Sorrento Therapeutics, Inc.
Form 10-Q
May 15, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2017

OR

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission file number 001-36150

SORRENTO THERAPEUTICS, INC.

(Exact Name of Registrant as Specified in Its Charter)

Delaware	33-0344842
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification Number)

4955 Directors Place

San Diego, California 92121

(Address of Principal Executive Offices)

(858) 210-3700

(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 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 file, a smaller reporting company or an emerging growth company. See the definitions of "large accelerated filer," "accelerated filer," "smaller reporting company," and "emerging growth company" in Rule 12b-2 of the Exchange Act:

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

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

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

The number of shares of the issuer's common stock, par value $0.0001 per share, outstanding as of April 28, 2017 was 75,309,267.

Sorrento Therapeutics, Inc.

Form 10-Q for the Quarter Ended March 31, 2017

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PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements.

SORRENTO THERAPEUTICS, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(Unaudited)

(In thousands, except for share amounts)

	March 31, 2017	December 31, 2016
ASSETS		
Current assets:		
Cash and cash equivalents	$33,919	$82,398
Marketable securities	1,265	1,106
Grants and accounts receivables, net	2,338	1,696
Income tax receivable	1,299	1,289
Prepaid expenses and other, net	3,272	3,165
Total current assets	42,093	89,654
Property and equipment, net	16,958	12,707
Intangibles, net	57,469	64,766
Goodwill	36,903	41,548
Investments in common stock	112,008	112,008
Equity method investments	76,046	76,994
Other, net	3,751	3,909
Total assets	$345,228	$401,586
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$11,607	$8,282
Accrued payroll and related benefits	5,001	3,565
Current portion of deferred compensation	—	1,012
Accrued expenses	4,158	4,741
Current portion of deferred revenue	9,666	9,666
Current portion of deferred rent	—	248
Acquisition consideration payable	41,401	48,362
Current portion of debt	—	209
Total current liabilities	71,833	76,085
Long-term debt	26,083	47,107
Deferred tax liabilities	48,764	53,238
Deferred revenue	131,960	134,376

Deferred rent and other	4,482	4,278
Total liabilities	283,122	315,084
Commitments and contingencies		
Equity:		
Sorrento Therapeutics, Inc. equity		
Preferred stock, $0.0001 par value; 100,000,000 shares authorized and no shares issued or outstanding	—	—
Common stock, $0.0001 par value; 750,000,000 shares authorized and 50,887,102 and 50,882,856 shares issued and outstanding at March 31, 2017 and December 31, 2016, respectively	6	6
Additional paid-in capital	304,610	303,865
Accumulated other comprehensive income (loss)	(56)	(118)
Accumulated deficit	(197,316)	(174,252)
Treasury stock, 7,568,182 shares at cost at March 31, 2017, and December 31, 2016, respectively	(49,464)	(49,464)
Total Sorrento Therapeutics, Inc. stockholders' equity	57,780	80,037
Noncontrolling interests	4,326	6,465
Total equity	62,106	86,502
Total liabilities and stockholders' equity	$345,228	$401,586

See accompanying unaudited notes

SORRENTO THERAPEUTICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended March 31,	
	2017	2016
Revenues:		
Grant	$101	$429
Royalty and license	2,417	13
Sales and services	2,356	546
Total revenues	4,874	988
Operating costs and expenses:		
Costs of revenues	1,064	359
Research and development	14,883	7,777
Acquired in-process research and development	200	13,000
General and administrative	11,887	4,495
Intangible amortization	627	111
Gain on contingent liability	(461)	(2,740)
Total operating costs and expenses	28,200	23,002
Loss from operations	(23,326)	(22,014)
Gain on marketable securities	159	—
Gain on expiration of derivative liability	—	5,520
Loss on equity investments	(948)	(499)
Interest expense	(1,609)	(307)
Interest income	225	13
Income (loss) before income tax	(25,499)	(17,287)
Income tax expense (benefit)	(1,696)	—
Net income (loss)	(23,803)	(17,287)
Net loss attributable to noncontrolling interests	(739)	(1,637)
Net income (loss) attributable to Sorrento	$(23,064)	$(15,650)
Net income (loss) per share - basic per share attributable to Sorrento	$(0.45)	$(0.41)
Net income (loss) per share - diluted per share attributable to Sorrento	$(0.45)	$(0.41)
Weighted-average shares used during period - basic per share attributable to Sorrento	50,886	37,965
Weighted-average shares used during period - diluted per share attributable to Sorrento	50,886	37,965

See accompanying unaudited notes

SORRENTO THERAPEUTICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(Unaudited)

(In thousands)

	Three Months Ended March 31,	
	2017	2016
Net loss	$(23,803)	$(17,287)
Other comprehensive income:		
Foreign currency translation adjustments	62	—
Unrealized loss on marketable securities, net of tax	—	(36,889)
Total other comprehensive loss	(23,741)	(54,176)
Comprehensive income (loss) attributable to noncontrolling interests	(739)	(1,637)
Comprehensive income (loss) attributable to Sorrento	$(23,002)	$(52,539)

See accompanying unaudited notes

SORRENTO THERAPEUTICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY

(Unaudited)

(In thousands, except for share amounts)

	Common Stock		Treasury Stock		Additional Paid-in	Accumulated Other Comprehensive	Accumulated	Noncontrolling	
	Shares	Amount	Shares	Amount	Capital	Income (Loss)	Deficit	Interest	Total
Balance, December 31, 2016	50,882,856	$ 6	7,568,182	(49,464)	$303,865	$ (118)	$(174,252)	$ 6,465	$86,502
Scilex acquisition adjustments	—	—	—	—	(627)	—	—	(1,400)	(2,027)
Issuance of common stock with exercise of options	—	—	—	—	—	—	—	—	—
Issuance of common stock for private placement and investments, net	4,246	—	—	—	30	—	—	—	30
Stock-based compensation	—	—	—	—	1,342	—	—	—	1,342
Foreign currency translation adjustment	—	—	—	—	—	62	—	—	62
Hercules warrant	—	—	—	—	—	—	—	—	—
Net loss	—	—	—	—	—	—	(23,064)	(739)	(23,803)
Balance, March 31, 2017	50,887,102	$ 6	7,568,182	(49,464)	$304,610	$ (56)	$(197,316)	$ 4,326	$62,106

Common Stock Treasury Stock Accumulated Noncontrolling

	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Deficit	Interest	Total
Balance, December 31, 2015	37,771,459	$ 4	—	—	$ 184,898	$ 73,579	$ (113,329)	$ (4,214)	$ 140,938
Issuance of common stock with exercise of options	56,676	—	—	—	275	—	—	—	275
Issuance of common stock for private placement and investments, net	560,108	—	—	—	3,486	—	—	—	3,486
Stock-based compensation	—	—	—	—	1,180	—	—	—	1,180
Change in unrealized gain on marketable Securities	—	—	—	—	—	(36,889)	—	—	(36,889)
Net loss	—	—	—	—	—	—	(15,650)	(1,637)	(17,287)
Balance, March 31, 2016	38,388,243	$ 4	—	—	$ 189,839	$ 36,690	$ (128,979)	$ (5,851)	$ 91,703

See accompanying unaudited notes

SORRENTO THERAPEUTICS, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(Unaudited)

(In thousands)

	Three Months Ended March 31,	
	2017	2016
Operating activities		
Net loss	$(23,803)	$(17,287)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,454	545
Non-cash interest expense	310	63
Gain on marketable securities	(159)	—
Amortization of debt issuance costs	166	—
Stock-based compensation	1,342	1,180
Acquired in-process research and development	—	3,000
Provision for doubtful accounts	—	30
Gain on expiration of derivative liability	—	(5,520)
Loss on equity investments	948	499
Gain on contingent liabilities	(461)	(2,740)
Deferred tax provision	(1,686)	—
Changes in operating assets and liabilities:		
Grants and other receivables	(642)	(273)
Accrued payroll	1,436	(1,321)
Prepaid expenses and other	(107)	140
Deposits and other assets	148	—
Accounts payable	2,392	1,787
Deferred revenue	(2,416)	(12)
Deferred rent and other	(44)	—
Accrued expenses and other liabilities	(792)	(277)
Net cash used for operating activities	(21,914)	(20,186)
Investing activities		
Purchases of property and equipment	(4,161)	(596)
Net cash (used in) provided by investing activities	(4,161)	(596)
Financing activities		
Repayment under the amended loan and security agreement	(21,500)	(1,204)
Payments under deferred compensation arrangements	(1,012)	—
Proceeds from issuance of common stock, net of issuance costs	30	3,486
Purchase of treasury stock	—	—
Proceeds from exercise of stock options	—	275
Net cash provided by (used in) financing activities	(22,482)	2,557

Net change in cash and cash equivalents	(48,557)	(18,225)
Net effect of exchange rate changes on cash	78	—
Cash and cash equivalents at beginning of period	82,398	39,038
Cash and cash equivalents at end of period	$33,919	$20,813
Supplemental disclosures:		
Cash paid during the period for:		
Income taxes	$—	$1
Interest paid	$1,300	$307
Supplemental disclosures of non-cash investing and financing activities:		
Change in unrealized gains or (losses) on marketable securities	$—	$(51,183)
Property and equipment costs incurred but not paid	$933	$12

See accompanying unaudited notes

SORRENTO THERAPEUTICS, INC.

NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

MARCH 31, 2017

1. Nature of Operations and Business Activities

Nature of Operations and Basis of Presentation

Sorrento Therapeutics, Inc. (NASDAQ: SRNE), together with its subsidiaries (collectively, the "Company") is a clinical stage biotechnology company focused on delivering clinically meaningful therapies to patients and their families, globally. The Company's primary focus is to transform cancer into a treatable or chronically manageable disease. The Company also has programs assessing the use of its technologies and products in auto-immune, inflammatory, neurodegenerative, infectious diseases and pain indications with high unmet medical needs.

At its core, the Company is an antibody-centric company and leverages its proprietary G-MAB™ library to identify, screen and validate fully human antibodies against high impact oncogenic targets and mutations, immune modulators and intracellular targets. To date, the Company has screened over 100 validated targets and generated a number of fully human antibodies against these targets which are at various stages of preclinical development. These include PD-1, PD-L1, CD38, CD123, CD47, c-MET, VEGFR2, CCR2, OX40, TIGIT and CD137 among others.

The Company's vision is to leverage these antibodies in conjunction with proprietary targeted delivery modalities to generate the next generation of cancer therapeutics. These modalities include proprietary antibody drug conjugates ("ADCs"), bispecific approaches, as well as T-Cell Receptor ("TCR")-like antibodies. With LA Cell, Inc. ("LA Cell"), the Company's joint venture with City of Hope, the Company's objective is to become the global leader in the development of antibodies against intracellular targets such as STAT3, mutant KRAS, MYC, p53 and TAU. Additionally, the Company has acquired and is assessing the regulatory and strategic path forward for its portfolio of late stage biosimilar/biobetter antibodies based on Erbitux®, Remicade®, Xolair®, and Simulect® as these may represent nearer term commercial opportunities.

With each of its programs, the Company aims to tailor its therapies to treat specific stages in the evolution of cancer, from elimination, to equilibrium and escape. In addition, the Company's objective is to focus on tumors that are resistant to current treatments and where the Company can design focused trials based on a genetic signature or biomarker to ensure patients have the best chance of a durable and significant response. The Company has several immuno-oncology programs that are in or near to entering the clinic. These include cellular therapies, an oncolytic virus and a palliative care program targeted to treat intractable cancer pain. Finally, as part of its global aim to provide a wide range of therapeutic products to meet underserved therapeutic markets, the Company has made investments and developed a separate pain focused franchise which the Company believes will serve to provide short term upside to its core thesis.

Through March 31, 2017, the Company had devoted substantially all of its efforts to product development, raising capital and building infrastructure.

The accompanying condensed consolidated financial statements include the accounts of the Company's subsidiaries. For consolidated entities where the Company owns or is exposed to less than 100% of the economics, the Company records net income (loss) attributable to noncontrolling interests in its condensed consolidated statements of operations equal to the percentage of the economic or ownership interest retained in such entities by the respective noncontrolling parties. All intercompany balances and transactions have been eliminated in consolidation.

In the opinion of management, the unaudited financial information for the interim periods presented reflects all adjustments, which are only normal, recurring and necessary for a fair statement of financial position, results of operations and cash flows. These condensed consolidated financial statements should be read in conjunction with the consolidated financial statements included in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016. Operating results for interim periods are not expected to be indicative of operating results for the Company's 2017 fiscal year, or any subsequent period.

2. Liquidity and Going Concern

The accompanying condensed consolidated financial statements have been prepared assuming that the Company will continue as a going concern which contemplates the realization of assets and satisfaction of liabilities in the normal course of business. The Company has incurred substantial net losses and negative operating cash flows and anticipates that it will continue to do so for the foreseeable future as it continues to identify and invest in advancing product candidates, as well as expanding corporate infrastructure.

As of March 31, 2017, the Company had a $30.0 million outstanding principal balance on the long term debt associated with the Loan and Security Agreement, dated November 23, 2016, by and among the Company and certain of its domestic subsidiaries (together with the Company, the "Borrowers") and Hercules Capital, Inc. ("Hercules"), as amended (as so amended, the "Loan Agreement"). The Loan Agreement contains covenants requiring the Company (i) to achieve certain fundraising requirements by certain dates and (ii) to maintain $20 million of U.S. unrestricted cash prior to achieving the corporate and fundraising milestones. As of March 31, 2017, the Company had $33.9 million of cash and cash equivalents, of which a majority is required to be maintained subject to the minimum cash requirement of the Loan Agreement. On April 19, 2017, the Company completed a public offering and received net proceeds of approximately $43.5 million as described in Note 18. The Company's available cash and financing sources will not be sufficient to meet its current and anticipated cash requirements without additional fundraising. Accordingly, these factors, among others, raise substantial doubt about the Company's ability to continue as a going concern.

The Company has plans in place to obtain sufficient additional fundraising to fulfill its operating and capital requirements for the next 12 months and to maintain compliance with the Loan Agreement covenants. The Company's plans include continuing to fund its operating losses and capital funding needs through public or private equity or debt financings, strategic collaborations, licensing arrangements, asset sales, government grants or other arrangements. Although management believes such plans, if executed as planned, should provide the Company sufficient financing to meet its needs, successful completion of such plans is dependent on factors outside of the Company's control. As such, management cannot be certain that that such plans will be effectively implemented within one year after the date that the financial statements are issued.

To the extent the Company is unable to execute on these plans, or is unable to amend the Loan Agreement to maintain compliance with the Loan Agreement covenants, the Company would be in default under the Loan Agreement and the outstanding loan balance may be declared immediately due and payable. Further, the provisions of the Loan Agreement allows for Hercules to exercise a material adverse event clause should the Company incur a material adverse event within the meaning provided by the Loan Agreement, which could include the going concern matters described herein. Should Hercules invoke the material adverse event clause, the outstanding loan balance may be declared immediately due and payable. Although reasonably possible, the Company believes that it is not probable that the material adverse event clause associated with the Loan Agreement will be exercised.

If the Company is unable to raise additional capital in sufficient amounts or on terms acceptable, the Company may have to significantly delay, scale back or discontinue the research, development or commercialization of one or more of its product candidates. The Company may also seek collaborators for one or more of its current or future product candidates at an earlier stage than otherwise would be desirable or on terms that are less favorable than might otherwise be available.

The condensed consolidated financial statements do not reflect any adjustments that might be necessary if the Company is unable to continue as a going concern.

Universal Shelf Registration

In November 2014, the Company filed a universal shelf registration statement on Form S-3 (the "Shelf Registration Statement") with the SEC, which was declared effective by the SEC in December 2014. This Shelf Registration Statement provides the Company with the ability to offer up to $250 million of securities, including equity and other securities as described in the registration statement. Included in the 2014 shelf registration is a sales agreement prospectus covering the offering, issuance and sale by the Company of up to a maximum aggregate offering price of $50.0 million of the Company's common stock that may be issued and sold under a sales agreement with MLV & Co. LLC (the "ATM Facility"). During the twelve months ended December 31, 2016 and the three months ended March 31, 2017, the Company sold approximately $3.6 million and no shares of common stock under the ATM Facility,

respectively. The Company can offer up to $46.4 million of additional shares of common stock under the ATM Facility, subject to certain limitations.

Pursuant to the Shelf Registration Statement, the Company may offer such securities from time to time and through one or more methods of distribution, subject to market conditions and the Company's capital needs. Specific terms and prices will be determined at the time of each offering under a separate prospectus supplement, which will be filed with the SEC at the time of any offering. However, the Company cannot be sure that such additional funds will be available on reasonable terms, or at all.

2016 Private Investment in Public Entity Financing

On April 3, 2016, the Company entered into a Securities Purchase Agreement (the "ABG Purchase Agreement") with ABG SRNE Limited and Ally Bridge LB Healthcare Master Fund Limited (collectively, "Ally Bridge"), pursuant to which, among other things, the Company agreed to issue and sell to Ally Bridge and other purchasers that may be designated by Ally Bridge (collectively, the "ABG Purchasers"), in a private placement transaction (the "ABG Private Placement"), up to $50.0 million in shares of the Company's common stock and warrants to purchase shares of common stock. Upon the closing of the ABG Private Placement, the

Company issued to the ABG Purchasers (1) an aggregate of 9,009,005 shares (the "ABG Shares") of common stock, and (2) warrants to purchase an aggregate of 2,702,700 shares of common stock (each, an "ABG Warrant"). Each ABG Warrant had an exercise price of $8.50 per share, was immediately exercisable upon issuance, had a term of three years and was exercisable on a cash or cashless exercise basis.

Under the terms of the ABG Purchase Agreement, the Company was obligated to prepare and file with the SEC, within 30 days of the closing date of the ABG Private Placement, a registration statement to register for resale the ABG Shares and the shares of common stock issuable upon exercise of each ABG Warrant (the "ABG Warrant Shares"), and may be required to effect certain registrations to register for resale the ABG Shares and the ABG Warrant Shares in connection with certain "piggy-back" registration rights granted to the ABG Purchasers.

On April 3, 2016, the Company also entered into a Securities Purchase Agreement (collectively, the "Additional Purchase Agreements") with each of Beijing Shijilongxin Investment Co., Ltd. ("Beijing Shijilongxin"), FREJOY Investment Management Co., Ltd. ("Frejoy") and Yuhan Corporation ("Yuhan"), pursuant to which, among other things, the Company agreed to issue and sell, in separate private placement transactions: (1) to Beijing Shijilongxin, 8,108,108 shares of common stock, and a warrant to purchase 1,176,471 shares of common stock, for an aggregate purchase price of $45.0 million; (2) to Frejoy, 8,108,108 shares of common stock, and a warrant to purchase 1,176,471 shares of common stock, for an aggregate purchase price of $45.0 million; and (3) to Yuhan, 1,801,802 shares of common stock, and a warrant to purchase 235,294 shares of common stock, for an aggregate purchase price of $10.0 million. The warrants to be issued pursuant to each of the Additional Purchase Agreements (collectively, the "Additional Warrants" and, together with each ABG Warrant, the "Warrants") had an exercise price of $8.50 per share, were immediately exercisable upon issuance, had a term of three years and were exercisable on a cash or cashless exercise basis.

Under the terms of the Additional Purchase Agreements, each of Beijing Shijilongxin, Frejoy and Yuhan had the right to demand, at any time beginning six months after the closing of the transactions contemplated by the applicable Additional Purchase Agreement, that the Company prepare and file with the SEC a registration statement to register for resale such investor's shares of common stock purchased pursuant to the applicable Additional Purchase Agreement and the shares of common stock issuable upon exercise of such investor's Additional Warrant. In addition, the Company may be required to effect certain registrations to register for resale such shares in connection with certain "piggy-back" registration rights granted to Beijing Shijilongxin, Frejoy and Yuhan.

On May 2, 2016, the Company closed its private placement of common stock and warrants with Yuhan for gross proceeds of $10.0 million. Yuhan purchased 1,801,802 shares of common stock at $5.55 per share and a warrant to purchase 235,294 shares of common stock. The warrant was exercisable for three years at an exercise price of $8.50 per share.

Between May 31, 2016 and June 7, 2016, the Company closed on the remainder of the $150.0 million financing with the ABG Purchasers, Beijing Shijilongxin, and Frejoy. The ABG Purchasers led the financing and, together with Beijing Shijilongxin and Frejoy, collectively purchased 25,225,221 shares of common stock at $5.55 per share, and warrants to purchase 5,055,642 shares of common stock for total cash consideration of $86.5 million and secured promissory notes (the "Notes") in an aggregate principal amount of $53.5 million.

On December 31, 2016, the Company entered into Warrant and Note Cancellation and Share Forfeiture Agreements (the "Cancellation and Forfeiture Agreements") with certain investors (the "Investors") that held an aggregate of 7,838,259 shares of common stock and certain of the Warrants granting the right to purchase an aggregate of 1,137,316 shares of common stock. Pursuant to the Cancellation and Forfeiture Agreements, effective December 31, 2016, the Warrants held by the Investors and the Notes, of which $43.5 million was then outstanding, were cancelled and the shares of common stock held by the Investors were forfeited and returned to the Company.

If the Company raises additional funds by issuing equity securities, substantial dilution to existing stockholders would result. If the Company raises additional funds by incurring debt financing, the terms of the debt may involve significant cash payment obligations as well as covenants and specific financial ratios that may restrict the Company's ability to operate its business.

3. Significant Accounting Policies

Use of Estimates

The preparation of consolidated financial statements in conformity with accounting principles generally accepted in the United States of America ("GAAP") requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the financial statements and the reported amounts of expenses during the reporting period. Management believes that these estimates are reasonable; however, actual results may differ from these estimates.

Cash and Cash Equivalents

The Company considers all highly liquid investments purchased with original maturities of three months or less to be cash equivalents. The Company minimizes its credit risk associated with cash and cash equivalents by periodically evaluating the credit quality of its primary financial institution. The balance at times may exceed federally insured limits. The Company has not experienced any losses on such accounts.

Fair Value of Financial Instruments

The Company follows accounting guidance on fair value measurements for financial instruments measured on a recurring basis, as well as for certain assets and liabilities that are initially recorded at their estimated fair values. Fair value is defined as the exit price, or the amount that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. The Company uses the following three-level hierarchy that maximizes the use of observable inputs and minimizes the use of unobservable inputs to value its financial instruments:

- Level 1: Observable inputs such as unadjusted quoted prices in active markets for identical instruments.
- Level 2: Quoted prices for similar instruments that are directly or indirectly observable in the marketplace.
- Level 3: Significant unobservable inputs which are supported by little or no market activity and that are financial instruments whose values are determined using pricing models, discounted cash flow methodologies, or similar techniques, as well as instruments for which the determination of fair value requires significant judgment or estimation.

Financial instruments measured at fair value are classified in their entirety based on the lowest level of input that is significant to the fair value measurement. The Company’s assessment of the significance of a particular input to the fair value measurement in its entirety requires it to make judgments and consider factors specific to the asset or liability. The use of different assumptions and/or estimation methodologies may have a material effect on estimated fair values. Accordingly, the fair value estimates disclosed or initial amounts recorded may not be indicative of the amount that the Company or holders of the instruments could realize in a current market exchange.

The carrying amounts of cash equivalents and marketable securities approximate their fair value based upon quoted market prices. Certain of the Company’s financial instruments are not measured at fair value on a recurring basis, but are recorded at amounts that approximate their fair value due to their liquid or short-term nature, such as cash, accounts receivable and payable, and other financial instruments in current assets or current liabilities.

Marketable Securities

Marketable securities are designated either as trading or available-for-sale securities and are accounted for at fair value. Marketable securities are classified as short-term or long-term based on the nature of the securities and their availability to meet current operating requirements. Marketable securities that are readily available for use in current operations and are classified as short-term available-for-sale securities are reported as a component of current assets in the accompanying condensed consolidated balance sheets. Marketable securities that are not trading securities and are not considered available for use in current operations are classified as long-term available-for-sale securities and are reported as a component of long-term assets in the accompanying condensed consolidated balance sheets.

Securities that are classified as trading are carried at fair value, with changes to fair value reported as a component of income. Securities that are classified as available-for-sale are carried at fair value, with temporary unrealized gains and losses reported as a component of stockholders' equity until their disposition. The cost of securities sold is based on the specific identification method.

All of the Company's marketable securities are subject to a periodic impairment review. The Company recognizes an impairment charge when a decline in the fair value of its investments below the cost basis is judged to be other-than-temporary. For the three months ended March 31, 2017 and 2016, no other-than-temporary impairment charges were recorded.

Grants and Accounts Receivable

Grants receivable at March 31, 2017 and December 31, 2016 represent amounts due under several federal contracts with the National Institute of Allergy and Infectious Diseases ("NIAID"), a division of the National Institutes of Health ("NIH"). The Company considers the grants receivable to be fully collectible; accordingly, no allowance for doubtful amounts has been established. If amounts become uncollectible, they are charged to operations.

Accounts receivable at March 31, 2017 and December 31, 2016 consist of trade receivables from sales and services provided to certain customers, which are generally unsecured and due within 30 days. Estimated credit losses related to trade accounts receivable are recorded as general and administrative expenses and as an allowance for doubtful accounts within grants and accounts receivable, net. The Company reviews reserves and makes adjustments based on historical experience and known collectability issues and disputes. When internal collection efforts on accounts have been exhausted, the accounts are written off by reducing the allowance for doubtful accounts. As of each of March 31, 2017 and December 31, 2016, the allowance for doubtful accounts was $26 thousand.

Property and Equipment

Property and equipment are carried at cost less accumulated depreciation. Depreciation of property and equipment is computed using the straight-line method over the estimated useful lives of the assets, which are generally three to five years. Leasehold improvements are amortized over the lesser of the life of the lease or the life of the asset. Repairs and maintenance are charged to expense as incurred.

Acquisitions and Intangibles

The Company has engaged in business combination activity. The accounting for business combinations requires management to make judgments and estimates of the fair value of assets acquired, including the identification and valuation of intangible assets, as well as liabilities assumed. Such judgments and estimates directly impact the amount of goodwill recognized in connection with each acquisition, as goodwill presents the excess of the purchase price of an acquired business over the fair value of its net tangible and identifiable intangible assets.

During the first quarter of 2017, the Company identified an error in the valuation of acquisition consideration associated with the Scilex Pharmaceuticals Inc. (“Scilex”) acquisition, primarily related to the acquisition consideration payable, resulting in an overstatement of acquisition consideration payable of $6.5 million, and a corresponding overstatement of intangible assets of $6.7 million, goodwill of $4.6 million, deferred income tax liability of $2.8 million, additional paid-in capital of $0.6 million, and noncontrolling interest of $1.4 million as of December 31, 2016. The Company evaluated the materiality of this misstatement from quantitative and qualitative perspectives, and concluded that it was immaterial to the prior periods. Consequently, the Company has corrected this error by recording the adjustment in the Company’s condensed consolidated balance sheet in the quarter ended March 31, 2017.

Goodwill and Other Long-Lived Assets

Goodwill, which has an indefinite useful life, represents the excess of cost over fair value of net assets acquired. Goodwill is reviewed for impairment at least annually during the fourth quarter, or more frequently if events occur indicating the potential for impairment. During its goodwill impairment review, the Company may assess qualitative factors to determine whether it is more likely than not that the fair value of its reporting unit is less than its carrying amount, including goodwill. The qualitative factors include, but are not limited to, macroeconomic conditions, industry and market considerations, and the overall financial performance of the Company. If, after assessing the totality of these qualitative factors, the Company determines that it is not more likely than not that the fair value of its reporting unit is less than its carrying amount, then no additional assessment is deemed necessary. Otherwise, the Company proceeds to perform the two-step test for goodwill impairment. The first step involves comparing the estimated fair value of the reporting unit with its carrying value, including goodwill. If the carrying amount of the reporting unit exceeds its fair value, the Company performs the second step of the goodwill impairment test to determine the amount of loss, which involves comparing the implied fair value of the goodwill to the carrying value of the goodwill. The Company may also elect to bypass the qualitative assessment in a period and elect to proceed to perform the first step of the goodwill impairment test. The Company performed its annual assessment for goodwill impairment in the fourth quarter of 2016, noting no impairment. There have not been any triggering events indicating

the potential for impairment through March 31, 2017.

The Company evaluates its long-lived and intangible assets with definite lives, such as property and equipment, acquired technology, customer relationships, patent and license rights, for impairment by considering competition by products prescribed for the same indication, the likelihood and estimated future entry of non-generic and generic competition with the same or similar indication and other related factors. The factors that drive the estimate of useful life are often uncertain and are reviewed on a periodic basis or when events occur that warrant review. Recoverability is measured by comparison of the assets' book value to future net undiscounted cash flows that the assets are expected to generate. There have not been any impairment losses of long-lived assets through March 31, 2017.

Acquisition Consideration Payable - Gain on Contingent Liabilities

Acquisition consideration payable relates to the Company's acquisition of businesses and various other assets and is recorded on the Company's condensed consolidated balance sheets at fair value and is re-measured at each balance sheet date until such contingent liabilities have been settled, with changes in fair value recorded as gain on contingent liabilities. The Company estimates the fair value of contingent consideration based on level 3 inputs primarily driven by the probability of achieving certain financing or operating related milestones.

The condensed consolidated statements of operations, comprehensive income (loss), stockholders' equity, and of cash flows for the quarter ended March 31, 2016 have been restated to correct for the effects of an immaterial error in the interim period related to the re-measurement of acquisition consideration payable. As a result of the restatement, an adjustment of $2.7 million to gain on contingent liabilities has been reflected in operating costs and expenses in the condensed consolidated statements of operations for the three months ended March 31, 2016. This adjustment includes a gain of $991 thousand that relates to 2015 but was recognized in 2016. As a result of this adjustment, the financial results for the quarter ended March 31, 2016 reflect the impact of the adjustment which resulted in a decrease in operating costs and expenses from $25.7 million to $23.0 million, a decrease in net loss attributable to the Company from $18.4 million to $15.7 million, and a decrease in net loss per share from ($0.48) to ($0.41) for the quarter ended March 31, 2016.

Derivative Liability

Derivative liabilities are recorded on the Company's condensed consolidated balance sheets at their fair value on the date of issuance and are revalued on each balance sheet date until such instruments are exercised or expire, with changes in the fair value between reporting periods recorded as other income or expense. The Company estimates the fair value of derivative liabilities using the Black-Scholes option pricing model.

Investments in Other Entities

The Company holds a portfolio of investments in equity securities that are accounted for under either the equity method or cost method. Investments in entities over which the Company has significant influence but not a controlling interest are accounted for using the equity method, with the Company's share of earnings or losses reported in loss on equity investments.

The Company's cost method investments are included in investments in common stock on the condensed consolidated balance sheets. The Company's equity method investments are included in equity method investments on the condensed consolidated balance sheets.

All investments are reviewed on a regular basis for possible impairment. If an investment's fair value is determined to be less than its net carrying value and the decline is determined to be other-than-temporary, the investment is written down to its fair value. Such an evaluation is judgmental and dependent on specific facts and circumstances. Factors considered in determining whether an other-than-temporary decline in value has occurred include: the magnitude of the impairment and length of time that the market value was below the cost basis; financial condition and business prospects of the investee; the Company's intent and ability to retain the investment for a sufficient period of time to allow for recovery in market value of the investment; issues that raise concerns about the investee's ability to continue as a going concern; any other information that the Company may be aware of related to the investment. The Company does not report the fair value of its equity investments in non-publicly traded companies because it is not practical to do so.

Research and Development Costs and Collaborations

All research and development costs are charged to expense as incurred. Such costs primarily consist of lab supplies, contract services, stock-based compensation expense, salaries and related benefits.

Acquired In-Process Research and Development Expense

The Company has acquired and may continue to acquire the rights to develop and commercialize new drug candidates. The up-front payments to acquire a new drug compound, as well as future milestone payments, are immediately expensed as acquired in-process research and development provided that the drug has not achieved regulatory approval for marketing and, absent obtaining such approval, have no alternative future use. Prior to November 8, 2016, all acquired IPR&D was expensed immediately. The acquired in-process research and development related to the business combination of Scilex Pharmaceuticals Inc. (“Scilex”) for which certain products are under development and expected to be commercialized in the near future was capitalized and recorded within “Intangibles, net” on the accompanying condensed consolidated balance sheet. Capitalized IPR&D will be reviewed annually for

impairment or more frequently as changes in circumstance or the occurrence of events suggest that the remaining value may not be recoverable.

Income Taxes

The provisions of the Financial Accounting Standards Board ("FASB") Accounting Standards Codification ("ASC") Topic 740 "Income Taxes," addresses the determination of whether tax benefits claimed or expected to be claimed on a tax return should be recorded in the financial statements. Under ASC Topic 740-10, the Company may recognize the tax benefit from an uncertain tax position only if it is more likely than not that the tax position will be sustained on examination by taxing authorities, based on the technical merits of the position. The Company has determined that it has uncertain tax positions.

The Company accounts for income taxes using the asset and liability method to compute the differences between the tax basis of assets and liabilities and the related financial amounts, using currently enacted tax rates.

The Company has deferred tax assets, which are subject to periodic recoverability assessments. Valuation allowances are established, when necessary, to reduce deferred tax assets to the amount that more likely than not will be realized. As of each of December 31, 2016 and March 31, 2017, the Company maintained a full valuation allowance against its deferred tax assets, with the exception of an amount equal to its deferred tax liabilities, which can be expected to reverse over a definite life, an amount equal to its alternative minimum tax credits and state research and development tax credits for which there is no expiration and the deferred tax assets related to its Scilex investment.

Revenue Recognition

The Company's revenues are generated primarily from license fees, various NIH grant awards, and from the sale of customized reagents and the provision of contract development services. The revenue from the NIH grant awards is based upon subcontractor and internal costs incurred that are specifically covered by the grant, and where applicable, a facilities and administrative rate that provides funding for overhead expenses. These revenues are recognized when expenses have been incurred by subcontractors or when the Company incurs internal expenses that are related to the grant.

License fees for the licensing of product rights are recorded as deferred revenue upon receipt of cash and recognized as revenue on a straight-line basis over the license period.

Revenues from sales are generated from the sale of customized reagents which include industrial standard cytotoxins, linkers, and linker-toxins used for preparing ADCs. Contract development services include providing synthetic expertise to customers' synthesis by delivering proprietary cytotoxins, linkers and linker-toxins and ADC service using industry standard toxin and antibodies provided by customers. Revenue is recognized when, (i) persuasive evidence of an arrangement exists, (ii) the product has been shipped or the services have been rendered, (iii) the price is fixed or determinable, and (iv) collectability is reasonably assured. Royalty revenues will be recognized as earned per the terms of underlying royalty bearing contracts.

The Company is obligated to accept from customers the return of products sold that are damaged or do not meet certain specifications. The Company may authorize the return of products sold in accordance with the terms of its sales contracts, and estimates allowances for such amounts at the time of sale. The Company has not experienced any sales returns.

Stock-based Compensation

The Company accounts for stock-based compensation in accordance with FASB ASC Topic 718 “Compensation – Stock Compensation,” which establishes accounting for equity instruments exchanged for employee services. Under such provisions, stock-based compensation cost is generally measured at the grant date, based on the calculated fair value of the award and an estimate of forfeitures, and is recognized as an expense, under the straight-line method, over the employee’s requisite service period (generally the vesting period of the equity grant).

The Company accounts for equity instruments, including restricted stock or stock options, issued to non-employees in accordance with authoritative guidance for equity based payments to non-employees. Stock options issued to non-employees are accounted for at their estimated fair value determined using the Black-Scholes option-pricing model. The fair value of options and restricted stock granted to non-employees is re-measured over the vesting period, and the resulting changes in fair value are recognized as expense in the period of the change in proportion to the services rendered to date.

Comprehensive (Loss) Income

Comprehensive loss is primarily comprised of net loss and adjustments for the change in unrealized gains and losses on the Company's investments in available-for-sale marketable securities, net of taxes. The Company displays comprehensive loss and its components in its condensed consolidated statements of comprehensive (loss) income.

Net Loss per Share

Basic net loss per share is computed by dividing net loss for the period by the weighted average number of common shares outstanding during the period. Diluted net loss per share reflects the additional dilution from potential issuances of common stock, such as stock issuable pursuant to the exercise of stock options or the exercise of outstanding warrants. The treasury stock method and if-converted method are used to calculate the potential dilutive effect of these common stock equivalents. Potentially dilutive shares are excluded from the computation of diluted net loss per share when their effect is anti-dilutive. In periods where a net loss is presented, all potentially dilutive securities are anti-dilutive and are excluded from the computation of diluted net loss per share.

Segment Information

The Company is engaged primarily in the discovery and development of innovative therapies focused on oncology and the treatment of chronic cancer pain as well as immunology and infectious diseases based on its platform technologies. Accordingly, the Company has determined that it operates in one operating segment.

Recent Accounting Pronouncements

In May 2014, the FASB issued Accounting Standards Update ("ASU") No. 2014-09, Revenue from Contracts with Customers (Topic 606), which supersedes all existing revenue recognition requirements, including most industry-specific guidance. The new standard requires a company to recognize revenue when it transfers goods or services to customers in an amount that reflects the consideration that the company expects to receive for those goods or services. ASU No. 20