THERAVANCE INC
Form 10-Q
August 03, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2011

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: 0-30319

THERAVANCE, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware	**94-3265960**
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

901 Gateway Boulevard

South San Francisco, CA 94080

(Address of Principal Executive Offices including Zip Code)

(650) 808-6000

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant: (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes x No o

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

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See definitions of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer o	Accelerated filer x
Non-accelerated filer o (Do not check if a smaller reporting company)	Smaller reporting company o

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

The number of shares of registrant s common stock outstanding on July 27, 2011 was 84,766,987

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PART I FINANCIAL INFORMATION

Item 1. Financial Statements

THERAVANCE, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except per share data)

	June 30, 2011 (Unaudited)	December 31, 2010 *
Assets		
Current assets:		
Cash and cash equivalents	$ 90,658	$ 163,333
Marketable securities	193,229	146,301
Accounts receivable from related party	32	194
Notes receivable	200	531
Prepaid expenses and other current assets	4,506	5,995
Total current assets	288,625	316,354
Restricted cash	893	893
Property and equipment, net	10,334	10,215
Notes receivable	340	400
Other assets	2,928	3,340
Total assets	$ 303,120	$ 331,202
Liabilities and stockholders net capital deficiency		
Current liabilities:		
Accounts payable	$ 2,165	$ 2,128
Accrued personnel-related expenses	5,154	8,617
Accrued clinical and development expenses	2,850	2,801
Accrued interest on convertible subordinated notes	2,372	2,372
Other current liabilities	1,935	2,008
Note payable and capital lease, current	162	206
Deferred revenue, current	20,553	21,922
Total current liabilities	35,191	40,054
Convertible subordinated notes	172,500	172,500
Deferred rent, non-current	5,518	3,574
Note payable and capital lease, non-current		69
Deferred revenue	127,393	137,425
Commitments and contingencies (Notes 4, 8 and 9)		
Stockholders net capital deficiency:		
Common stock, $0.01 par value; authorized: 200,000 shares; outstanding: 75,365 at June 30, 2011 and 70,950 at December 31, 2010	754	710

Class A common stock, $0.01 par value; authorized: 30,000 shares; outstanding: 9,402 at June 30, 2011 and December 31, 2010		94		94
Additional paid-in capital		1,210,006		1,177,359
Accumulated other comprehensive income (loss)		(8)		33
Accumulated deficit		(1,248,328)		(1,200,616)
Total stockholders net capital deficiency		(37,482)		(22,420)
Total liabilities and stockholders net capital deficiency	$	303,120	$	331,202

* Condensed consolidated balance sheet at December 31, 2010 has been derived from audited consolidated financial statements.

See accompanying notes to condensed consolidated financial statements.

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THERAVANCE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	**2010**	**2011**	**2010**
Revenue (including amounts from a related party of $2,456 for the three months ended June 30, 2011 and 2010, and $4,913 for the six months ended June 30, 2011 and 2010)	$ 6,389	$ 6,264	$ 12,719	$ 11,979
Operating expenses:				
Research and development	22,798	18,705	43,262	39,057
General and administrative	7,248	6,991	14,417	13,467
Total operating expenses	30,046	25,696	57,679	52,524
Loss from operations	(23,657)	(19,432)	(44,960)	(40,545)
Interest income	118	134	263	229
Interest expense	(1,506)	(1,508)	(3,015)	(3,025)
Net loss	$ (25,045)	$ (20,806)	$ (47,712)	$ (43,341)
Basic and diluted net loss per share	$ (0.31)	$ (0.28)	$ (0.59)	$ (0.63)
Shares used in computing basic and diluted net loss per share	81,811	73,282	81,415	69,124

See accompanying notes to condensed consolidated financial statements.

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THERAVANCE, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Six Months Ended June 30,	
	2011	**2010**
Cash flows from operating activities		
Net loss	$ (47,712)	$ (43,341)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	3,407	3,137
Stock-based compensation	11,134	9,820
Forgiveness of notes receivable	1	4
Changes in operating assets and liabilities:		
Receivables	(53)	(159)
Prepaid expenses and other current assets	1,717	1,364
Accounts payable	813	(283)
Accrued personnel-related expenses, accrued clinical and development expenses, accrued interest on convertible subordinated notes and other current liabilities	(3,488)	(1,571)
Deferred rent	1,932	931
Deferred revenue	(11,401)	(10,400)
Other liabilities, non-current		(389)
Net cash used in operating activities	(43,650)	(40,887)
Cash flows from investing activities		
Purchases of property and equipment	(2,763)	(133)
Purchases of marketable securities	(176,322)	(103,861)
Sales of marketable securities	8,750	
Maturities of marketable securities	119,476	70,000
Release of restricted cash		417
Additions to notes receivable	(140)	
Payments received on notes receivable	530	110
Net cash used in investing activities	(50,469)	(33,467)
Cash flows from financing activities		
Payments on note payable and capital lease	(113)	(89)
Proceeds from issuances of common stock, net	21,557	96,620
Net cash provided by financing activities	21,444	96,531
Net increase (decrease) in cash and cash equivalents	(72,675)	22,177
Cash and cash equivalents at beginning of period	163,333	47,544
Cash and cash equivalents at end of period	$ 90,658	$ 69,721

See accompanying notes to condensed consolidated financial statements.

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Theravance, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation and Significant Accounting Policies

Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Theravance, Inc. (the Company) have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information and the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In the opinion of the Company s management, the unaudited condensed consolidated financial statements have been prepared on the same basis as audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, necessary for the fair presentation of the Company s financial position, results of operations and cash flows. The interim results are not necessarily indicative of the results of operations to be expected for the year ending December 31, 2011 or any other period.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2010 filed with the Securities and Exchange Commission (SEC) on February 28, 2011.

Principles of Consolidation

The condensed consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Use of Management s Estimates

The preparation of condensed consolidated financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ materially from those estimates.

Other-than-Temporary Impairment Assessment

The Company reviews its investment portfolio to identify and evaluate investments that have indications of possible impairment. Factors considered in determining whether a loss is other-than-temporary include the length of time and extent to which fair value has been less than the cost basis, the financial condition and near-term prospects of the investee, credit quality and the Company s conclusion that it does not intend to sell an impaired investment and is not more likely than not to be required to sell the security before it recovers its amortized cost basis. If the Company determines that the impairment of an investment is other-than-temporary, the investment is written down with a charge recorded in interest income.

Inventory

Inventory is stated at the lower of cost or market value and is included in prepaid and other current assets in the accompanying condensed consolidated balance sheets. Inventory is comprised of VIBATIV® active pharmaceutical ingredient. Inventory was $0.5 million at June 30, 2011 and $1.7 million at December 31, 2010. During the three months ended June 30, 2011, Astellas Pharma Inc. (Astellas) purchased $1.2 million of VIBATIV® inventory from the Company at cost. If Astellas decides not to purchase some or any of the remaining VIBATIV® inventory, the Company will be required to expense a portion of, or the entire remaining, capitalized inventory.

Research and Development Costs

Research and development costs are expensed in the period that services are rendered or goods are received. Research and development costs consist of salaries and benefits, laboratory supplies and facility costs, as well as fees paid to third parties that conduct certain research and development activities on behalf of the Company, net of certain external research costs reimbursed by GlaxoSmithKline plc (GSK) and Astellas.

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Fair Value of Stock-based Compensation Awards

The Company uses the fair value method of accounting for stock-based compensation arrangements. Stock-based compensation arrangements currently include stock options granted, restricted stock unit awards (RSUs) granted, performance-contingent RSUs granted, restricted stock awards (RSAs) granted, and performance-contingent RSAs granted under the 2004 Equity Incentive Plan (2004 Plan) and the 2008 New Employee Equity Incentive Plan (2008 Plan) and purchases of common stock by the Company s employees at a discount to the market price during offering periods under the Company s Employee Stock Purchase Plan (ESPP). Non-statutory options, RSUs, and RSAs were granted under the 2008 Plan to the Company s newly hired employees until April 27, 2010, the date on which stockholders approved the Company s amended and restated 2004 Plan. No further awards will be granted under the 2008 Plan. Stock options were granted with an exercise price not less than 100% of the fair market value of the common stock on the date of grant. Stock options were generally granted with terms of up to ten years and vest over a period of four years.

The Company uses the Black-Scholes valuation model for stock-based payment awards granted. The Company s determination of the fair value of stock-based payment awards on the grant date using the Black-Scholes option valuation model requires the use of assumptions, including the expected term of the award and the expected stock price volatility. The Company used the simplified method as described in Staff Accounting Bulletin No. 107 for the expected option term. Beginning April 1, 2011, the Company used its historical volatility to estimate expected stock price volatility. Prior to April 1, 2011, the Company used peer company price volatility to estimate expected stock price volatility due to the Company s limited historical common stock price volatility since its initial public offering in 2004.

Stock-based compensation expense was calculated based on awards ultimately expected to vest and has been reduced for estimated forfeitures at the time of grant and revised, if necessary, in subsequent periods if actual forfeitures differ from those estimates. The Company s estimated annual forfeiture rates for stock options, RSUs and RSAs are based on its historical forfeiture experience.

The estimated fair value of stock options, RSUs and RSAs is expensed on a straight-line basis over the expected term of the grant and the fair value of performance-contingent RSUs and RSAs is expensed during the term of the award when the Company determines that it is probable that certain performance milestones will be achieved. Compensation expense for purchases under the ESPP is recognized based on the estimated fair value of the common stock during each offering period and purchase discount percentage.

The Company has not recognized, and does not expect to recognize in the near future, any tax benefit related to employee stock-based compensation costs as a result of the full valuation allowance on the Company s net deferred tax assets including deferred tax assets related to its net operating loss carryforwards.

Recent Accounting Updates

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2011-05, Presentation of Comprehensive Income an update to Accounting Standards Codification (ASC) Topic 220, Comprehensive Income . The amendments of this update require that all nonowner changes in stockholders equity be presented either in a single continuous statement of comprehensive income or in two separate but consecutive statements. This update is to be applied retroactively and is effective for financial statements issued for fiscal years, and interim periods within those years, beginning after December 15, 2011, and interim and annual periods thereafter. This update will be

effective for the Company January 1, 2012. The Company does not expect the adoption of this guidance to have a material impact on its condensed consolidated financial statements.

In April 2010, the FASB issued ASU No. 2010-17, Revenue Recognition Milestone Method an update to ASC Topic 605, Revenue Recognition . The amendments of this update provide guidance on defining the milestone and determining when the use of the milestone method of revenue recognition for research and development transactions is appropriate. It provides criteria for evaluating if the milestone is substantive and clarifies that a vendor can recognize consideration that is contingent upon achievement of a milestone as revenue in the period in which the milestone is achieved, if the milestone meets all the criteria to be considered substantive. The guidance became effective on a prospective basis in fiscal years beginning on or after June 15, 2010 and early adoption was permitted. The Company elected to adopt the milestone method of revenue recognition on a prospective basis effective January 1, 2011. The election of the milestone method did not have a material impact on the Company s condensed consolidated financial statements. However, the election will result in different accounting treatment for future substantive milestones earned after the date of this adoption. Non-substantive milestones will continue to be recognized over the remaining performance period.

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In October 2009, the FASB issued ASU No. 2009-13, Revenue Recognition - Multiple-Deliverable Revenue Arrangements a consensus of the FASB Emerging Issues Task Force , an update to ASC Topic 605, Revenue Recognition . The amendments of this update require companies to allocate the overall consideration to each deliverable by using a best estimate of the selling price of individual deliverables in the arrangement in the absence of vendor specific objective evidence or other third party evidence of the selling price. The guidance became effective on a prospective basis in fiscal years beginning on or after June 15, 2010 and early adoption was permitted. Companies may elect to adopt this guidance prospectively for all revenue arrangements entered into or materially modified after the date of adoption or retrospectively for all periods presented. The Company elected to adopt this update on a prospective basis effective January 1, 2011. The adoption of this update did not have a material impact on the Company s condensed consolidated financial statements. However, the election may result in different accounting treatment for future collaboration arrangements than the accounting treatment applied to previous and existing collaboration arrangements.

2. Net Loss per Share

Basic net loss per share (basic EPS) is computed by dividing net loss by the weighted average number of common shares outstanding during the period, less RSAs subject to forfeiture. Diluted net loss per share (diluted EPS) is computed by dividing net loss by the weighted average number of common shares outstanding during the period, less RSAs subject to forfeiture, plus dilutive potential common shares. Diluted EPS is identical to basic EPS for all periods presented since potential common shares are excluded from the calculation, as their effect is anti-dilutive.

Weighted Average Shares Outstanding

The following table sets forth the computation of basic and diluted net loss and the weighted average number of shares used in computing basic and diluted net loss per share:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands, except for per share amounts)	**2011**	**2010**	**2011**	**2010**
Net loss	$ (25,045)	$ (20,806)	$ (47,712)	$ (43,341)
Weighted average shares of common stock outstanding	84,263	73,339	83,867	69,181
Less: unvested RSAs	(2,452)	(57)	(2,452)	(57)
Weighted average shares used in computing basic and diluted net loss per common share	81,811	73,282	81,415	69,124
Basic and diluted net loss per common share	$ (0.31)	$ (0.28)	$ (0.59)	$ (0.63)

Anti-dilutive securities

Securities that could potentially dilute basic EPS in the future that were not included in the computation of diluted EPS because their effect would have been anti-dilutive were as follows:

(in thousands)	Three Months Ended June 30, 2011	2010	Six Months Ended June 30, 2011	2010
Shares issuable upon the exercise of stock options	4,500	6,191	4,663	6,016
Shares issuable under RSUs and RSAs	944	770	929	881
Shares issuable upon the conversion of convertible debt	6,668	6,668	6,668	6,668
Total anti-dilutive securities	12,112	13,629	12,260	13,565

3. Comprehensive Loss

Comprehensive loss is comprised of net loss and changes in other comprehensive loss, which consists of unrealized gains and losses on the Company s marketable securities. Comprehensive loss was as follows:

(in thousands)	Three Months Ended June 30, 2011	2010	Six Months Ended June 30, 2011	2010
Net loss	$ (25,045)	$ (20,806)	$ (47,712)	$ (43,341)
Other comprehensive loss:				
Net unrealized loss on available-for-sale securities	(36)	(8)	(41)	(61)
Comprehensive loss	$ (25,081)	$ (20,814)	$ (47,753)	$ (42,402)

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4. Collaboration Arrangements

LABA collaboration with GSK

In November 2002, the Company entered into its long-acting beta2 agonist (LABA) collaboration with GSK to develop and commercialize once-daily LABA products for the treatment of chronic obstructive pulmonary disease (COPD) and asthma. For the treatment of COPD, the collaboration is developing combination products, RELOVAIR and the LAMA/LABA (GSK573719/vilanterol or 719/VI). For the treatment of asthma, the collaboration is developing RELOVAIR . RELOVAIR is an investigational once-daily combination medicine consisting of a LABA, VI, previously referred to as GW642444 or 444, and an inhaled corticosteroid (ICS), fluticasone furoate (FF). The LAMA/LABA, 719/VI, is an investigational once-daily combination medicine consisting of the long-acting muscarinic antagonist (LAMA) 719, and the LABA, VI.

The current lead product candidates in the LABA collaboration, VI and FF, were discovered by GSK. In the event that VI is successfully developed and commercialized, the Company will be obligated to make milestone payments to GSK which could total as much as $220.0 million if both a single-agent and a combination product or two different combination products are launched in multiple regions of the world. If the results of the Phase 3 studies with RELOVAIR are positive, a portion of these potential milestone payments could be payable to GSK within the next two years. The Company is entitled to annual royalties from GSK of 15% on the first $3.0 billion of annual global net sales and 5% for all annual global net sales above $3.0 billion. Sales of single-agent LABA medicines and combination medicines would be combined for the purposes of this royalty calculation. For other products combined with a LABA from the LABA collaboration, such as 719/VI, royalties are upward tiering and range from the mid-single digits to 10%. However, if GSK is not selling a LABA/ICS combination product at the time that the first other LABA combination is launched, then the royalties described above for the LABA/ICS combination medicine would be applicable.

In connection with the LABA collaboration, in 2002, GSK purchased through an affiliate shares of the Company s Series E preferred stock for an aggregate purchase price of $40.0 million.

Strategic Alliance with GSK

In March 2004, the Company entered into its strategic alliance with GSK. Under this alliance, GSK received an option to license exclusive development and commercialization rights to product candidates from all of the Company s full drug discovery programs initiated prior to September 1, 2007, on pre-determined terms and on an exclusive, worldwide basis. Pursuant to the terms of the strategic alliance agreement, the Company initiated three new full discovery programs between May 2004 and August 2007. These three programs are (i) the oral Peripheral Mu Opioid Receptor Antagonist (PμMA) program for opioid-induced constipation, (ii) the AT1 Receptor-Neprilysin Inhibitor (ARNI) program for cardiovascular disease and (iii) the MonoAmine Reuptake Inhibitor (MARIN) program for chronic pain. GSK still has the right to license the ARNI and MARIN programs, and must exercise this right no later than sixty days subsequent to the final delivery to GSK of all material, data and supporting documentation relating to achievement of clinical proof-of-concept of the first product candidate in the applicable program. For these two programs, proof-of-concept is generally defined as the successful completion of a Phase 2a clinical study showing efficacy and tolerability. Under the terms of the strategic alliance agreement, GSK has only one opportunity to license each of the Company s programs.

Upon GSK s decision to license a program, GSK is responsible for funding all future development, manufacturing and commercialization activities for product candidates in that program. In addition, GSK is obligated to use diligent efforts to develop and commercialize product candidates from any program that it licenses. Consistent with the Company s strategy, the Company is obligated to use diligent efforts at the Company s sole cost to discover two structurally different product candidates for any programs on which GSK has an option under the alliance. If these programs are successfully advanced through development by GSK, the Company is entitled to receive clinical, regulatory and commercial milestone payments and royalties on any sales of medicines developed from these programs. For any programs licensed under this agreement, the royalty structure for a product containing one of the Company s compounds as a single active ingredient would result in an average percentage royalty rate in the low double digits. For single-agent MABA products, the Company is entitled to receive royalties from GSK of between 10% and 20% of annual global net sales up to $3.5 billion, and 7.5% for all annual global net sales above $3.5 billion. For combination products, such as a MABA/ICS, the royalty rate is 70% of the rate applicable to sales of single-agent MABA medicines. If a product is successfully commercialized, in addition to any royalty revenue that the Company receives, the total upfront and milestone payments that the Company could receive in any given program that GSK licenses range from $130.0 million to $162.0 million for programs with single-agent medicines and up to $252.0 million for programs with both a single-agent and a combination medicine. If GSK chooses not to license a program, the Company retains all rights to the program and may continue the program alone or with a third party. To date, GSK has licensed the Company s two COPD programs: LAMA and MABA. In 2009, GSK returned the LAMA program to the Company because the formulation of the lead product candidate was incompatible with GSK s proprietary inhaler device. GSK has chosen not to license the Company s antibacterial, anesthesia, 5-HT4 and PµMA programs.

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In May 2004, GSK purchased through an affiliate 6,387,096 shares of the Company s Class A common stock for an aggregate purchase price of $108.9 million and, upon the closing of the Company s initial public offering on October 8, 2004, GSK purchased through an affiliate an additional 433,757 shares of Class A common stock for an aggregate purchase price of $6.9 million. In addition, GSK purchased through an affiliate in a private placement 5,750,000 shares of the Company s common stock for an aggregate purchase price of $129.4 million on November 29, 2010. On February 24, 2011 and May 3, 2011, GSK purchased through an affiliate 152,278 shares and 261,299 shares, respectively, of the Company s common stock from the Company for an aggregate purchase price of $3.6 million and $6.7 million, respectively, pursuant to its rights under the Company s governance agreement with GSK dated June 4, 2004, as amended.

GSK Upfront Fees, Milestone Payments and Revenue

Upfront fees and certain milestone payments have been deferred and are being amortized ratably into revenue over the estimated period of performance (the product development period). Upfront fees and milestone payments received from GSK under the LABA collaboration and strategic alliance agreements were as follows:

	Through June 30, 2011		
(in thousands)	**Upfront Fees**	**Milestone Payments**	**Total**
GSK Collaborations			
LABA/RELOVAIR collaboration(1)	$ 10,000	$ 50,000	$ 60,000
Strategic alliance agreement	20,000		20,000
Strategic alliance LAMA license(2)	5,000	3,000	8,000
Strategic alliance MABA license	5,000	13,000	18,000
Total	$ 40,000	$ 66,000	$ 106,000

(1) The Company does not currently expect to be eligible for any additional milestones under this collaboration.

(2) In August 2004, GSK exercised its right to license the Company s LAMA program pursuant to the terms of the strategic alliance. In 2009, GSK returned the program to the Company.

The eligible milestones related to the MABA program and any future milestones that may be earned if GSK exercises its right to license either ARNI or MARIN are not deemed substantive due to the fact that the outcome predominantly relates to GSK s performance of future development, manufacturing and commercialization activities for product candidates after licensing the program.

Revenue recognized through amortization of the deferred upfront fees and milestone payments from GSK under the LABA collaboration and strategic alliance agreement was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	**2011**	**2010**	**2011**	**2010**

GSK Collaborations				
LABA/ RELOVAIR collaboration	$ 1,270	$ 1,270	$ 2,540	$ 2,540
Strategic alliance agreement	684	684	1,369	1,369
Strategic alliance MABA license	502	502	1,004	1,004
Total	$ 2,456	$ 2,456	$ 4,913	$ 4,913

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License, Development and Commercialization Agreement with Astellas

In November 2005, the Company entered into a collaboration arrangement with Astellas for the development and commercialization of telavancin. In July 2006, Japan was added to the collaboration, thereby giving Astellas worldwide rights to this medicine. Under this arrangement, the Company is responsible for substantially all costs to develop and obtain U.S. regulatory approval for telavancin and Astellas is responsible for substantially all other costs associated with commercialization of telavancin. The Company is entitled to receive royalties from Astellas on global net sales of VIBATIV® that, on a percentage basis, range from the high teens to the upper twenties depending on sales volume.

Through June 30, 2011, the Company had received $191.0 million in upfront, milestone and other fees from Astellas. The Company recorded these payments as deferred revenue and is amortizing them ratably over its estimated period of performance (development and commercialization period). The Company is eligible to receive up to an additional $15.0 million in milestone payments. The Company has deemed $10.0 million of the remaining potential milestone payments to be substantive as the Company is responsible for substantially all activities to develop and obtain U.S. regulatory approval for telavancin for the treatment of nosocomial pneumonia. However, the Company s management believes the likelihood of achieving this milestone is low. The remaining eligible milestone payment of $5.0 million is not deemed substantive due to the fact that pursuing regulatory approval of telavancin in the regions of the world outside of the U.S. is predominantly the responsibility of Astellas.

Revenue recognized under this collaboration agreement was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	**2011**	**2010**	**2011**	**2010**
Amortization of deferred revenue	$ 3,244	$ 3,244	$ 6,488	$ 6,487
Royalties from net sales of VIBATIV®	694	114	1,324	124
Proceeds from VIBATIV® delivered to Astellas	1,171	1,393	1,171	1,393
Cost of VIBATIV® delivered to Astellas	(1,177)	(943)	(1,177)	(938)
Total net revenue	$ 3,932	$ 3,808	$ 7,806	$ 7,066

5. Marketable Securities

The Company manages, monitors and measures its investments in highly liquid investment grade securities by major security type. Investments in debt securities are accounted for as available-for-sale securities, carried at fair value with unrealized gains and losses reported in accumulated other comprehensive income (loss), held for use in current operations and classified in current assets as marketable securities. The cost of securities sold is based on the specific-identification method.

The estimated fair value amounts were determined using available market information. Available-for-sale debt securities recorded in cash equivalents, marketable securities or restricted cash in the Company s condensed consolidated balance sheets were as follows:

(in thousands)	June 30, 2011 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value	December 31, 2010 Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
U.S. government securities	$ 66,496	$ 28	$ (6)	$ 66,518	$ 25,966	$ 10	$	$ 25,976
U.S. government agencies	77,717	18	(39)	77,696	54,625	30	(7)	54,648
U.S. corporate notes	21,100	1	(10)	21,091	34,695	9	(9)	34,695
U.S. commercial paper	44,356			44,356	97,221			97,221
Money market funds	72,393			72,393	91,805			91,805
Total	282,062	47	(55)	282,054	304,312	49	(16)	304,345
Less amounts classified as cash equivalents	(87,932)			(87,932)	(157,151)			(157,151)
Less amounts classified as restricted cash	(893)			(893)	(893)			(893)
Amounts classified as marketable securities	$ 193,237	$ 47	$ (55)	$ 193,229	$ 146,268	$ 49	$ (16)	$ 146,301

At June 30, 2011, all of the marketable securities had contractual maturities within twelve months and the average duration of marketable securities was approximately seven months. The Company does not intend to sell the investments which are in an unrealized loss position and it is unlikely that the Company will be required to sell the investments before recovery of their amortized cost basis, which may be maturity. The Company has determined that the gross unrealized losses on its marketable securities at June 30, 2011 were temporary in nature. All marketable securities with unrealized losses have been in a loss position for less than twelve months.

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6. Fair Value Measurements

The Company defines fair value 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.

The Company s valuation techniques are based on observable and unobservable inputs. Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs reflect the Company s market assumptions. The Company classifies these inputs into the following hierarchy:

Level 1 Inputs Quoted prices for identical instruments in active markets.

Level 2 Inputs Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations whose inputs are observable or whose significant value drivers are observable.

Level 3 Inputs Unobservable inputs and little, if any, market activity for the assets.

The estimated fair values of the Company s financial assets were as follows:

	June 30, 2011 Fair Value Measurements at Reporting Date Using			
(in thousands)	Quoted Prices in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total
U.S. government securities	$ 66,518	$	$	$ 66,518
U.S. government agency securities	63,874	13,822		77,696
U.S. corporate notes	20,522	569		21,091
U.S. commercial paper		44,356		44,356
Money market funds	72,393			72,393
Total	$ 223,307	$ 58,747	$	$ 282,054

	December 31, 2010 Fair Value Measurements at Reporting Date Using		
	Quoted Prices in Active Markets for Identical Assets	Significant Other Observable Inputs	Significant Unobservable Inputs

(in thousands)	Level 1	Level 2	Level 3	Total
U.S. government securities	$ 25,976	$	$	$ 25,976
U.S. government agency securities	24,375	30,273		54,648
U.S. corporate notes	34,695			34,695
U.S. commercial paper		97,221		97,221
Money market funds	91,805			91,805
Total	$ 176,851	$ 127,494	$	$ 304,345

7. Convertible Subordinated Notes

In January 2008, the Company closed an underwritten public offering of $172.5 million aggregate principal amount of unsecured convertible subordinated notes which will mature on January 15, 2015. The financing raised proceeds, net of issuance costs, of $166.7 million. The notes bear interest at the rate of 3.0% per year; which is payable semi-annually in arrears in cash on January 15 and July 15 of each year, beginning on July 15, 2008.

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The notes are convertible, at the option of the holder, into shares of the Company s common stock at an initial conversion rate of 38.6548 shares per $1,000 principal amount of the notes, subject to adjustment in certain circumstances, which represents an initial conversion price of approximately $25.87 per share. The debt issuance costs, which are included in other long-term assets, are being amortized on a straight-line basis over the life of the notes.

Holders of the notes will be able to require the Company to repurchase some or all of their notes upon the occurrence of a fundamental change (as defined) at 100% of the principal amount of the notes being repurchased plus accrued and unpaid interest. The Company may not redeem the notes prior to January 15, 2012. On or after January 15, 2012 and prior to the maturity date, the Company, upon notice of redemption, may redeem for cash all or part of the notes if the last reported sale price of its common stock has been greater than or equal to 130% of the conversion price then in effect for at least 20 trading days during any 30 consecutive trading day period prior to the date on which it provides notice of redemption. The redemption price will equal 100% of the principal amount of the notes to be redeemed, plus accrued and unpaid interest up to but excluding the redemption date.

The fair value of debt was estimated based on the quoted price of the instrument. The carrying values and estimated fair values for the notes were as follows.

	June 30, 2011		December 31, 2010	
(in thousands)	Carrying Value	Estimated Fair Value	Carrying Value	Estimated Fair Value
Convertible subordinated notes	$ 172,500	$ 190,409	$ 172,500	$ 202,391

8. Operating Lease

The Company leases its South San Francisco, California, facilities under a non-cancelable operating lease. Future minimum lease payments under this lease, exclusive of executory costs, at June 30, 2011, were as follows:

(in thousands)	Minimum Lease Commitments
Years ending December 31:	
Remainder of 2011	$ 2,229
2012	5,429
2013	5,029
2014	4,859
2015	5,005
Thereafter	23,962
Total	$ 46,513

9. Commitments and Contingencies

Guarantees and Indemnifications

The Company indemnifies its officers and directors for certain events or occurrences, subject to certain limits. The Company believes the fair value of these indemnification agreements is minimal. Accordingly, the Company has not recognized any liabilities relating to these agreements as of June 30, 2011.

10. Stock-Based Compensation

Equity Incentive Plan

The 2004 Plan provides for the granting of stock options, stock appreciation rights, RSUs and RSAs to employees, officers, directors and consultants of the Company. Stock options may be granted with an exercise price not less than 100% of the fair market value of the common stock on the date of grant. On April 27, 2010, an amendment and restatement of the 2004 Plan was approved by the Company s stockholders to, among other things, reserve additional shares of common stock for issuance thereunder. As of June 30, 2011, total shares remaining available for issuance under the 2004 Plan were 2,439,637.

Employee Stock Purchase Plan

As of June 30, 2011, a total of 2,025,000 shares of common stock were approved and authorized for issuance under the Employee Stock Purchase Plan (ESPP). Through June 30, 2011, the Company issued 1,419,532 shares under the ESPP at an average price of $9.90 per share.

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Stock-Based Compensation Expense

The allocation of stock-based compensation expense included in the condensed consolidated statements of operations was as follows:

	Three Months Ended June 30,		Six Months Ended June 30,	
(in thousands)	**2011**	**2010**	**2011**	**2010**
Research and development	$ 3,379	$ 2,618	$ 6,511	$ 5,145
General and administrative	2,896	2,704	5,305	4,675
Total	$ 6,275	$ 5,322		