ARENA PHARMACEUTICALS INC
Form 10-Q
May 11, 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 March 31, 2015

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: 000-31161

ARENA PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**23-2908305**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**
6154 Nancy Ridge Drive, San Diego, CA	**92121**
(Address of principal executive offices)	**(Zip Code)**

858.453.7200

(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. x 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 x 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. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act.

Large accelerated filer x	Accelerated filer ¨
Non-accelerated filer ¨ (Do not check if a smaller reporting company)	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 x No

The number of shares of common stock outstanding as of the close of business on May 6, 2015:

Class	**Number of Shares Outstanding**
Common Stock, $0.0001 par value	242,039,838

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ARENA PHARMACEUTICALS, INC.

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TRADEMARKS AND CERTAIN TERMS

Arena Pharmaceuticals®, Arena® and our corporate logo are registered service marks of Arena. BELVIQ® and BELVIQ XR® are registered trademarks of our wholly owned subsidiary, Arena Pharmaceuticals GmbH. Any other brand names or trademarks appearing in this Quarterly Report on Form 10-Q are the property of their respective holders.

In this Quarterly Report on Form 10-Q, Arena Pharmaceuticals, Arena, we, us and our refer to Arena Pharmaceu Inc., and our wholly owned subsidiaries on a consolidated basis, unless the context otherwise provides. APD is an abbreviation for Arena Pharmaceuticals Development.

Lorcaserin has been approved for marketing in the United States and South Korea for weight management, and is being commercialized under the brand name BELVIQ (which is pronounced as BEL-VEEK). There are pending applications for the regulatory approval of lorcaserin for weight management in a number of additional territories, and we intend to investigate lorcaserin s potential using different formulations, in combination with other agents and for other possible indications.

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PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

ARENA PHARMACEUTICALS, INC.

Condensed Consolidated Balance Sheets

(In thousands)

	March 31, 2015 (Unaudited)	December 31, 2014[1]
Assets		
Current assets:		
Cash and cash equivalents	$ 240,981	$ 163,209
Accounts receivable	12,209	3,712
Inventory	11,386	10,831
Prepaid expenses and other current assets	4,048	4,144
Total current assets	268,624	181,896
Land, property and equipment, net	82,096	82,919
Intangibles, net	8,500	8,482
Other non-current assets	3,069	3,088
Total assets	$ 362,289	$ 276,385
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable and other accrued liabilities	$ 7,124	$ 10,209
Accrued clinical and preclinical study fees	5,449	7,027
Payable to Eisai	22,472	23,705
Payable to Siegfried for acquisition of land and building	8,396	8,217
Current portion of deferred revenues	26,291	15,238
Derivative liabilities	2,023	474
Current portion of lease financing obligations	2,609	2,492
Total current liabilities	74,364	67,362
Deferred rent	398	369
Deferred revenues, less current portion	91,035	93,064
Lease financing obligations, less current portion	67,558	68,245
Commitments and contingencies		
Stockholders equity:		
Common stock	24	22

Additional paid-in capital	1,418,683	1,312,656
Accumulated other comprehensive income	2,763	2,908
Accumulated deficit	(1,292,536)	(1,268,241)
Total stockholders equity	128,934	47,345
Total liabilities and stockholders equity	$ 362,289	$ 276,385

[1] The balance sheet data at December 31, 2014, has been derived from audited financial statements at that date. It does not include, however, all of the information and notes required by US generally accepted accounting principles for complete financial statements.

See accompanying notes to unaudited condensed consolidated financial statements.

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ARENA PHARMACEUTICALS, INC.

Condensed Consolidated Statements of Operations and Comprehensive Income (Loss)

(In thousands, except per share data)

(Unaudited)

	Three months ended March 31,	
	2015	**2014**
Revenues:		
Net product sales	$ 6,618	$ 2,882
Other Eisai collaborative revenue	2,136	3,347
Toll manufacturing	346	448
Other collaborative revenue	3,156	137
Total revenues	12,256	6,814
Operating Costs and Expenses:		
Cost of product sales	3,191	831
Cost of toll manufacturing	402	496
Research and development	21,968	20,988
General and administrative	8,439	8,037
Total operating costs and expenses	34,000	30,352
Loss from operations	(21,744)	(23,538)
Interest and Other Income (Expense):		
Interest income	34	29
Interest expense	(1,696)	(1,747)
Loss from valuation of derivative liabilities	(1,549)	(110)
Other	660	111
Total interest and other expense, net	(2,551)	(1,717)
Net loss	$ (24,295)	$ (25,255)
Net loss per share:		
Basic	$ (0.10)	$ (0.12)
Diluted	$ (0.10)	$ (0.12)
Shares used in calculating net loss per share:		
Basic	235,703	219,222

Diluted	235,703	219,222
Comprehensive Income (Loss):		
Net loss	$ (24,295)	$ (25,255)
Foreign currency translation gain (loss)	(145)	91
Unrealized gain on available-for-sale securities	0	53,234
Comprehensive income (loss)	$ (24,440)	$ 28,070

See accompanying notes to unaudited condensed consolidated financial statements.

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ARENA PHARMACEUTICALS, INC.

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Three months ended March 31,	
	2015	**2014**
Operating Activities		
Net loss	$ (24,295)	$ (25,255)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	2,425	1,992
Amortization of intangibles	27	181
Share-based compensation	3,833	3,201
Loss from valuation of derivative liabilities	1,549	110
Amortization of prepaid financing costs	34	34
Gain on sale of equipment	0	(45)
Changes in assets and liabilities:		
Accounts receivable	(8,612)	8,934
Inventory	(197)	903
Prepaid expenses and other assets	257	(2,806)
Payables and accrued liabilities	(6,711)	(1,613)
Deferred revenues	8,644	(4,786)
Deferred rent	29	34
Net cash used in operating activities	(23,017)	(19,116)
Investing Activities		
Purchases of property and equipment	(1,069)	(2,469)
Proceeds from sale of equipment	0	45
Other non-current assets	0	209
Net cash used in investing activities	(1,069)	(2,215)
Financing Activities		
Principal payments on lease financing obligations	(570)	(466)
Proceeds from issuance of common stock	101,979	2,927
Net cash provided by financing activities	101,409	2,461
Effect of exchange rate changes on cash	449	264
Net increase (decrease) in cash and cash equivalents	77,772	(18,606)
Cash and cash equivalents at beginning of period	163,209	221,878
Cash and cash equivalents at end of period	$ 240,981	$ 203,272

See accompanying notes to unaudited condensed consolidated financial statements.

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ARENA PHARMACEUTICALS, INC.

Notes to Unaudited Condensed Consolidated Financial Statements

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Arena Pharmaceuticals, Inc., which include our wholly owned subsidiaries, should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2014, as filed with the Securities and Exchange Commission, or SEC, from which we derived our balance sheet as of December 31, 2014. The accompanying financial statements have been prepared in accordance with US generally accepted accounting principles, or GAAP, for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, since they are interim statements, the accompanying financial statements do not include all of the information and notes required by GAAP for complete financial statements. The accompanying financial statements reflect all adjustments, consisting of normal recurring adjustments, that are, in the opinion of our management, necessary to a fair statement of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year.

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, No. 2014-09, Revenue from Contracts with Customers. ASU No. 2014-09 outlines a comprehensive revenue recognition model which will supersede most current revenue recognition guidance. As issued, ASU No. 2014-09 is effective for annual reporting periods, and interim periods within those periods, beginning after December 15, 2016; however, in April 2015, the FASB issued a proposal to defer the effective date of ASU No. 2014-09 such that it would be effective for annual reporting periods, and interim periods within those periods, beginning after December 15, 2017. ASU No. 2014-09 allows for two methods of adoption: (a) full retrospective adoption, meaning the standard is applied to all periods presented, or (b) modified retrospective adoption, meaning the cumulative effect of applying ASU No. 2014-09 is recognized as an adjustment to the opening retained earnings balance for the year of implementation. We have not yet selected an adoption method as we are currently evaluating the impact of ASU No. 2014-09 on our consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, Presentation of Financial Statements Going Concern: Disclosure of Uncertainties about an Entity s Ability to Continue as a Going Concern. Under GAAP, continuation of a reporting entity as a going concern is presumed as the basis for preparing financial statements unless and until the entity s liquidation becomes imminent. Preparation of financial statements under this presumption is commonly referred to as the going concern basis of accounting. If and when an entity s liquidation becomes imminent, financial statements should be prepared under the liquidation basis of accounting. Even when an entity s liquidation is not imminent, there may be conditions or events that raise substantial doubt about the entity s ability to continue as a going concern. In those situations, financial statements should continue to be prepared under the going concern basis of accounting, but ASU No. 2014-15 should be followed to determine whether to disclose information about the relevant conditions and events. ASU No. 2014-15 is effective for the annual reporting period ending after December 15, 2016, and for annual and interim periods thereafter. We do not expect the adoption of ASU No. 2014-15 to have a material impact on our consolidated financial statements.

In April 2015, the FASB issued ASU No. 2015-05, Customer s Accounting for Fees Paid in a Cloud Computing Arrangement. ASU No. 2015-05 provides guidance to customers about whether a cloud computing arrangement includes a software license. If a cloud computing arrangement includes a software license, the customer should account for the software license element of the arrangement consistent with the acquisition of other software licenses. If a cloud computing arrangement does not include a software license, the customer should account for the

arrangement as a service contract. The new guidance does not change the accounting for a customer s accounting for service contracts. ASU No. 2015-05 is effective for interim and annual reporting periods beginning after December 15, 2015. We do not expect the adoption of ASU No. 2015-05 to have a material impact on our consolidated financial statements.

The preparation of financial statements in accordance with GAAP requires our management to make estimates and assumptions that affect the reported amounts (including assets, liabilities, revenues and expenses) and related disclosures. The amounts reported could differ under different estimates and assumptions.

2. Fair Value Disclosures

We measure our financial assets and liabilities at fair value, which 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.

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We use the following three-level valuation hierarchy that maximizes the use of observable inputs and minimizes the use of unobservable inputs to value our financial assets and liabilities:

Level 1 - Observable inputs such as unadjusted quoted prices in active markets for identical instruments.

Level 2 - Quoted prices for similar instruments in active markets or inputs that are observable for the asset or liability, either directly or indirectly.

Level 3 - Significant unobservable inputs based on our assumptions.

The following tables present our valuation hierarchy for our financial assets and liabilities that are measured at fair value on a recurring basis, in thousands:

	Fair Value Measurements at March 31, 2015			
	Balance	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds[1]	$ 208,947	$ 208,947	$ 0	$ 0
Liabilities:				
Warrant derivative liabilities	$ 2,023	$ 0	$ 2,023	$ 0

	Fair Value Measurements at December 31, 2014			
	Balance	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds[1]	$ 143,913	$ 143,913	$ 0	$ 0
Liabilities:				
Warrant derivative liabilities	$ 474	$ 0	$ 474	$ 0

(1) Included in cash and cash equivalents on our condensed consolidated balance sheets.

3. Inventory

Inventory consisted of the following, in thousands:

	March 31, 2015	December 31, 2014
Raw materials	$ 2,247	$ 1,167
Work in process	3,937	3,520

Finished goods at Arena GmbH	4	3,681
Finished goods at Eisai	4,943	2,463
Finished goods at Ildong	255	0
Total inventory	$ 11,386	$ 10,831

4. Land, Property and Equipment

Land, property and equipment consisted of the following, in thousands:

	March 31, 2015	December 31, 2014
Cost	$ 176,619	$ 174,938
Less accumulated depreciation and amortization	(94,523)	(92,019)
Land, property and equipment, net	$ 82,096	$ 82,919

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5. Accounts Payable and Other Accrued Liabilities

Accounts payable and other accrued liabilities consisted of the following, in thousands:

	March 31, 2015	December 31, 2014
Accounts payable	$ 1,957	$ 2,844
Accrued compensation	3,839	4,792
Other accrued liabilities	1,328	2,573
Total accounts payable and other accrued liabilities	$ 7,124	$ 10,209

6. Derivative Liabilities

In August 2008, we issued a warrant to purchase 1,106,344 shares of our common stock at an exercise price of $7.71 per share that expires on August 14, 2015. As a result of the warrant s anti-dilution provision and certain of our subsequent equity issuances at prices below the adjustment price of $6.72 defined in the warrant agreement, the number of shares issuable upon exercise of the warrant increased and the exercise price decreased. At March 31, 2015, the number of shares issuable upon exercise of the outstanding warrant was 1,965,418 at an exercise price of $4.34 per share. The outstanding warrant, which was valued at $2.0 million and $0.5 million at March 31, 2015, and December 31, 2014, respectively, is recorded as a current derivative liability on our condensed consolidated balance sheets.

Our outstanding warrant is revalued on each balance sheet date, with changes in the fair value between reporting periods recorded in the interest and other income (expense) section of our condensed consolidated statements of operations and comprehensive income (loss).

7. Marketing and Supply Agreement with Eisai

In November 2013, our wholly owned subsidiary, Arena Pharmaceuticals GmbH, or Arena GmbH, and Eisai Inc. and Eisai Co., Ltd. (collectively with Eisai Inc., Eisai) entered into the Second Amended and Restated Marketing and Supply Agreement, or Eisai Agreement. The Eisai Agreement amended and restated the previous agreement and expanded Eisai s exclusive commercialization rights for lorcaserin to all of the countries in the world, except for South Korea, Taiwan, Australia, New Zealand and Israel. Lorcaserin is approved in the United States for chronic weight management in adults who are overweight with a comorbidity or obese, and was made available to patients by prescription in the United States by Eisai in June 2013. In addition to providing commercialization rights, which are subject to applicable regulatory approval, we manufacture and sell lorcaserin to Eisai and provide Eisai with services related to development and regulatory activities. Under the Eisai Agreement, we have received an upfront payment and payments from sales of lorcaserin, and are entitled to receive payments from future sales of lorcaserin, milestone payments based on the achievement of regulatory filings and approvals, one-time purchase price adjustment payments and other payments.

Prior to entering into the Eisai Agreement, Arena GmbH and Eisai Inc. entered into the original marketing and supply agreement in July 2010, under which we granted Eisai Inc. exclusive commercialization rights for lorcaserin solely in the United States and its territories and possessions. In May 2012, Arena GmbH and Eisai Inc. amended and restated such agreement by entering into the first amended agreement, which expanded Eisai Inc. s exclusive

commercialization rights to include most of North and South America.

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The following table summarizes the revenues we recognized under our collaboration with Eisai for the periods presented, in thousands:

	Three months ended March 31,	
	2015	2014
Net product sales	$ 4,436	$ 2,882
Amortization of upfront payments	1,885	1,975
Reimbursement of development expenses	191	745
Milestone payment	0	500
Reimbursement of patent and trademark expenses	60	127
Subtotal other Eisai collaborative revenue	2,136	3,347
Total	$ 6,572	$ 6,229

The following table summarizes the deferred revenues under our collaboration with Eisai, in thousands:

	March 31, 2015	December 31, 2014
Upfront payments	$ 92,589	$ 94,474
Net product sales	17,806	7,081
Total deferred revenues attributable to Eisai	110,395	101,555
Less current portion	(25,347)	(14,622)
Deferred revenues attributable to Eisai, less current portion	$ 85,048	$ 86,933

Upfront and Milestone Payments.

In connection with entering into the Eisai Agreement, we received from Eisai an upfront payment of $60.0 million. This payment is in addition to the $50.0 million and $5.0 million in upfront payments we received from Eisai in connection with entering into the original agreement and the first amended agreement, respectively. Revenues from these upfront payments were deferred, as we determined that the exclusive rights did not have standalone value without our ongoing development and regulatory activities. Accordingly, these payments are recognized ratably as revenue over the periods in which we expect the services to be rendered, which are approximately 15 years for the Eisai Agreement and first amended agreement and 16 years for the original agreement. In addition to the upfront payments, we have received from Eisai a total of $86.5 million in milestones payments, and we are eligible to receive up to an aggregate of $176.0 million in additional regulatory and development milestone payments.

Product Purchase Price and Purchase Price Adjustment Payments.

We manufacture lorcaserin at our facility in Switzerland, and sell lorcaserin to Eisai for Eisai s commercialization in the United States and, subject to applicable regulatory approval, in the other territories under the Eisai Agreement (other than Europe, China and Japan) for a purchase price starting at 31.5% and 30.75%, respectively (and starting at 27.5% in Europe, China and Japan), of Eisai s aggregate annual net product sales (which are the gross invoiced sales less certain deductions described in the Eisai Agreement), or the Eisai Product Purchase Price, in the respective territory. The Eisai Product Purchase Price will increase on a tiered basis in the United States and the other territories (other than Europe, China and Japan) to as high as 36.5% and 35.75%, respectively, on the portion of Eisai s annual aggregate net product sales exceeding $750.0 million in all territories other than Europe, China and Japan. The Eisai Product Purchase Price will increase to 35% in Europe, China and Japan on the portion of Eisai s annual aggregate net product sales exceeding $500.0 million in such territories. The Eisai Product Purchase Price is subject to reduction (for sales in a particular country), including in the event of generic competition in the applicable country. The revenue we recognize for BELVIQ product revenue related to the use of vouchers and product samples is based on our cost of goods sold.

In addition to payments for purchases of lorcaserin, we are eligible to receive up to an aggregate of $1.56 billion in one-time purchase price adjustment payments and other payments. These payments include up to an aggregate of $1.19 billion that are based on Eisai s annual net product sales of lorcaserin in all of the territories under the Eisai Agreement on an aggregate basis, with the first and last amounts payable with annual net product sales of $250.0 million and $2.5 billion, respectively. Of these payments, Eisai will pay us a total of $330.0 million for annual net product sales of up to $1.0 billion. The $1.56 billion also includes $370.0 million in one-time purchase price adjustment payments we are eligible to receive based on annual net product sales in the non-US territories, comprised of $185.0 million based on Eisai s annual net product sales in the non-US territories in North and South America and

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$185.0 million based on Eisai s annual net product sales in the territories outside of North and South America. The first and last amounts are payable upon first achievement of annual net product sales of $100.0 million and $1.0 billion, respectively, with respect to each of the following areas: (i) the non-US territories in North and South America and (ii) the territories outside of North and South America. In addition, we are also eligible to receive certain payments by Eisai if certain annual minimum sales requirements in Mexico, Canada and Brazil are not met during the first ten years after initial commercial sale in such territories.

The amount that Eisai pays us for lorcaserin product supply is based on Eisai s estimated price at the time the order is shipped, which is Eisai s estimate of the Eisai Product Purchase Price, and is subject to change on April 1 and October 1 of each year. Eisai s estimate of the Eisai Product Purchase Price was changed as of October 1, 2013, and there was no further change as of April 1, 2014, October 1, 2014, and April 1, 2015. At the end of Eisai s fiscal year (March 31), the estimated price paid to us for product that Eisai sold to their distributors is compared to the Eisai Product Purchase Price of such product, and the difference is either refunded back to Eisai (for overpayments) or paid to us (for underpayments). On a monthly basis, Eisai provides us the total amount of net product sales for the month, details of the total deductions from gross to net product sales and the sales in units. We recognize our revenues monthly based on our percentage of Eisai s monthly net product sales figures. When the revenues we recognize differ from the estimated price that Eisai paid us for such product, the difference is reclassified from deferred revenues to a receivable or payable account, as appropriate. We also adjust the deferred revenues balance for the product supply held at Eisai based on the most current net product sales figures provided to us, with the difference reclassified from deferred revenues to a receivable or payable account.

In the three months ended March 31, 2015, we recognized revenues from net product sales of BELVIQ to Eisai of $4.4 million, of which $4.0 million related to sales at the Eisai Product Purchase Price and $0.4 million related to redemptions of vouchers. The Eisai Product Purchase Price for the product Eisai has sold to date was lower than the initial estimated price that Eisai paid us for such product, primarily because (i) the price that Eisai paid us did not include deductions for the use of vouchers and savings cards or for certain items related to product launch and (ii) the subsequent allocation of certain bottles of BELVIQ for product sampling initiated by Eisai as part of its commercialization efforts. In January 2015, Eisai announced the launch of a new savings card which enables eligible patients without commercial coverage for BELVIQ to pay no more than $75 for each monthly prescription while those patients with commercial coverage for BELVIQ are able to use the card to obtain additional savings if their copay is greater than $50 per monthly prescription. The new savings card is subject to certain restrictions, including the exclusion of patients who are eligible for state or federal healthcare programs.

These excess payments, which total the $22.5 million classified as Payable to Eisai on our condensed consolidated balance sheet at March 31, 2015, are primarily related to the above deductions, product sampling and the January 2015 launch of the new savings card. On a quarterly basis, subsequent to the end of each calendar quarter, we refund to Eisai the portion of these excess payments related to product sampling for product shipped to physicians during the quarter. On an annual basis, subsequent to the end of Eisai s fiscal year, we refund to Eisai the portion of these excess payments related to product sold by Eisai to their distributors through March 31. We expect to pay approximately $10 million to $11 million to Eisai in May 2015 for the annual refund for product sold by Eisai to their distributors.

Development Payments.

In connection with the US approval of BELVIQ, the US Food and Drug Administration, or FDA, is requiring (i) an evaluation as part of the cardiovascular outcomes trial, or CVOT, of the effect of long-term treatment with BELVIQ on the incidence of major adverse cardiovascular events, or MACE, in overweight and obese patients with cardiovascular disease or multiple cardiovascular risk factors and (ii) the conduct of postmarketing studies to assess the safety and efficacy of BELVIQ for weight management in obese pediatric and adolescent patients. In addition to

the FDA-required studies, we and Eisai initially prioritized the development areas of a once-daily formulation, smoking cessation, co-administration with phentermine, as well as potentially exploring, including as part of the CVOT, BELVIQ s effect on conversion to type 2 diabetes and improvements in cardiovascular outcomes.

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The chart below summarizes the general agreement regarding cost sharing between Eisai and us for significant development activities under the Eisai Agreement. In addition, Eisai or we may from time to time conduct approved development of lorcaserin at such party s own expense.

Eisai Second Amended and Restated Marketing and Supply Agreement: Cost Sharing for Development

		Rest of	
	United States	**North and South America**	**Remaining Territories**
BELVIQ	Not Applicable	**General**	Up to a total of $100.0 million -
- Pre-approval*		Eisai: 90%; Arena: 10%	Eisai: 50%; Arena: 50%
		Certain stability work Eisai: 50%; Arena: 50%	Thereafter, Eisai: 100%
BELVIQ	**General**	**General**	Up to a total of $50.0 million -
- Post-approval*	Eisai: 90%; Arena 10%	Eisai: 90%; Arena: 10%	Eisai: 50%; Arena: 50%
	Non-FDA required portion of CVOT	**Certain stability work**	Thereafter, Eisai: 90%;
	Up to $80.0 million -	Eisai: 50%; Arena: 50%	Arena: 10%
	Eisai: 50%; Arena: 50%		
	Thereafter, Eisai: 100%		
	Certain pediatric studies		
	Eisai: 50%; Arena: 50%		
Lorcaserin products other than BELVIQ ***- Pre-approval***	Up to a total of $250.0 million (as reduced by up to $80.0 million for non-FDA required portion of CVOT) -Eisai: 50%; Arena: 50%		
Lorcaserin products other than	Up to a total of $100.0 million in the aggregate across all additional products - Eisai: 50%; Arena: 50%		

BELVIQ	Thereafter, Eisai: 90%; Arena: 10%

- Post-approval

* Development required by a regulatory authority, with the exception of the non-FDA required portions of the CVOT.

Certain Other Terms

Please refer to our Annual Report on Form 10-K for the year ended December 31, 2014, for additional information regarding termination, indemnification, product liability, certain limitations and other provisions included in the Eisai Agreement.

8. Marketing and Supply Agreement with Ildong

In November 2012, Arena GmbH and Ildong Pharmaceutical Co., Ltd., or Ildong, entered into the Marketing and Supply Agreement, or Ildong Agreement. Under this agreement, we granted Ildong exclusive rights to commercialize BELVIQ in South Korea for weight loss or weight management in obese and overweight patients. We also provide certain services and will manufacture and sell BELVIQ to Ildong. Ildong has agreed not to conduct activities outside of our agreement related to the approval or commercialization of any other pharmaceutical product for weight loss, weight management or obesity in South Korea, with the exception of phentermine.

In connection with entering into the Ildong Agreement, we received from Ildong an upfront payment of $5.0 million, less withholding taxes. Revenues from this upfront payment were deferred, as we determined that the exclusive rights did not have standalone value without our ongoing development and regulatory activities. Accordingly, this payment is recognized ratably as revenue over the period in which we expect the services to be rendered, which is approximately 14 years. In addition to the upfront payment, we received a milestone payment of $3.0 million, less withholding taxes, in March 2015, which we earned upon the February 2015 approval of BELVIQ for marketing in South Korea for weight management.

We manufacture BELVIQ at our facility in Switzerland, and sell BELVIQ to Ildong for a purchase price starting at the higher of the defined minimum amount or 35% of Ildong s annual net product sales (which are the gross invoiced sales less certain deductions described in the Ildong Agreement), or the Ildong Product Purchase Price. The Ildong Product Purchase Price will increase on a tiered basis up to the higher of the defined minimum amount or 45% on the portion of annual net product sales exceeding $15.0 million. However, in no event

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will the Ildong Product Purchase Price be less than a defined minimum amount adjusted annually based on a consumer price index. For the three months ended March 31, 2015, the Ildong Product Purchase Price equaled the defined minimum amount (which exceeded the 45% tier). If certain annual net product sales amounts are not met, we can convert Ildong s right to commercialize BELVIQ in South Korea to be non-exclusive. We recognized revenues from net product sales of BELVIQ to Ildong of $2.2 million for the three months ended March 31, 2015.

9. Share-based Activity

Share-based Compensation.

We recognized share-based compensation expense as follows, in thousands:

	Three months ended March 31,	
	2015	**2014**
Research and development	$ 2,056	$ 1,781
General and administrative	1,777	1,420
Total share-based compensation expense	$ 3,833	$ 3,201
Total share-based compensation expense capitalized into inventory	$ 62	$ 0

Share-based Award Activity.

The following table summarizes our stock option activity during the three months ended March 31, 2015, in thousands (except per share data):

	Options	**Weighted-Average Exercise Price**
Outstanding at January 1, 2015	15,831	$ 5.25
Granted	2,999	4.48
Exercised	(603)	2.05
Forfeited/cancelled/expired	(493)	6.30
Outstanding at March 31, 2015	17,734	$ 5.20

The following table summarizes activity with respect to our time-based restricted stock unit awards, or RSUs, during the three months ended March 31, 2015, in thousands (except per share data):

RSUs

		Weighted-Average Grant-Date Fair Value
Unvested at January 1, 2015	456	$ 5.72
Granted	0	
Vested	(44)	6.50
Forfeited/cancelled	0	
Unvested at March 31, 2015	412	$ 5.64

In March 2015, we granted our executive officers Total Stockholder Return, or TSR, performance restricted stock unit, or PRSU, awards. The PRSUs may be earned and converted into outstanding shares of our common stock based on the TSR of our common stock relative to the TSR over a three-year performance period beginning March 1, 2015, of the NASDAQ Biotechnology Index. In the aggregate, the target number of shares of common stock that may be earned under the PRSUs granted in March 2015 is 745,000; however, the actual number of shares that may be earned ranges from 0% to 200% of such amount. In addition, there is a cap on the number of shares that can be earned under the PRSUs equal to six times the grant-date fair value of each award, and funding is capped at 100% if the absolute 3-year TSR is negative even if performance is above the median. As these awards contain a market condition, we used a Monte Carlo simulation

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model to estimate the grant-date fair value, which totaled $3.4 million and which is being recognized over the performance period. The following table sets forth the assumptions used to value the PRSUs granted in March 2015 and their estimated grant-date fair value:

Risk-free interest rate	1.1%
Dividend yield	0%
Expected volatility	75%
Remaining performance period (years)	2.97
Estimated fair value per share of PRSUs granted	$ 4.50

The aggregate intrinsic value of all of the outstanding PRSUs granted to date at March 31, 2015, was $9.7 million. All of the PRSUs granted to date were outstanding and unvested at March 31, 2015.

10. Concentrations of Credit Risk and Major Customers

Financial instruments, which potentially subject us to concentrations of credit risk, consist primarily of cash and cash equivalents. We limit our exposure to credit loss by holding our cash primarily in US dollars or, from time to time, placing our cash and investments in US government, agency and government-sponsored enterprise obligations and in corporate debt instruments that are rated investment grade, in accordance with an investment policy approved by our Board of Directors.

Eisai and Ildong are the exclusive distributors of BELVIQ in the United States and South Korea, respectively, which are the only jurisdictions for which BELVIQ has received regulatory approval for marketing. We also produce drug products for Siegfried AG, or Siegfried, under a toll manufacturing agreement, and all of our toll manufacturing revenues are attributable to Siegfried.

Percentages of our total revenues are as follows:

	Three months ended March 31,	
	2015	2014
Eisai Agreement	53.6%	91.4%
Ildong Agreement	43.0%	1.3%
Toll manufacturing agreement with Siegfried	2.8%	6.6%
Other collaborative agreements	0.6%	0.7%
Total percentage of revenues	100.0%	100.0%

11. Net Loss Per Share

We calculate basic and diluted net loss per share using the weighted-average number of shares of common stock outstanding during the period.

Since we are in a net loss position, in addition to excluding potentially dilutive out-of-the money securities, we have excluded from our calculation of diluted net loss per share all potentially dilutive in-the-money (i) stock options,

(ii) RSUs, (iii) PRSUs, (iv) unvested restricted stock in our deferred compensation plan and (v) our only outstanding warrant, and our diluted net loss per share is the same as our basic net loss per share. The following table presents the weighted-average number of potentially dilutive securities that were excluded from our calculation of diluted net loss per share for the periods presented, in thousands:

	Three months ended March 31,	
	2015	**2014**
Stock options	15,949	14,962
Warrant	131	679
RSUs, PRSUs and unvested restricted stock	512	766
Total	16,592	16,407

Because the market condition for 745,000 PRSUs issued in March 2015, 695,000 PRSUs issued in March 2014, and 780,000 PRSUs issued in March 2013, was not satisfied at March 31, 2015, such securities are excluded from the table above for the three months ended March 31, 2015. Because the market condition for 780,000 PRSUs issued in March 2013, was not satisfied at March 31, 2014, such securities are excluded from the table above for the three months ended March 31, 2014.

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12. Legal Proceedings

Beginning on September 20, 2010, a number of complaints were filed in the US District Court for the Southern District of California against us and certain of our current and former employees and directors on behalf of certain purchasers of our common stock. The complaints were brought as purported stockholder class actions, and, in general, include allegations that we and certain of our current and former employees and directors violated federal securities laws by making materially false and misleading statements regarding our BELVIQ program, thereby artificially inflating the price of our common stock. The plaintiffs sought unspecified monetary damages and other relief. On August 8, 2011, the Court consolidated the actions and appointed a lead plaintiff and lead counsel. On November 1, 2011, the lead plaintiff filed a consolidated amended complaint. On March 28, 2013, the Court dismissed the consolidated amended complaint without prejudice. On May 13, 2013, the lead plaintiff filed a second consolidated amended complaint. On November 5, 2013, the Court dismissed the second consolidated amended complaint without prejudice as to all parties except for Robert E. Hoffman, who was dismissed from the action with prejudice. On November 27, 2013, the lead plaintiff filed a motion for leave to amend the second consolidated amended complaint. On March 20, 2014, the Court denied plaintiff s motion and dismissed the second consolidated amended complaint with prejudice. On April 18, 2014, the lead plaintiff filed a notice of appeal, and on August 27, 2014, the lead plaintiff filed his appellate brief in the US Court of Appeals for the Ninth Circuit. On October 24, 2014, we filed our answering brief in response to the lead plaintiff s appeal. On December 5, 2014, the lead plaintiff filed his reply brief. Due to the stage of these proceedings, we are not able to predict or reasonably estimate the ultimate outcome or possible losses relating to these claims.

13. Issuance of Common Stock

In January 2015, we sold 21,000,000 shares of our common stock, par value $0.0001 per share, at a price of $4.8139 per share to the underwriters. We received approximately $100.7 million in net proceeds from this offering after deducting offering expenses.

14. Subsequent Event

On May 8, 2015, Arena GmbH and Roivant Sciences Ltd., or Roivant, entered into a Development, Marketing and Supply Agreement for nelotanserin, our internally discovered inverse agonist of the serotonin 2A receptor that we previously studied for insomnia before discontinuing development for such indication. Under this agreement, we granted Roivant exclusive worldwide rights to develop and commercialize nelotanserin, subject to regulatory approval.

In connection with entering into the agreement, we expect to receive an upfront payment of $4.0 million from Roivant in May 2015. We are also eligible to receive up to $41.5 million in development and regulatory milestone payments and are eligible to receive payments from sales of nelotanserin and purchase price adjustment payments based on Roivant s annual net product sales.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations.

This discussion and analysis should be read in conjunction with our financial statements and notes thereto included in this quarterly report on Form 10-Q, or Quarterly Report, and the audited consolidated financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2014, or 2014 Annual Report, as filed with the Securities and Exchange Commission, or SEC. Operating results are not necessarily indicative of results that may occur in future periods.

This Quarterly Report includes forward-looking statements that involve a number of risks, uncertainties and assumptions. These forward-looking statements can generally be identified as such because the context of the statement will include words such as may, will, intend, plan, believe, anticipate, expect, estimate, pred continue, likely, or opportunity, the negative of these words or other similar words. Similarly, statements that describe our plans, strategies, intentions, expectations, objectives, goals or prospects and other statements that are not historical facts are also forward-looking statements. For such statements, we claim the protection of the Private Securities Litigation Reform Act of 1995. Readers of this Quarterly Report are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the time this Quarterly Report was filed with the SEC. These forward-looking statements are based largely on our expectations and projections about future events and future trends affecting our business, and are subject to risks and uncertainties that could cause actual results to differ materially from those anticipated in the forward-looking statements. These risks and uncertainties include, without limitation, the risk factors identified in our SEC reports, including this Quarterly Report. In addition, past financial or operating performance is not necessarily a reliable indicator of future performance, and you should not use our historical performance to anticipate results or future period trends. We can give no assurances that any of the events anticipated by the forward-looking statements will occur or, if any of them do, what impact they will have on our results of operations and financial condition. Except as required by law, we undertake no obligation to update publicly or revise our forward-looking statements.

OVERVIEW AND RECENT DEVELOPMENTS

We are a biopharmaceutical company focused on discovering, developing and commercializing novel drugs that target G protein-coupled receptors, or GPCRs, to address unmet medical needs. Our US operations are located in San Diego, California, and our operations outside of the United States, including our commercial manufacturing facility, are located in Zofingen, Switzerland.

Our internally discovered drug, lorcaserin, is approved by the US Food and Drug Administration, or FDA, for marketing in the United States for chronic weight management, and our collaborator, Eisai made lorcaserin available by prescription in June 2013 to adults who are overweight with a comorbidity or obese, under the brand name BELVIQ® (which is pronounced as BEL-VEEK). Eisai is responsible for marketing and distributing BELVIQ in the United States and, as described below, potentially in other

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territories under the Second Amended and Restated Marketing and Supply Agreement, or Eisai Agreement, which is among our wholly owned subsidiary, Arena Pharmaceuticals GmbH, or Arena GmbH, Eisai Inc. and Eisai Co., Ltd., which we refer to collectively with Eisai Inc. as Eisai.

With respect to commercializing BELVIQ in the United States, Eisai has been focused on physician awareness and education, reimbursement coverage, and patient awareness and access. As part of its strategy, Eisai has promoted the use of BELVIQ by providing patient access to discounted or free product, which has included vouchers for a 15-day supply of BELVIQ at no patient cost, free product samples and savings cards for discounted product. In April 2015, Eisai announced plans to realign its operations in the United States, including reducing its workforce by approximately 25% across various US functions. As part of this restructuring, Eisai informed us that it will have an internal sales force consisting of 90 sales representatives that will promote BELVIQ and two other Eisai products and a shared contract sales force of 230 representatives to promote BELVIQ on behalf of Eisai and another product on behalf of another pharmaceutical company.

Arena GmbH also has a marketing and supply agreement with Ildong Pharmaceutical Co., Ltd., or Ildong, for BELVIQ in South Korea (which we refer to as the Ildong Agreement), and, in February 2015, the Ministry of Food and Drug Safety, or MFDS, approved, and Ildong began marketing, BELVIQ in South Korea for weight management in adults who are overweight with a comorbidity or obese. Under the Ildong Agreement, Ildong paid us a milestone payment for this approval of $3.0 million, less withholding taxes, in March 2015.

With respect to the rest of the world, Arena GmbH granted Eisai exclusive commercialization rights for lorcaserin in all other countries, except for South Korea, Taiwan, Australia, New Zealand and Israel. In addition to the agreements with Eisai and Ildong, Arena GmbH has marketing and supply agreements with CY Biotech Company Limited, or CYB, in Taiwan (which we refer to as the CYB Agreement) and with Teva Pharmaceuticals Ltd. s Israeli subsidiary, Abic Marketing Limited, or Teva, in Israel (which we refer to as the Teva Agreement). The Ildong Agreement, the CYB Agreement and the Teva Agreement provide such collaborators with rights to BELVIQ for weight loss or weight management in obese and overweight patients, subject to applicable regulatory approval, as well as the possibility of us granting them rights to additional lorcaserin products or indications.

The marketing of BELVIQ is subject to applicable regulatory approval, and it has not been approved for marketing outside of the United States and South Korea. Our collaborators are responsible for regulatory activities related to obtaining marketing approval of BELVIQ in the territories covered under the respective agreement. Outside of the United States and South Korea, our collaborators have pending applications for the potential marketing of BELVIQ in certain of the territories under our agreements, and we have had prior applications in other territories that were withdrawn or rejected. There is no assurance of whether, where or when BELVIQ will be approved for marketing in any additional territories.

In addition to commercializing BELVIQ, we intend to investigate, with our collaborators or independently, lorcaserin s therapeutic potential for other indications, using different formulations, and in combination with other agents. If any such investigation results in a potential product, the product would need to be approved by the applicable regulatory authority before it could be marketed.

Under the Eisai Agreement, we and Eisai initially prioritized the development areas of a once-daily formulation, smoking cessation, co-administration with phentermine, as well as potentially exploring, including as part of the FDA-required cardiovascular outcomes trial, or CVOT, BELVIQ s effect on conversion to type 2 diabetes and improvements in cardiovascular outcomes. With respect to the once-daily formulation, we recently announced the completion of two Phase 1 registrational clinical trials that we and Eisai believe demonstrate bioequivalence of an investigational once-daily, extended release formulation of lorcaserin. We expect the results from these trials will

allow us to submit later this year a New Drug Application with the FDA for the treatment of weight management. If the FDA agrees that we have established bioequivalence and approves the once-daily formulation, we expect the drug will be marketed as BELVIQ XR, which is the brand name conditionally approved by the FDA.

We own composition of matter patents for lorcaserin that have been issued in major jurisdictions globally that, in most cases, are capable of continuing into 2023. We have filed applications for patent term extension on patents directed to composition of matter in the United States, which, if granted, would extend the composition of matter patent term into 2026 or potentially into 2027. In addition, the US Patent and Trademark Office recently granted us a method-of-treatment patent, US Patent No. 8,999,970, which describes a method for selecting appropriate patients based on renal function for BELVIQ and may extend exclusivity for BELVIQ until 2033.

On May 8, 2015, Arena GmbH and Roivant Sciences Ltd., or Roivant, entered into a Development, Marketing and Supply Agreement for nelotanserin, our internally discovered inverse agonist of the serotonin 2A receptor that we previously studied for insomnia before discontinuing development for such indication. Under this agreement, we granted Roivant exclusive worldwide rights to develop and commercialize nelotanserin, subject to regulatory approval. In connection with entering into the agreement, we expect to receive an upfront payment of $4.0 million from Roivant in May 2015. We are also

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eligible to receive up to $41.5 million in development and regulatory milestone payments and are eligible to receive payments from sales of nelotanserin and purchase price adjustment payments based on Roivant s annual net product sales.

We also intend to utilize our discovery and development approach focused on GPCRs to advance other of our internally discovered drug candidates, which include the following clinical-stage, orally available candidates:

Ralinepag, an agonist of the prostacyclin receptor intended for the treatment of vascular diseases, including potentially pulmonary arterial hypertension, or PAH, has completed single- and multiple-ascending dose Phase 1 trials. Around the beginning of this year, we initiated a Phase 2 clinical trial of ralinepag to evaluate the drug candidate for PAH. The FDA has granted ralinepag orphan drug status for the treatment of PAH.

APD334, a modulator of the sphingosine 1-phosphate subtype 1, or $S1P_1$, receptor intended for the treatment of a number of autoimmune diseases, has completed a Phase 1 program. We plan to advance APD334 into a Phase 2 clinical trial this year for ulcerative colitis. We believe APD334 may also provide a clinical benefit in Crohn s and other autoimmune diseases, and are evaluating whether to enter into one or more additional Phase 2 trials. The potential start and related timing of a trial for an indication in addition to ulcerative colitis is under assessment and may not occur this year.

APD371, an agonist of the cannabinoid-2, or CB2, receptor intended for the treatment of pain and fibrotic diseases, for which we recently announced results of a Phase 1 single-ascending dose clinical trial.

Temanogrel, an inverse agonist of the serotonin 2A receptor intended for the treatment of thrombotic diseases, has completed single- and multiple-ascending dose Phase 1 trials. Under our Co-Development and License Agreement with Ildong, we expect Ildong to fund and complete an additional Phase 1 trial in healthy volunteers to investigate the safety of co-administration with clopidogrel and aspirin and potentially a Phase 2a proof-of-concept trial in patients. Ildong initiated a Phase 1 program in the first quarter of 2014.

Developing drugs and obtaining marketing approval is a long, uncertain and expensive process, and our ability to achieve our goals, including furthering our collaborators efforts to develop, obtain regulatory approval of, and commercialize BELVIQ and drug candidates, conducting required postmarketing and other studies of lorcaserin, and advancing our drug candidates, depends on numerous factors, many of which we do not control. We will continue to seek to balance the high costs of research, development and manufacturing against the need to maintain our operations long enough to achieve sustained profitability.

It will require substantial cash to achieve our goals. To date, we have generated limited revenues from sales of BELVIQ, which is our first and only drug approved by any regulatory authority. We may continue to incur substantial net losses in the future as we manufacture lorcaserin for commercial sale and studies, manufacture other drug candidates and drugs, advance our research and development programs and continue our efforts to discover additional drug candidates. We do not expect to generate consistent positive operating cash flows for at least the short term. We will need to receive additional funds under our existing collaborative agreements, under any collaborative agreements we may enter into in the future (including for one or more of our drug candidates or programs), or by raising additional funds through equity, debt or other transactions.

We refer you to our previously filed SEC reports for a more complete discussion of certain of our recent developments.

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RESULTS OF OPERATIONS

We are providing the following summary of our revenues, research and development expenses and general and administrative expenses to supplement the more detailed discussion below. The dollar values in the following tables are in millions.

Revenues

	Three months ended March 31,	
Source of revenue	**2015**	**2014**
Net product sales to Eisai	$ 4.4	$ 2.9
Milestone payment from Ildong	3.0	0.0
Net product sales to Ildong	2.2	0.0
Amortization of upfront payments from Eisai	1.9	2.0
Toll manufacturing agreement with Siegfried	0.3	0.4
Reimbursements of development expenses and patent and trademark expenses from Eisai	0.3	0.9
Amortization of upfront payment from Ildong	0.1	0.1
Other collaborative agreements	0.1	0.0
Milestone payment from Eisai	0.0	0.5
Total revenues	$ 12.3	$ 6.8

Research and development expenses

	Three months ended March 31,	
Type of expense	**2015**	**2014**
Salary and other personnel costs (excluding non-cash share-based compensation)	$ 7.8	$ 7.5
External clinical and preclinical study fees and internal non-commercial manufacturing costs	7.5	7.4
Facility and equipment costs	2.3	2.4
Non-cash share-based compensation	2.1	1.8
Research supply costs	1.9	1.3
Other	0.4	0.6
Total research and development expenses	$ 22.0	$ 21.0

General and administrative expenses

Type of expense	Three months ended March 31, 2015	2014
Salary and other personnel costs (excluding non-cash share-based compensation)	$ 3.3	$ 3.1
Legal, accounting and other professional fees	1.4	1.9
Facility and equipment costs	1.2	1.1
Non-cash share-based compensation	1.8	1.4
Other	0.7	0.5
Total general and administrative expenses	$ 8.4	$ 8.0

THREE MONTHS ENDED MARCH 31, 2015, AND 2014

Revenues. We recognized revenues of $12.3 million for the three months ended March 31, 2015, compared to $6.8 million for the three months ended March 31, 2014. This increase was primarily due to an increase of $3.7 million in net product sales of

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BELVIQ and the $3.0 million milestone payment from Ildong that we earned in February 2015 for the approval of BELVIQ in South Korea. The increase in net product sales of BELVIQ was due to sales of BELVIQ in South Korea commencing during the three months ended March 31, 2015, and an increase in the volume of bottles sold to distributors in the United States.

When collaborators pay us before revenues are earned, we record such payments as deferred revenues. At March 31, 2015, we had a total of $117.3 million in deferred revenues. Of such amount, $92.6 million is attributable to upfront payments we received under our collaboration with Eisai, $18.1 million is attributable to product supply of BELVIQ and the remaining amount is primarily attributable to the upfront payments we received under our other collaborative agreements for lorcaserin.

Absent any new collaborations, we expect that our 2015 revenues will primarily relate to (i) net product sales of BELVIQ, (ii) amortization of the upfront payments we have received from Eisai, (iii) reimbursements from Eisai for development expenses and (iv) milestone payments from our collaborators.

Revenues from sales of BELVIQ and for milestones that may be achieved in the future are difficult to predict, and our revenues will likely vary significantly from quarter to quarter and year to year.

With respect to the United States and South Korea, we expect that overall sales of BELVIQ will increase, but, due to the early stage of commercialization, it is difficult to predict the amount, timing or fluctuation of such sales or the related revenues we will generate. We believe that future sales of BELVIQ will depend on, among other factors, the availability and use of BELVIQ, the effectiveness of our collaborators marketing program and other efforts, competition and reimbursement coverage. We also believe that demand for BELVIQ may fluctuate based on various other outside forces, such as economic changes, national and world events, holidays and seasonal changes. We believe that demand for weight-management products may be lower around certain holidays and in the second half of any particular calendar year, and it is unknown whether, or to the extent by which, marketing programs or other efforts will offset favorably any such outside forces that are negative.

Revenues we generate from sales of BELVIQ depend on net product sales of BELVIQ, which are the gross invoiced sales less certain deductions described in the applicable collaborative agreements. Deductions from gross sales to net product sales may vary from period to period, particularly in the near term, depending on the amount and extent of such deductions, which may include deductions for vouchers, savings cards or other promotions for free or discounted product. In the United States, the majority of all BELVIQ prescriptions utilized vouchers or savings cards.

In addition to revenues from commercialization of BELVIQ in the United States and South Korea, we expect that our revenues in the longer term will be impacted by whether and when BELVIQ receives regulatory approval, and is commercialized, outside of such territories.

Cost of product sales. Cost of product sales consists primarily of direct and indirect costs related to manufacturing BELVIQ, including, among other costs, salaries, share-based compensation and other personnel costs, machinery depreciation costs and amortization expense related to our manufacturing facility production licenses. We recognized cost of products sold of $3.2 million for the three months ended March 31, 2015, and $0.8 million for the three months ended March 31, 2014.

Cost of toll manufacturing. Cost of toll manufacturing consists primarily of direct and indirect costs associated with manufacturing drug products for Siegfried AG, or Siegfried, under our toll manufacturing agreement, including related salaries, other personnel costs, machinery depreciation costs and amortization expense related to our manufacturing facility production licenses. Cost of toll manufacturing decreased by $0.1 million to $0.4 million for

the three months ended March 31, 2015, from $0.5 million for the three months ended March 31, 2014, primarily due to the reduced volume of toll manufacturing performed.

Research and development expenses. Research and development expenses, which account for the majority of our expenses, consist primarily of salaries and other personnel costs, clinical trial costs (including payments to contract research organizations, or CROs), preclinical study fees, manufacturing costs for non-commercial products, costs for the development of our earlier-stage programs and technologies, research supply costs and facility and equipment costs. We expense research and development costs as they are incurred when these expenditures have no alternative future uses. We generally do not track our earlier-stage, internal research and development expenses by project; rather, we track such expenses by the type of cost incurred.

Research and development expenses increased by $1.0 million to $22.0 million for the three months ended March 31, 2015, from $21.0 million for the three months ended March 31, 2014. We expect to incur substantial research and development expenses in 2015, which we expect will be substantially higher than in 2014. Such expenses will include costs for FDA-required and potentially other development work relating to lorcaserin, as well as expenses for our other research and development programs.

Included in the $7.5 million of total external clinical and preclinical study fees and internal non-commercial manufacturing costs noted in the table above for the three months ended March 31, 2015, were the following:

$4.3 million of non-commercial manufacturing and other development costs related to lorcaserin,

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$1.8 million related to ralinepag, and

$0.7 million related to APD334.

Included in the $7.4 million of total external clinical and preclinical study fees and internal non-commercial manufacturing costs noted in the table above for the three months ended March 31, 2014, were the following:

$6.6 million of non-commercial manufacturing and other development costs related to lorcaserin,

$0.4 million related to ralinepag, and

$0.1 million related to APD334.

General and administrative expenses. General and administrative expenses increased by $0.4 million to $8.4 million for the three months ended March 31, 2015, from $8.0 million for the three months ended March 31, 2014. We expect that our 2015 general and administrative expenses will be higher than in 2014.

Interest and other expense, net. Interest and other expense, net, increased by $0.9 million to $2.6 million for the three months ended March 31, 2015, from $1.7 million for the three months ended March 31, 2014, primarily due to an increase of $1.4 million in loss from revaluation of our derivative liabilities, which was partially offset by a $0.5 million increase in foreign currency transaction gain.

LIQUIDITY AND CAPITAL RESOURCES

We have accumulated a large deficit since inception that has primarily resulted from the significant research and development expenditures we have made in seeking to identify and validate new drug targets and develop compounds that could become marketed drugs. As described above, our internally discovered drug, lorcaserin, has been approved for marketing for weight management in the United States and South Korea, under the brand name BELVIQ. It is difficult to predict the payments we will receive from commercialization of BELVIQ in the United States, South Korea or in any other territory in which BELVIQ may be approved for marketing. We may incur substantial losses for at least the short term as a result of manufacturing BELVIQ for commercial sale and studies, conducting required postmarketing and other studies of lorcaserin, including for other indications, formulations or combinations, and advancing our other research and development programs.

Short term.

At March 31, 2015, we had $241.0 million in cash and cash equivalents, which includes $100.7 million in net proceeds, after deducting offering expenses, from our January 2015 offering of 21,000,000 shares of common stock, which we sold to the underwriters at a price of $4.8139 per share. We believe our cash and cash equivalents will be sufficient to fund our operations for at least the next 12 months. We expect that our short-term operating expenses will be substantial as we continue to fund lorcaserin-related activities, and, at the same time, advance certain of our research and development programs.

In addition to payments expected from Eisai and Ildong for purchases of product supply of BELVIQ, other potential sources of liquidity in the short term include (i) milestone and other payments from collaborators, (ii) entering into

new collaborative, licensing or commercial agreements for one or more of our drug candidates or programs and (iii) the sale or lease of facilities or other assets we own.

Eisai is commercializing BELVIQ in the United States, and, subject to applicable regulatory approval, we expect Eisai to commercialize lorcaserin in additional territories under the Eisai Agreement. In addition, in February 2015, Ildong began commercializing BELVIQ in South Korea. Our collaborators have filed regulatory applications for approval of lorcaserin in a number of territories outside of the United States and South Korea, but there is no assurance of whether, where or when our collaborators will file any additional applications. There is also no assurance of whether, where or when lorcaserin will be approved for marketing in any other territories. Therefore, we expect that all or most of the revenues for sales of BELVIQ in the short term will be from commercialization of BELVIQ in the United States and South Korea.

We manufacture BELVIQ at our facility in Switzerland, and sell BELVIQ to Eisai for Eisai s commercialization in the United States and, subject to applicable regulatory approval, in the other territories under the Eisai Agreement (other than Europe, China and Japan) for a purchase price starting at 31.5% and 30.75%, respectively (and starting at 27.5% in Europe, China and Japan), of Eisai s aggregate annual net product sales (which are the gross invoiced sales less certain deductions described in the Eisai Agreement), or the Eisai Product Purchase Price, in the respective territory. The Eisai Product Purchase Price will increase on a tiered basis in the United States and the other territories (other than Europe, China and Japan) to as high as 36.5% and 35.75%, respectively, on the portion of Eisai s annual aggregate net product sales exceeding $750.0 million in all territories other than Europe, China and Japan. The Eisai Product Purchase Price will increase to 35% in Europe, China and Japan on the portion of Eisai s annual aggregate net product sales exceeding $500.0 million in such territories. The Eisai Product Purchase Price is subject to reduction (for sales in a particular country),

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including in the event of generic competition in the applicable country. The revenue we recognize for net product sales of BELVIQ related to redemption of vouchers and product samples is based on our cost of goods sold. Under the Eisai Agreement, we are eligible to receive up to an aggregate of $176.0 million in additional regulatory and development milestone payments. In the short term, we do not expect to receive the majority (or potentially any) of such milestone payments or for the purchase price percentages to increase beyond the starting percentage in any territory.

The purchase price for BELVIQ that Eisai has sold to date was lower than the initial estimated price that Eisai paid us for such product, primarily because the price that Eisai paid us did not include deductions for the use of vouchers and savings cards, for certain items related to product launch or for Eisai s recent allocation of certain bottles of BELVIQ for product sampling. Excess payments to us related to these deductions and product sampling are reflected in the Payable to Eisai on our condensed consolidated balance sheets, which at March 31, 2015, was $22.5 million. On a quarterly basis, subsequent to the end of each calendar quarter, we will refund to Eisai the portion of these excess payments related to product sampling for product shipped to physicians during the quarter. On an annual basis, subsequent to the end of Eisai s fiscal year, we will refund to Eisai the portion of these excess payments related to our product sold by Eisai to their distributors through March 31. We expect to pay approximately $10 million to $11 million to Eisai in May 2015 for the annual refund for product sold by Eisai to their distributors.

Under the Ildong Agreement, we receive payments from net product sales of BELVIQ. We sell BELVIQ to Ildong for a purchase price starting at the higher of a defined minimum amount or 35% of Ildong s annual net product sales (which are the gross invoiced sales less certain deductions described in the Ildong Agreement), or the Ildong Product Purchase Price. The Ildong Product Purchase Price will increase on a tiered basis up to the higher of a defined minimum amount or 45% on the portion of annual net product sales exceeding $15.0 million. However, in no event will the Ildong Product Purchase Price be less than a defined minimum amount adjusted annually based on a consumer price index. For the three months ended March 31, 2015, the Ildong Product Purchase Price equaled the defined minimum amount (which exceeded the 45% tier).

As part of the US approval of BELVIQ, the FDA is requiring the evaluation of the effect of long-term treatment with BELVIQ on the incidence of major adverse cardiovascular events, or MACE, in overweight and obese patients with cardiovascular disease or multiple cardiovascular risk factors (which is the FDA-required portion of CAMELLIA), as well as the conduct of postmarketing studies to assess the safety and efficacy of BELVIQ for weight management in obese pediatric and adolescent patients. With respect to such studies, which we expect will take several years to complete, Eisai and we will be responsible for 90% and 10%, respectively, of the expenses for the FDA-required portion of the cardiovascular outcomes trial, and we will share equally with Eisai the expenses of certain pediatric and adolescent studies.

Eisai is responsible for the regulatory activities related to lorcaserin under the Eisai Agreement. If the regulatory authority for a country in the additional territories requires development work before or following approval of lorcaserin in such country, we and Eisai will share expenses for such work. In addition, CYB and Teva are responsible for the regulatory approval and, ultimately, marketing and distribution of BELVIQ for weight management in Taiwan and Israel, respectively, including, with respect to CYB, related development costs and other expenses.

We expect to incur additional expenses for the development of lorcaserin products that are in addition to BELVIQ. We expect Eisai to share such expenses, but, nevertheless, that such expenses will be significant. Under the Eisai Agreement, we and Eisai initially prioritized the development areas of a once-daily formulation, smoking cessation and co-administration with phentermine, as well as potentially exploring, including as part of CAMELLIA, BELVIQ s effect on conversion to type 2 diabetes and improvements in cardiovascular outcomes.

In January 2008, we acquired from Siegfried certain drug