Sorrento Therapeutics, Inc.
Form 10-Q
November 09, 2018

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 September 30, 2018
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) 203-4100
(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 every Interactive Data File required to be submitted 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 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	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 November 6, 2018 was 122,273,467.

Sorrento Therapeutics, Inc.
Form 10-Q for the Quarter Ended September 30, 2018
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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)

	September 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$135,441	$20,429
Marketable securities	297	441
Grants and accounts receivables, net	2,278	2,211
Income tax receivable	424	1,715
Prepaid expenses and other	6,805	4,904
Total current assets	145,245	29,700
Property and equipment, net	21,467	19,345
Intangibles, net	69,133	71,013
Goodwill	38,298	38,298
Cost method investments	237,008	237,008
Equity method investments	29,073	32,999
Restricted cash	45,000	—
Other, net	2,740	3,250
Total assets	$587,964	$431,613
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$17,203	$9,911
Accrued payroll and related benefits	8,168	4,485
Accrued expenses	12,938	7,274
Current portion of deferred revenue	632	3,864
Current portion of deferred rent	309	212
Acquisition consideration payable	14,929	53,209
Current portion of debt	28,231	—
Total current liabilities	82,410	78,955
Long-term debt	145,535	5,211
Deferred tax liabilities	12,472	15,535
Deferred revenue	118,127	119,287
Deferred rent and other	5,860	6,015
Total liabilities	364,404	225,003
Commitments and contingencies (See Note 14)		
Equity:		
Sorrento Therapeutics, Inc. equity		
Preferred stock, $0.0001 par value; 100,000,000 shares authorized and no shares issued or outstanding	—	—
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Common stock, $0.0001 par value; 750,000,000 shares authorized and 118,867,459 and 82,903,567 shares issued and outstanding at September 30, 2018 and December 31, 2017, respectively		
Additional paid-in capital	588,938	413,901
Accumulated other comprehensive income (loss)	79	242
Accumulated deficit	(317,974)	(165,120)
Treasury stock, 7,568,182 shares at cost at September 30, 2018, and December 31, 2017	(49,464)	(49,464)
Total Sorrento Therapeutics, Inc. stockholders' equity	221,592	199,568
Noncontrolling interests	1,968	7,042
Total equity	223,560	206,610
Total liabilities and stockholders' equity	$587,964	$431,613

See accompanying unaudited notes

SORRENTO THERAPEUTICS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(Unaudited)
(In thousands, except per share amounts)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues:				
Grant	$294	$11	$294	$206
Royalty and license	120	118,667	360	123,500
Sales and services	3,691	3,232	13,610	7,743
Total revenues	4,105	121,910	14,264	131,449
Operating costs and expenses:				
Costs of revenues	2,177	1,085	4,715	2,965
Research and development	19,567	16,604	52,124	42,667
Acquired in-process research and development	9,478	902	9,478	1,102
General and administrative	20,102	10,214	41,102	31,194
Intangible amortization	655	656	1,974	1,948
Loss (gain) on contingent liabilities and acquisition consideration payable	33	(4,468)	13,696	(8,558)
Total operating costs and expenses	52,012	24,993	123,089	71,318
Income (loss) from operations	(47,907)	96,917	(108,825)	60,131
Income (loss) on trading securities	(26)	231	(144)	(218)
Gain (loss) on foreign currency exchange	18	(215)	(551)	(215)
Interest expense	(2,684)	(1,208)	(48,744)	(4,017)
Interest income	219	(265)	229	192
Income (loss) before income tax	(50,380)	95,460	(158,035)	55,873
Income tax expense (benefit)	(826)	57,480	(3,152)	54,386
Loss on equity method investments	(900)	(36,527)	(3,926)	(38,577)
Net income (loss)	(50,454)	1,453	(158,809)	(37,090)
Net income (loss) attributable to noncontrolling interests	(3,126)	3,514	(5,045)	2,223
Net loss attributable to Sorrento	$(47,328)	$(2,061)	$(153,764)	$(39,313)
Net loss per share - basic per share attributable to Sorrento	$(0.40)	$(0.03)	$(1.52)	$(0.59)
Net loss per share - diluted per share attributable to Sorrento	$(0.40)	$(0.03)	$(1.52)	$(0.59)
Weighted-average shares used during period - basic per share attributable to Sorrento	117,021	76,887	100,959	66,122
Weighted-average shares used during period - diluted per share attributable to Sorrento	117,021	76,888	100,959	66,122

See accompanying unaudited notes

SORRENTO THERAPEUTICS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)
(Unaudited)
(In thousands)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income (loss)	$(50,454)	$1,453	$(158,809)	$(37,090)
Other comprehensive income (loss):				
Foreign currency translation adjustments	(74)	(95)	(163)	241
Total other comprehensive income (loss)	(74)	(95)	(163)	241
Comprehensive income (loss)	(50,528)	1,358	(158,972)	(36,849)
Comprehensive income (loss) attributable to noncontrolling interests	(3,126)	3,514	(5,045)	2,223
Comprehensive loss attributable to Sorrento	$(47,402)	$(2,156)	$(153,927)	$(39,072)

See accompanying unaudited notes

SORRENTO THERAPEUTICS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(Unaudited)
(In thousands, except for share amounts)

Nine Months Ended September 30, 2018

	Common Stock		Treasury Stock			Accumulated			
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Other Comprehensive Income (Loss)	Accumulated Deficit	Noncontrolling Interest	Total
Balance, December 31, 2017	82,903,567	$ 9	7,568,182	(49,464)	$413,901	$ 242	$(165,120)	$ 7,042	$206,610
Adoption impact of ASC 606	—	—	—	—	—	—	910	—	910
Issuance of common stock upon exercise of stock options	42,565	—	—	—	302	—	—	—	302
Issuance of common stock for BDL settlement	309,916	—	—	—	2,340	—	—	—	2,340
Issuance of common stock for Scilex settlement	1,381,346	—	—	—	13,744	—	—	—	13,744
Issuance of common stock for public placement, net	10,396,489	2	—	—	71,475	—	—	—	71,477
Issuance of common stock for Virttu settlement	1,795,011	—	—	—	11,308	—	—	—	11,308
Issuance of common stock related to conversion of notes payable	22,038,565	2	—	—	49,998	—	—	—	50,000
Beneficial conversion feature recorded on convertible notes	—	—	—	—	12,006	—	—	—	12,006
Warrants issued in connection with convertible notes	—	—	—	—	9,646	—	—	—	9,646
Stock-based compensation	—	—	—	—	4,218	—	—	(29)	4,189
Foreign currency translation	—	—	—	—	—	(163)	—	—	(163)

adjustment										
Net loss	—	—	—	—	—	—	(153,764)	(5,045)	(158,809)
Balance, September 30, 2018	118,867,459	$ 13	7,568,182	(49,464)	$588,938	$ 79	$(317,974)	$ 1,968	$223,560

Three Months Ended September 30, 2018

	Common Stock		Treasury Stock			Accumulated			
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Other Comprehensive Income (Loss)	Accumulated Deficit	Noncontrolling Interest	Total
Balance, June 30, 2018	116,240,963	12	7,568,182	(49,464)	574,316	153	(270,646)	5,094	259,465
Issuance of common stock upon exercise of stock options	16,750	—	—	—	141	—	—	—	141
Issuance of common stock for public placement, net	2,609,746	1	—	—	13,204	—	—	—	13,205
Stock-based compensation	—	—	—	—	1,277	—	—	—	1,277
Foreign currency translation adjustment	—	—	—	—	—	(74)	—	—	(74)
Net income (loss)	—	—	—	—	—	—	(47,328)	(3,126)	(50,454)
Balance, September 30, 2018	118,867,459	13	7,568,182	(49,464)	588,938	79	(317,974)	1,968	223,560

Nine Months Ended September 30, 2017

	Common Stock		Treasury Stock						
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Noncontrolling 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 for public placement and investments, net	26,082,325	3	—	—	47,641	—	—	—	47,644
Issuance of common stock for private placement and investments, net	4,246	—	—	—	30	—	—	—	30
Stock-based compensation	—	—	—	—	3,936	—	—	—	3,936
Foreign currency translation adjustment	—	—	—	—	—	241	—	—	241
Issuance of common stock for business combinations, net	1,552,011	—	—	—	3,053	—	—	—	3,053
Net income (loss)	—	—	—	—	—	—	(39,313)	2,223	(37,090)
Balance, September 30, 2017	78,521,438	$ 9	7,568,182	(49,464)	$357,898	$ 123	$(213,565)	$ 7,288	$102,289

Three Months Ended September 30, 2017

	Common Stock		Treasury Stock						
	Shares	Amount	Shares	Amount	Additional Paid-in Capital	Accumulated Other Comprehensive Income (Loss)	Accumulated Deficit	Noncontrolling Interest	Total
Balance, June 30, 2017	76,540,055	9	7,568,182	(49,464)	353,162	218	(211,503)	3,774	96,196
Issuance of common stock for public placement and investments, net	1,226,453	—	—	—	2,045	—	—	—	2,045
Stock-based compensation	—	—	—	—	1,310	—	—	—	1,310
	—	—	—	—	—	(95)	—	—	(95)

Foreign currency translation adjustment									
Issuance of common stock for business combinations, net	754,930	—	—	—	1,381	—	—	—	1,381
Net income (loss)	—	—	—	—	—	—	(2,062)	3,514	1,453
Balance, September 30, 2017	78,521,438	9	7,568,182	(49,464)	357,898	123	(213,565)	7,288	102,289

See accompanying unaudited notes

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SORRENTO THERAPEUTICS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(Unaudited) (In thousands)

	Nine Months Ended September 30, 2018	2017
Operating activities		
Net loss	$ (158,809)	$ (37,090)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	6,192	5,271
Non-cash interest expense	44,272	920
Loss on trading securities	144	218
Acquired in process research and development	9,478	—
Amortization of debt issuance costs and debt discount	2,634	455
Stock-based compensation	4,188	3,936
Loss on equity method investments	3,926	38,577
Non-cash income on cost method investments	—	(116,249)
Loss (gain) on contingent liabilities and acquisition consideration payable	13,696	(8,558)
Deferred tax provision	(3,062)	54,445
Changes in operating assets and liabilities, excluding effect of acquisitions:		
Grants and other receivables	(67)	3
Accrued payroll	3,683	593
Prepaid expenses and other	(1,900)	886
Deposits and other assets	1,801	233
Accounts payable	7,233	4,572

Deferred revenue	(3,482	)	(2,243	)
Deferred rent and other	(359	)	212	
Acquisition consideration payable	(2,020	)	—	
Accrued expenses and other liabilities	5,663		(509	)
Net cash used for operating activities	(66,789	)	(54,328	)
Investing activities				
Purchases of property and equipment	(5,748	)	(9,371	)
Purchase of assets related to Sofusa	(10,000	)	—	
Investment in Celularity	—		(5,000	)
Purchase of business, net of cash acquired	—		(557	)
Net cash used in investing activities	(15,748	)	(14,928	)
Financing activities				
Proceeds from bridge loan for Scilex regulatory milestone	20,000		—	
Repayment of bridge loan for Scilex regulatory milestone	(20,000	)	—	
Repayment under the amended loan and security agreement	—		(21,500	)
Proceeds from loan agreement	1,586		—	
Payments under deferred compensation arrangements	—		(1,012	)
Short-term bridge loan, net of issuance costs	19,675		—	
Scilex consideration for regulatory milestone	(22,466	)	—	
Proceeds from issuance of common stock, net of issuance costs	71,481		47,674	
Proceeds from issuance of Scilex notes	140,000		—	
Scilex notes issuance costs	(5,725	)	—	

Proceeds from issuance of convertible notes	37,849			—		
Proceeds from exercise of stock options	303			—		
Net cash provided by financing activities	242,703			25,162		
Net change in cash, cash equivalents, and restricted cash	160,166			(44,094		)
Net effect of exchange rate changes on cash	(154		)	19		
Cash, cash equivalents, and restricted cash at beginning of period	20,429			82,398		
Cash, cash equivalents, and restricted cash at end of period	$	180,441		$	38,323	
Supplemental disclosures:						
Cash paid during the period for:						
Income taxes	$	15		$	34	

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Interest paid	$1,453	$2,808
Supplemental disclosures of non-cash investing and financing activities:		
Virttu acquisition non-cash consideration	$11,308	$15,465
BDL non-cash consideration	$2,340	$—
Property and equipment costs incurred but not paid	$59	$130
Scilex non-cash consideration for regulatory milestone	$13,744	$1,380
Conversion of convertible notes	$50,000	$—
Reconciliation of cash, cash equivalents, and restricted cash within the Company's condensed consolidated balance sheets:		
Cash and cash equivalents	135,441	38,323
Restricted cash	45,000	—
Cash, cash equivalents, and restricted cash	180,441	38,323

See accompanying unaudited notes

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SORRENTO THERAPEUTICS, INC.
NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
September 30, 2018

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 as well as investments in drug delivery technology aimed at increased efficacy for delivering injectable medicines.
Through September 30, 2018, 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, 2017. Operating results for interim periods are not expected to be indicative of operating results for the Company's 2018 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 historically operated with working capital deficiencies and expects to operate in the future with working capital deficiencies and has incurred substantial net losses for the years ended December 31, 2017 and 2016, 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. These conditions, among others, raise substantial doubt about the Company's ability to continue as a going concern.

As of September 30, 2018, the Company had $37.8 million of long term debt issued in a private placement (the "Private Placement") pursuant to a Securities Purchase Agreement, dated as of March 26, 2018, as amended by Amendment No. 1 thereto, dated as of June 13, 2018 (the “Securities Purchase Agreement”), among the Company and certain accredited investors (collectively, the “Purchasers”). Pursuant to the Securities Purchase Agreement, the Company issued and sold to the Purchasers (1) convertible promissory notes in an aggregate principal amount of $37,848,750 (the “Notes”), which accrue simple interest at a rate equal to 5.0% per annum and mature upon the earlier to occur of (a) June 13, 2023, and (b) the date of the closing of a change in control of the Company (the “Maturity Date”), and (2) warrants (the “Warrants”) to purchase an aggregate of 2,698,662 shares of the common stock of the Company.

Each of the Notes provide that, upon the occurrence of an event of default, the Purchasers thereof may, by written notice to the Company, declare all of the outstanding principal and interest under such Notes immediately due and payable. For purposes of the Notes, an event of default includes, among other things, one or more events that have, or could reasonably be expected to have, a material adverse effect on (i) the Company’s ability to comply with its obligations under the Securities Purchase Agreement, the Notes or the Warrants or the registration rights agreement entered into with the Purchasers in connection with the Private Placement, or (ii) the rights of the Purchasers under the Notes. The Company believes that it is not probable that the material adverse event clause under the Notes will be exercised.

As of September 30, 2018, the Company had approximately $224.0 million of senior notes issued by Scilex Pharmaceuticals Inc. (“Scilex”), a majority owned subsidiary of the Company, which entered into Purchase Agreements (the “2018 Purchase Agreements”) with certain investors (collectively, the “Purchasers”) and the Company on September 7, 2018. Pursuant to the 2018 Purchase Agreements, on September 7, 2018, Scilex, among other things, issued and sold to the Purchasers senior secured notes due 2026 in an aggregate principal amount of $224,000,000 (the “Scilex Notes”) for an aggregate purchase price of $140,000,000 (the “Offering”). In connection with the Offering, Scilex also entered into an indenture (the “Indenture”) governing the Scilex Notes with U.S. Bank National Association, a national banking association, as trustee (the “Trustee”) and collateral agent (the “Collateral Agent”), and the Company. Pursuant to the Indenture, the Company agreed to irrevocably and unconditionally guarantee, on a senior unsecured basis, the punctual performance and payment when due of all obligations of Scilex under the Indenture (the “Guarantee”).

The net proceeds of the Offering were approximately $89.3 million, after deducting the Offering expenses payable by Scilex and funding a segregated reserve account with $20.0 million (the “Reserve Account”) and a segregated collateral account with $25.0 million (the “Collateral Account”) pursuant to the terms of the Indenture. The net proceeds of the Offering will be used by Scilex to support the commercialization of ZTlido™ (lidocaine topical system 1.8%), for working capital and general corporate purposes in respect of the commercialization of ZTlido™ (lidocaine topical system 1.8%). Funds in the Reserve Account will be released to Scilex upon receipt by the Trustee of an officer’s certificate under the Indenture from Scilex confirming receipt of a marketing approval letter from the United States Food and Drug Administration with respect to ZTlido™ (lidocaine topical system 5.4%) or a similar product with a concentration of not less than 5% (the “Marketing Approval Letter”) on or prior to July 1, 2023.

Funds in the Collateral Account will be released upon receipt of a written consent authorizing such release from the holders of a majority in principal amount of the Scilex Notes issued.

The Company has plans in place to obtain sufficient additional fundraising to fulfill its operating and capital requirements for the next 12 months. 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 conclude that such plans will be effectively implemented within one year after the date that the condensed consolidated financial statements are issued.

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 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 “2014 Shelf Registration Statement”) with the SEC, which was declared effective by the SEC in December 2014. This 2014 Shelf Registration Statement provided 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 was 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 could be issued and sold under a sales agreement with MLV & Co. LLC (the “2014 ATM Facility”). During the twelve months ended December 31, 2017, the Company sold approximately $13.9 million in shares of common stock under the 2014 ATM Facility. The 2014 Shelf Registration Statement expired in December 2017.

In April 2017, the Company completed a public offering of $47.5 million of shares of common stock pursuant to the 2014 Shelf Registration Statement for net proceeds of approximately $43.1 million.

In November 2017, the Company filed a universal shelf registration statement on Form S-3 (the “2017 Shelf Registration Statement”) with the SEC, which was declared effective by the SEC in December 2017. The 2017 Shelf Registration Statement provides the Company with the ability to offer up to $350 million of securities, including equity and other securities as described in the registration statement. Included in the 2017 Shelf Registration Statement is a sales agreement prospectus covering the offering, issuance and sale by the Company of up to a maximum aggregate offering price of $100.0 million of the Company’s common stock that may be issued and sold under a sales agreement with B. Riley FBR, Inc. (the “ATM Facility”). During the twelve months ended December 31, 2017, the Company sold approximately $0.9 million in shares of common stock under the ATM Facility. During the three and nine month periods ended September 30, 2018, the Company sold approximately $0.5 million and approximately $60.7 million in shares of common stock, respectively, under the ATM Facility. The Company can offer up to approximately $39.3 million of additional shares of common stock under the ATM Facility, subject to certain limitations.

Pursuant to the 2017 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 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 has an exercise price of $8.50 per share, was immediately exercisable upon issuance, has a term of three years and is 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 issued pursuant to each of the Additional Purchase Agreements (collectively, the “Additional Warrants” and, together with each ABG Warrant, the “ABG Warrants”) have an exercise price of $8.50 per share, were immediately exercisable upon issuance, have a term of three years and are 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 is 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 "ABG 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 ABG Warrants held by the Investors and the ABG 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.

2017 Private Investment in Public Entity Financing

On December 11, 2017, the Company entered into a Securities Purchase Agreement (the "December 2017 Securities Purchase Agreement") with certain accredited investors (collectively, the "December 2017 Purchasers"). Pursuant to the December 2017 Securities Purchase Agreement, on December 21, 2017, the Company issued and sold to the December 2017 Purchasers, in a private placement transaction, (1) convertible promissory notes in an aggregate principal amount of $50,000,000 (the "December 2017 Notes"), which accrued simple interest at a rate equal to 5.0% per annum and would mature upon the earlier to occur of (a) December 21, 2022, and (b) the date of the closing of a change in control of the Company (the "December 2017 Warrant Maturity Date"), and (2) warrants (the "December 2017 Warrants") to purchase an aggregate of 12,121,210 shares of the common stock of the Company.

At any time and from time to time before the December 2017 Warrant Maturity Date, each December 2017 Purchaser had the option to convert any portion of the outstanding principal amount of such December 2017 Purchaser's December 2017 Note that was equal to or greater than the lesser of: (1) $4,000,000, and (2) the then-outstanding principal amount of such December 2017 Purchaser's December 2017 Note into shares of common stock at a price per share of $2.26875, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions. Accrued but unpaid interest on the December 2017 Notes was to be paid in cash semi-annually in arrears on or prior to the 30th day of June and 31st day of December of each calendar year commencing with the year ending December 31, 2018.

Each December 2017 Warrant has an exercise price of $2.61 per share, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions, became exercisable on June 20, 2018, has a term of five and a half years and is exercisable on a cash basis, unless there is not an effective registration statement covering the resale of the shares issuable upon exercise of the December 2017 Warrants, in which case the December 2017 Warrants shall also be exercisable on a cashless exercise basis.

On May 17, 2018, the December 2017 Purchasers converted the full outstanding principal under the December 2017 Notes into 22,038,565 shares of the Company's common stock, and the Company paid to the December 2017 Purchasers cash in an aggregate amount of $1.0 million in accrued but unpaid interest. The unamortized discount remaining at the date of conversion of $44.3 million was recognized immediately at that date as interest expense.

See Note 3 for discussion of the Company's policies for accounting for debt with detachable warrants. In connection with the issuance of the Notes and Warrants, the Company recorded a debt discount of approximately $44.8 million based on an allocation of proceeds to the Warrants of approximately $12.7 million and a beneficial conversion

feature of approximately $32.1 million, before issuance costs. The Company accounts for the debt at amortized cost and amortizes the debt discount to interest expense using the effective interest method over the expected term of the Notes.
2018 Private Investment in Public Entity Financing

On March 26, 2018, the Company entered into the Securities Purchase Agreement with the Purchasers. Pursuant to the Securities Purchase Agreement, the Company agreed to issue and sell to the Purchasers, in the Private Placement, the Notes in an aggregate principal amount of $120,500,000 and Warrants to purchase an aggregate of 8,591,794 shares.
On June 13, 2018, the Company entered into an amendment (the "Amendment") to the Securities Purchase Agreement. Under the terms of the Amendment, the Company and the Purchasers agreed that the aggregate principal amount of the Notes was reduced to $37,848,750 and that the aggregate number of shares of the common stock issuable upon exercise of the Warrants was reduced to 2,698,662, and also agreed to certain other adjustments to the threshold principal amount of the Notes required to remain outstanding in order for certain rights and obligations to apply to the Notes.
On June 13, 2018, pursuant to the Securities Purchase Agreement, the Company issued and sold to the Purchasers, in the Private Placement (1) Notes in an aggregate principal amount of $37,848,750, and (2) Warrants to purchase an aggregate of 2,698,662 shares of the common stock of the Company.
At any time and from time to time before the Maturity Date, each Purchaser shall have the option to convert any portion of the outstanding principal amount of such Purchaser's Note that is equal to or greater than the lesser of: (1) $4,000,000, and (2) the then-outstanding principal amount of such Purchaser's Note into shares of common stock at a price per share of $7.0125, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions. Accrued but unpaid interest on the Notes shall be paid in cash semi-annually in arrears on or prior to the 30th day of June and 31st day of December of each calendar year commencing with December 31, 2018. If a Purchaser elects to convert any of the principal amount of their Note, then all accrued but unpaid interest on such portion of the principal amount shall become due and payable in cash. The Notes contain restrictive covenants and event of default provisions that are customary for transactions of this type.
Each Warrant has an exercise price of $8.77 per share, subject to adjustment for stock splits, reverse stock splits, stock dividends and similar transactions, will become exercisable on December 11, 2018, has a term of five and a half years from the date of issuance and will be exercisable on a cash basis, unless there is not an effective registration statement covering the resale of the shares issuable upon exercise of the Warrants, in which case the Warrants shall also be exercisable on a cashless exercise basis.
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 condensed 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 condensed consolidated 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.

Restricted Cash

Restricted cash in our condensed consolidated balance sheet as of September 30, 2018, included approximately $45 million of restricted cash related to the Scilex Notes in the form of both the Reserve Account and the Collateral Account.

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

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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 inv