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.

In addition, if the market for pharmaceutical stocks or the stock market in general experiences uneven investor confidence, the market price of our common stock could decline for reasons unrelated to our business, operating results or financial condition. For example, if one or more securities or industry analysts downgrades our stock or publishes an inaccurate research report about our company, the market price for our common stock would likely decline. The market price of our common stock might also decline in reaction to events that affect other companies within, or outside, our industry even if these events do not directly affect us.

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***We have incurred operating losses in the past and 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 three and six months ended June 30, 2015, we recognized a net loss of \$21.7 million and \$33.3 million, respectively and net income of \$12.7 million and \$30.7 million the three and six months ended June 30, 2014, respectively. We will incur operating losses in 2015 and may incur operating losses 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 future operations or product acquisitions and strategic transactions which we may pursue.***

We fund our operations primarily through revenues from product sales and do not have any committed sources of capital. To the extent that our existing capital resources and revenues from ongoing operations are insufficient to fund our future operations, or product acquisitions and strategic transactions which we may pursue, we will have to raise additional funds through the sale of our equity securities, through additional debt financing, from development and licensing arrangements, or the sale of assets. 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.

***The development of drug candidates is inherently difficult and uncertain and we cannot be certain that any of our product candidates or those of our collaborative partners 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 trials 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, our prior product candidate, 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.

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.

We are unable to predict whether any of our product candidates or those of our collaborative partners 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 assuming 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 or those of our collaborative partners could adversely impact our financial position and liquidity.

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***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 commercial, scientific and financial 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.

***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 the effectiveness 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 also publicly attest to the effectiveness of our internal control over financial reporting. 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 the effectiveness of our internal control over financial reporting, 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.

***Changes in fair value of contingent consideration and/or the liability for the unfavorable contract assumed as part of our acquisitions could adversely affect our results of operations.***

Contingent consideration obligations arise from the Zipsor®, CAMBIA®, Lazanda® acquisitions and relate to the potential future milestone payments and royalties payable under the respective agreements. The liability for the unfavorable contract relates to a contract we assumed in connection with the acquisition of CAMBIA® and represents the milestone payable to the vendor as well as the value of the amounts by which the contract terms are unfavorable compared to current pricing. The contingent consideration and the liability for the unfavorable contract is initially recognized at its fair value on the acquisition date and is re-measured to fair value at each reporting date until the contingency is resolved with changes in fair value recognized in earnings. The estimates of fair values for the contingent consideration and the unfavorable manufacturing contract contain uncertainties as it involves assumptions about the probability assigned to the potential milestones and royalties being achieved and the discount rate. Significant judgment is employed in determining these assumptions as of the acquisition date and for each subsequent period. Updates to assumptions could have a significant impact on our results of operations in any given period.

***The value of our deferred tax assets could become impaired, which could adversely affect our results of operations.***

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As of June 30, 2015, we had a significant amount of deferred tax assets, exclusive of a deferred tax liability for the convertible debt issuance. These deferred tax assets are principally comprised of state net operating loss carryovers and temporary differences related to intangible assets and other temporary differences that are expected to reverse in the future. We assess on a quarterly basis the probability of the realization of deferred tax assets, using significant judgments and estimates with respect to, among other things, the historical operating results, expectations of future earnings and significant risks and uncertainties related to our business. If we determine in the future that there is not sufficient positive evidence to support the valuation of these assets, due to the risk factors described herein or other factors, we may be required to further adjust the valuation allowance to reduce our deferred tax assets. Such a reduction could result in material non-cash expenses in the period in which the valuation allowance is adjusted and could have an adverse effect on our results of operations.

***We may not have the ability to raise the funds necessary to settle conversions of the Convertible Notes in cash, to repurchase the Convertible Notes upon a fundamental change or to repurchase the Senior Notes upon a major transaction put or as required in the event that the principal amount outstanding under the Convertible Notes as of March 31, 2021 is greater than \$100.0 million.***

Holders of the Convertible Notes will have the right to require us to repurchase all or a portion of their Convertible Notes upon the occurrence of certain events deemed to be a fundamental change at a repurchase price equal to 100% of the principal amount of the outstanding Convertible Notes to be repurchased, plus accrued and unpaid interest, if any. In addition, upon conversion of the Convertible Notes, unless we elect to deliver solely shares of our common stock to settle such conversion (other than paying cash in lieu of delivering any fractional share), we will be required to make cash payments in respect of the Convertible Notes being converted.

Furthermore, holders of the Senior Notes will have the right to require us to repurchase all of their Senior Notes (i) if the principal amount outstanding under the Convertible Notes as of March 31, 2021 is greater than \$100.0 million, at a repurchase price equal to 100% of the principal amount of the outstanding Senior Notes to be repurchased, plus accrued and unpaid interest, if any, or (ii) upon the occurrence of certain events deemed to be a major transaction at a repurchase price equal to: (a) 100% of the principal amount of the outstanding Senior Notes to be repurchased, plus (b) accrued and unpaid interest, if any, plus (c) a prepayment premium, which may be substantial.

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However, we may not have enough available cash or be able to obtain financing at the time we are required to make repurchases of Convertible Notes or Senior Notes or pay cash with respect to Convertible Notes being converted. In addition, our ability to repurchase or to pay cash upon conversion of the Convertible Notes may be limited by law, regulatory authority or agreements governing our future indebtedness. An event of default under the indenture governing the Convertible Notes, including our failure to repurchase Convertible Notes when required by the indenture governing the Convertible Notes, would constitute a default under the Note Purchase Agreement. In addition, an event of default under the Note Purchase Agreement, including our failure to repurchase Senior Notes when the repurchase is required by the Note Purchase Agreement, would constitute a default under the indenture governing the Convertible Notes. Moreover, the occurrence of a fundamental change under the indenture governing the Convertible Notes or a major transaction under the Note Purchase Agreement could constitute an event of default under either the indenture governing the Convertible Notes or the Note Purchase Agreement, as applicable and any agreements that may govern any future indebtedness. Following an event of default, if the payment of our outstanding indebtedness were to be accelerated after any applicable notice or grace periods, we may not have sufficient funds to repay such indebtedness.

***The conditional conversion feature of the Convertible Notes, if triggered, may adversely affect our financial condition and operating results.***

In the event the conditional conversion feature of the Convertible Notes is triggered, holders of Convertible Notes will be entitled to convert the Convertible Notes at any time during specified periods at their option. If one or more holders elect to convert their Convertible Notes, unless we elect to satisfy our conversion obligation by delivering solely shares of our common stock (other than paying cash in lieu of delivering any fractional share), we would be required to settle a portion or all of our conversion obligation in cash, which could adversely affect our liquidity. In addition, even if holders do not elect to convert their Convertible Notes, we could be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the Convertible Notes as a current rather than long-term liability, which would result in a material reduction of our net working capital.

***The accounting method for convertible debt securities that may be settled in cash, such as the Convertible Notes could have a material effect on our reported financial results.***

In May 2008, FASB issued FASB Staff Position No. APB 14-1, Accounting for Convertible Debt Instruments That May Be Settled in Cash upon Conversion (Including Partial Cash Settlement), which has subsequently been codified as Accounting Standards Codification 470-20, Debt with Conversion and Other Options (ASC 470-20). Under ASC 470-20, an entity must separately account for the liability and equity components of the convertible debt instruments (such as the Convertible Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. The effect of ASC 470-20 on the accounting for the Convertible Notes is that the equity component is required to be included in the additional paid-in capital within shareholders' equity on our consolidated balance sheet at the issuance date and the value of the equity component would be treated as debt discount for purposes of accounting for the debt component of the Convertible Notes. As a result, we will be required to record a greater amount of non-cash interest expense as a result of the accretion of the discounted carrying value of the Convertible Notes to their face amount over the term of the notes. We will report lower net income (or larger net losses) in our financial results because ASC 470-20 will require interest to include both the accretion of the debt discount and the instrument's non-convertible coupon interest rate, which could adversely affect our reported or future financial results, the trading price of our common stock.

In addition, if the Convertible Notes become convertible, we would be required under applicable accounting rules to reclassify all or a portion of the outstanding principal of the Convertible Notes as a current rather than a long-term liability, which would result in a material reduction of our net working capital. Finally, we use the if-converted method to compute diluted earnings per share with respect to our convertible debt, which could be more dilutive than assuming the debt would be settled in cash as opposed to shares.

Any of these factors could cause a decrease in the market price of our common stock.

*Certain provisions applicable to the Convertible Notes and the Senior Notes could delay or prevent an otherwise beneficial takeover or takeover attempt.*

Certain provisions applicable to the Convertible Notes and the indenture governing the Convertible Notes, the Senior Notes and the Note Purchase Agreement, could make it more difficult or more expensive for a third party to acquire us. For example, if an acquisition event constitutes a fundamental change under the indenture for the Convertible Notes or a major transaction under the Note Purchase Agreement, holders of the Convertible Notes or the Senior Notes, as applicable, will have the right to require us to



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repurchase their notes in cash. In addition, if an acquisition event constitutes a make-whole fundamental change under the indenture, we may be required to increase the conversion rate for holders who convert their Convertible Notes in connection with such make-whole fundamental change. In any of these cases, and in other cases, our obligations under the Convertible Notes and the indenture, the Senior Notes and the Note Purchase Agreement, as well as provisions of our organizational documents and other agreements, could increase the cost of acquiring us or otherwise discourage a third party from acquiring us or removing incumbent management.

***Provisions in our restated articles of incorporation and bylaws, our shareholder rights plan and California law might discourage, delay or prevent a change of control of our company or changes in our management and, therefore, depress the market price of our common stock.***

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.

On July 12, 2015, our board of directors declared a dividend of one right (Right) for each outstanding share of our common stock to shareholders of record at the close of business on July 23, 2015. The description and terms of the Rights are set forth in a Rights Agreement dated as of July 12, 2015 as it may from time to time be supplemented or amended (the Rights Agreement) between Depomed and Continental Stock Transfer & Trust Company, as Rights Agent. The Rights will have certain anti-takeover effects. The Rights will cause substantial dilution to any person or group that attempts to acquire us without the approval of our board of directors. As a result, the overall effect of the Rights may be to render more difficult or discourage any attempt to acquire us even if such acquisition may be favorable to the interests of our shareholders.

On July 12, 2015, our board of directors adopted and approved an amendment and restatement to our Bylaws (the Amended Bylaws). The Amended Bylaws, among other things, provide for the establishment of a measurement record date for purposes of ascertaining shareholders eligible to call for a special meeting of shareholders and establish certain other procedures relating to the calling of a special meeting of shareholders. The Amended Bylaws also supplement the advanced notice requirements and procedures for the submission by shareholders of nominations for the board of directors and of other proposals to be presented at shareholder meetings, and provide that the exclusive forum for any shareholder to bring any: (i) derivative action, (ii) claim asserting a breach of fiduciary duty, (iii) action under the California Corporations Code or the our organizational documents or (iv) other action relating to our internal affairs, shall in each case be the Santa Clara County Superior Court within the State of California or, if no state court located within the State of California has jurisdiction, the federal district court for the Northern District of California. The Amended Bylaws also make certain other ministerial changes.

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 are subject to a disruptive, hostile takeover proposal.***

Horizon has announced an unsolicited, highly conditional, non-binding proposal to acquire all of our outstanding common stock. Responding to Horizon's unsolicited proposal may distract management attention away from our business and may require us to incur significant costs. Moreover, the hostile and unsolicited nature of the proposal may disrupt our business by causing uncertainty among current and potential

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employees, suppliers, customers, and other constituencies important to our success, which could negatively impact our financial results and business initiatives. In addition to potential disruptions to our business, the unsolicited proposal may impact the timing of, and our ability to consummate strategic transactions with third parties, such as product or company acquisitions, that we believe are complementary to our business.

***We do not intend to pay dividends on our common stock so any returns on shares of our common stock will be limited to changes in the value of our common stock.***

We have never declared or paid any cash dividends on our common stock. We currently anticipate that we will retain future earnings for the development, operation and expansion of our business and do not anticipate declaring or paying any cash dividends for the foreseeable future. In addition, our ability to pay cash dividends on our common stock may be prohibited or limited by the terms of any future debt financing arrangement. Any return to shareholders will therefore be limited to the increase, if any, of our stock price.

***Business interruptions could limit our ability to operate our business.***

Our operations and infrastructure, and those of our partners, third party suppliers and vendors are vulnerable to damage or interruption from cyber-attacks and security breaches, human error, natural disasters, fire, flood, power loss, telecommunications failures, equipment failures, intentional acts of theft, vandalism, terrorism 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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*Our product revenues have historically been lower in the first quarter of the year as compared to the fourth quarter of the preceding year which may cause our stock price to decline.*

Our product revenues have historically been lower in the first quarter of the year as compared to the fourth quarter of the preceding year. We believe this arises primarily as a result of the reduction by our wholesalers of inventory of our products in the first quarter and annual changes in health insurance plans that occur at the beginning of the calendar year.

In 2013 and 2014, our wholesalers ended the calendar year with higher levels of inventory of our products than at the end of the first quarter of the following year. As a result, in the first quarter of 2014 and 2015, product shipments were lower than prescription demand and net sales decreased as a result of the reduction of product inventory at our wholesalers. Any material reduction by our wholesalers of their inventory of our products in the first quarter of any calendar year as compared to the fourth quarter of the preceding calendar year, could adversely affect our operating results and may cause our stock price to decline.

Many health insurance plans and government programs reset annual limits on deductibles and out-of-pocket costs at the beginning of each calendar year and require participants to pay for substantially all of the costs of medical services and prescription drug products until such deductibles and annual out-of-pocket cost limits are met. In addition, enrollment in high-deductible health insurance plans has increased significantly in recent years. As a result of these factors, patients may delay filling or refilling prescriptions for our products or substitute less expensive generic products until such deductibles and annual out-of-pocket cost limits are met. Any reduction in the demand for our products, including as a result of the foregoing factors, could adversely affect our business, operating results and financial condition.

**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.

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**ITEM 6. EXHIBITS**

(a) Exhibits

- 3.1 (1) Amended and Restated Articles of Incorporation
- 3.2 (2) Certificate of Amendment to Amended and Restated Articles of Incorporation
- 3.3 (3) Certificate of Determination of Series RP Preferred Stock of the Company
- 3.4 (4) Certificate of Amendment to Certificate of Determination of Series RP Preferred Stock of Depomed, Inc.
- 3.5 (4) Certificate of Determination of Series B Junior Participating Preferred Stock of Depomed, Inc.
- 3.6 (5) Certificate of Amendment to Certificate of Determination of Series A Preferred Stock of Depomed, Inc.
- 3.7 (4) Bylaws, as amended
- 4.1 (4) Rights Agreement as of July 12, 2015 between Depomed, Inc. and Continental Stock Transfer & Trust
- 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

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- (1) Incorporated by reference to the Company's registration statement on Form SB-2 (File No. 333-25445)
  - (2) Incorporated by reference to the Company's Form 10-K filed on March 31, 2003
  - (3) Incorporated by reference to the Company's Form 10-Q filed on May 10, 2005
  - (4) Incorporated by reference to the Company's Form 8-K filed on July 13, 2015
  - (5) Incorporated by reference to the Company's Form 8-K filed on July 29, 2015
  
  - (\*) Filed herewith

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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 3, 2015

DEPOMED, INC.

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

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