UNITED THERAPEUTICS Corp
Form 10-Q
October 28, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2014

OR

o TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934.

For the transition period from to

Commission file number 0-26301

United Therapeutics Corporation

(Exact Name of Registrant as Specified in Its Charter)

Delaware (State or Other Jurisdiction of Incorporation or Organization)	**52-1984749** (I.R.S. Employer Identification No.)
1040 Spring Street, Silver Spring, MD (Address of Principal Executive Offices)	**20910** (Zip Code)

(301) 608-9292

(Registrant s Telephone Number, Including Area Code)

(Former Name, Former Address and Former Fiscal Year, If Changed Since Last Report)

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

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

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

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

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

The number of shares outstanding of the issuer s common stock, par value $.01 per share, as of October 21, 2014 was 47,508,910.

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PART I. FINANCIAL INFORMATION

Item 1. Consolidated Financial Statements

UNITED THERAPEUTICS CORPORATION

CONSOLIDATED BALANCE SHEETS

(In thousands, except share data)

	September 30, 2014 (Unaudited)	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$ 497,291	$ 284,258
Marketable investments	270,372	409,645
Accounts receivable, net of allowance of none for 2014 and 2013	139,903	126,297
Inventories, net	63,669	47,758
Other current assets	107,250	46,424
Total current assets	1,078,485	914,382
Marketable investments	205,953	448,134
Goodwill and other intangibles, net	14,499	14,115
Property, plant and equipment, net	481,049	464,950
Deferred tax assets, net	193,653	192,718
Other assets	98,411	53,268
Total assets	$ 2,072,050	$ 2,087,567
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable and accrued expenses	$ 127,961	$ 92,244
Convertible notes	224,701	215,845
Share tracking awards plan	301,853	287,956
Line of credit and mortgages payable current	66,614	66,614
Other current liabilities	39,519	25,015
Total current liabilities	760,648	687,674
Other liabilities	94,843	95,582
Total liabilities	855,491	783,256
Commitments and contingencies:		
Temporary equity	36,180	45,037
Stockholders equity:		
Preferred stock, par value $.01, 10,000,000 shares authorized, no shares issued		
Series A junior participating preferred stock, par value $.01, 100,000 shares authorized, no shares issued		
Common stock, par value $.01, 245,000,000 shares authorized, 64,236,646 and 63,013,192 shares issued, and 47,436,015 and 50,388,140 shares outstanding at September 30, 2014 and December 31, 2013, respectively	642	630
Additional paid-in capital	1,161,083	1,057,224
Accumulated other comprehensive loss	(16,930)	(13,183)
Treasury stock at cost, 16,800,631 and 12,625,052 shares at September 30, 2014 and December 31, 2013, respectively	(916,595)	(513,437)

Retained earnings		952,179		728,040
Total stockholders equity		1,180,379		1,259,274
Total liabilities and stockholders equity	$	2,072,050	$	2,087,567

See accompanying notes to consolidated financial statements.

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UNITED THERAPEUTICS CORPORATION

CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share data)

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
	(Unaudited)		(Unaudited)	
Revenues:				
Net product sales	$ 328,269	$ 300,006	$ 934,152	$ 820,647
Other	1,681	2,219	8,004	7,320
Total revenues	329,950	302,225	942,156	827,967
Operating expenses:				
Research and development	118,876	72,749	171,067	177,796
Selling, general and administrative	202,507	94,111	300,753	236,832
Cost of product sales	40,803	30,716	110,113	92,349
Total operating expenses	362,186	197,576	581,933	506,977
Operating (loss) income	(32,236)	104,649	360,223	320,990
Other (expense) income:				
Interest expense	(4,709)	(4,540)	(14,065)	(13,496)
Other, net	1,112	1,070	4,258	3,039
Total other expense, net	(3,597)	(3,470)	(9,807)	(10,457)
(Loss) income before income taxes	(35,833)	101,179	350,416	310,533
Income tax benefit (expense)	10,596	(38,494)	(126,277)	(105,659)
Net (loss) income	$ (25,237)	$ 62,685	$ 224,139	$ 204,874
Net (loss) income per common share:				
Basic	$ (0.53)	$ 1.25	$ 4.63	$ 4.10
Diluted	$ (0.53)	$ 1.17	$ 4.12	$ 3.90
Weighted average number of common shares outstanding:				
Basic	47,297	50,014	48,427	50,007
Diluted	47,297	53,688	54,360	52,570

See accompanying notes to consolidated financial statements.

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UNITED THERAPEUTICS CORPORATION

CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME

(In thousands)

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
	(Unaudited)		(Unaudited)	
Net (loss) income	$ (25,237)	$ 62,685	$ 224,139	$ 204,874
Other comprehensive (loss) income:				
Foreign currency translation (loss) gain	(2,538)	1,809	(2,156)	(854)
Defined benefit pension plan:				
Prior service cost arising during period, net of tax			(2,415)	
Actuarial gain arising during period, net of tax			221	51
Less: amortization of actuarial gain and prior service cost included in net periodic pension cost, net of tax	226	255	678	767
Total defined benefit pension plan, net	226	255	(1,516)	818
Unrealized gain (loss) on available-for-sale securities, net of tax	9	(12)	(75)	(70)
Other comprehensive (loss) gain, net of tax	(2,303)	2,052	(3,747)	(106)
Comprehensive (loss) income	$ (27,540)	$ 64,737	$ 220,392	$ 204,768

See accompanying notes to consolidated financial statements.

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UNITED THERAPEUTICS CORPORATION

CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
	(Unaudited)	
Cash flows from operating activities:		
Net income	$ 224,139	$ 204,874
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	23,313	23,506
Current and deferred income tax expense	126,277	105,659
Share-based compensation expense	157,730	142,584
Amortization of debt discount and debt issue costs	9,968	9,412
Amortization of discount or premium on investments	4,195	3,066
Other	1,478	1,108
Excess tax benefits from share-based compensation	(23,183)	(5,807)
Changes in operating assets and liabilities:		
Accounts receivable	(13,324)	(15,244)
Inventories	(16,870)	(11,634)
Other assets	4,055	4,554
Accounts payable and accrued expenses	35,855	12,633
Other liabilities	(268,979)	(153,865)
Net cash provided by operating activities	264,654	320,846
Cash flows from investing activities:		
Purchases of property, plant and equipment	(45,157)	(18,497)
Purchases of held-to-maturity investments	(115,170)	(438,633)
Maturities of held-to-maturity investments	491,833	349,275
Purchase of investments under the cost method, net	(45,000)	(30,766)
Net cash provided by (used in) investing activities	286,506	(138,621)
Cash flows from financing activities:		
Payments to repurchase common stock	(403,158)	(42,438)
Proceeds from line of credit	140,000	
Payments on the line of credit	(140,000)	
Proceeds from the exercise of stock options	39,391	19,896
Issuance of stock under employee stock purchase plan	3,329	2,734
Excess tax benefits from share-based compensation	23,183	5,807
Net cash used in financing activities	(337,255)	(14,001)
Effect of exchange rate changes on cash and cash equivalents	(872)	(24)
Net increase in cash and cash equivalents	213,033	168,200
Cash and cash equivalents, beginning of period	284,258	154,030
Cash and cash equivalents, end of period	$ 497,291	$ 322,230
Supplemental schedule of cash flow information:		
Cash paid for interest	$ 4,743	$ 4,782
Cash paid for income taxes	$ 177,683	$ 119,632
Non-cash investing activities:		
Non-cash investing activity: Non-cash additions to property, plant and equipment	$ 3,298	$ 3,054

See accompanying notes to consolidated financial statements.

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UNITED THERAPEUTICS CORPORATION

NOTES TO CONSOLIDATED FINANCIAL STATEMENTS

September 30, 2014

(UNAUDITED)

1. Organization and Business Description

United Therapeutics Corporation is a biotechnology company focused on the development and commercialization of unique products to address the unmet medical needs of patients with chronic and life-threatening conditions. As used in these notes to the consolidated financial statements, unless the context otherwise requires, the terms we , us , our, and similar terms refer to United Therapeutics Corporation and its consolidated subsidiaries.

We have approval from the United States Food and Drug Administration (FDA) to market the following therapies: Remodulin® (treprostinil) Injection (Remodulin), Tyvaso® (treprostinil) Inhalation Solution (Tyvaso), Adcirca® (tadalafil) Tablets (Adcirca) and Orenitram® (treprostinil) Extended-Release Tablets (Orenitram). We commenced commercial sales of Orenitram during the second quarter of 2014. Remodulin has also been approved in various countries outside the United States.

2. Basis of Presentation

The accompanying unaudited consolidated financial statements have been prepared in accordance with the rules and regulations of the United States Securities and Exchange Commission (SEC) for interim financial information. Accordingly, they do not include all of the information required by United States generally accepted accounting principles (GAAP) for complete financial statements. These consolidated financial statements should be read in conjunction with the audited consolidated financial statements and the accompanying notes to the consolidated financial statements contained in our Annual Report on Form 10-K for the year ended December 31, 2013, as filed with the SEC on February 25, 2014.

In our management s opinion, the accompanying consolidated financial statements contain all adjustments, including normal, recurring adjustments, necessary to fairly present our financial position as of September 30, 2014, results of operations and comprehensive income for the three- and nine-month periods ended September 30, 2014 and 2013, and cash flows for the nine-month periods ended September 30, 2014 and 2013. Interim results are not necessarily indicative of results for an entire year. We have reclassified certain amounts in prior periods to conform to the current year presentation.

3. Inventories

Inventories are stated at the lower of cost (first-in, first-out method) or market (current replacement cost) and consist of the following, net of reserves (in thousands):

	September 30, 2014	December 31, 2013
Raw materials	$ 21,693	$ 18,377
Work-in-progress	14,964	11,802
Finished goods	27,012	17,579
Total inventories	$ 63,669	$ 47,758

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4. Fair Value Measurements

Assets and liabilities subject to fair value measurements are required to be disclosed within a fair value hierarchy. The fair value hierarchy ranks the quality and reliability of inputs used to determine fair value. Accordingly, assets and liabilities carried at, or permitted to be carried at, fair value are classified within the fair value hierarchy in one of the following categories based on the lowest level input that is significant in measuring fair value:

Level 1 Fair value is determined by using unadjusted quoted prices that are available in active markets for identical assets and liabilities.

Level 2 Fair value is determined by using inputs other than Level 1 quoted prices that are directly or indirectly observable. Inputs can include quoted prices for similar assets and liabilities in active markets or quoted prices for identical assets and liabilities in inactive markets. Related inputs can also include those used in valuation or other pricing models such as interest rates and yield curves that can be corroborated by observable market data.

Level 3 Fair value is determined by using inputs that are unobservable and not corroborated by market data. Use of these inputs involves significant and subjective judgment.

Assets and liabilities subject to fair value measurements are as follows (in thousands):

	As of September 30, 2014			
	Level 1	**Level 2**	**Level 3**	**Balance**
Assets				
Money market funds (1)	$ 369,042	$	$	$ 369,042
Federally-sponsored and corporate debt securities (2)		476,667		476,667
Total assets	$ 369,042	$ 476,667	$	$ 845,709
Liabilities				
Convertible notes due 2016 (3)	$ 686,840	$	$	$ 686,840
Contingent consideration (4)			4,736	4,736
Total liabilities	$ 686,840	$	$ 4,736	$ 691,576

	As of December 31, 2013			
	Level 1	**Level 2**	**Level 3**	**Balance**
Assets				
Money market funds (1)	$ 145,194	$	$	$ 145,194
Federally-sponsored and corporate debt securities (2)		857,711		857,711
Total assets	$ 145,194	$ 857,711	$	$ 1,002,905
Liabilities				
Convertible notes due 2016 (3)	$ 593,750	$	$	$ 593,750
Contingent consideration (4)			6,616	6,616
Total liabilities	$ 593,750	$	$ 6,616	$ 600,366

(1) Included in cash and cash equivalents on the accompanying consolidated balance sheets.

(2) Included in current and non-current marketable investments on the accompanying consolidated balance sheets. The fair value of these securities is primarily measured or corroborated by trade data for identical securities or comparable securities in which related trading activity is not sufficiently frequent to be considered a Level 1 input. See also Note 5 *Investments Marketable Investments Held-to-Maturity Investments* to these consolidated financial statements.

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(3) Included in convertible notes on the accompanying consolidated balance sheets. The fair value of our 1.0 percent Convertible Senior Notes due September 15, 2016 (Convertible Notes) is estimated using Level 1 observable inputs since our Convertible Notes are trading with sufficient frequency such that we believe related pricing can be used as the primary basis for measuring their fair value. At both September 30, 2014 and December 31, 2013, the fair value of the Convertible Notes was substantially higher than their book value. This was primarily due to the excess conversion value of the notes compared to the notes par value, and the fact that any such excess would be paid in shares of our common stock.

(4) Included in other liabilities on the accompanying consolidated balance sheets. The fair value of contingent consideration has been estimated using probability weighted discounted cash flow models (DCF). The DCFs incorporate Level 3 inputs including estimated discount rates that we believe market participants would consider relevant in pricing and the projected timing and amount of cash flows, which are estimated and developed, in part, based on the requirements specific to each acquisition agreement. We analyze and evaluate these fair value measurements quarterly to determine whether valuation inputs continue to be relevant and appropriate or whether current period developments warrant adjustments to valuation inputs and related measurements. Any increases or decreases in discount rates would have an inverse impact on the corresponding fair value, while increases or decreases in expected cash flows would result in corresponding increases or decreases in fair value. As of both September 30, 2014 and December 31, 2013, the cost of debt and weighted average cost of capital used to discount projected cash flows relating to our contingent consideration ranged from 8.7 percent to 16.5 percent, respectively.

A reconciliation of the beginning and ending balances of Level 3 liabilities for the three- and nine-month periods ended September 30, 2014 is presented below (in thousands):

		Contingent Consideration
Balance, July 1, 2014 Asset (Liability)	$	(4,777)
Transfers into Level 3		
Transfers out of Level 3		
Total gains/(losses) realized/unrealized:		
Included in earnings		
Included in other comprehensive income		41
Purchases		
Sales		
Issuances		
Settlements		
Balance September 30, 2014 Asset (Liability)	$	(4,736)
Amount of total gains/(losses) for the three-month period ended September 30, 2014 included in earnings that are attributable to the change in unrealized gains or losses related to outstanding liabilities	$	

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		Contingent Consideration
Balance January 1, 2014 Asset (Liability)	$	(6,616)
Transfers into Level 3		
Transfers out of Level 3		
Total gains/(losses) realized/unrealized:		
Included in earnings		1,132
Included in other comprehensive income		64
Purchases		
Sales		
Issuances		
Settlements		684
Balance September 30, 2014 Asset (Liability)	$	(4,736)
Amount of total gains/(losses) for the nine-month period ended September 30, 2014 included in earnings that are attributable to the change in unrealized gains or losses related to outstanding liabilities	$	1,132

Fair Value of Financial Instruments

The carrying amounts of cash and cash equivalents, accounts receivable, accounts payable, and accrued expenses approximate fair value because of their short maturities. The fair values of our marketable investments and our Convertible Notes are reported above within the fair value hierarchy. The carrying value of our Wells Fargo mortgage loan approximates its fair value as it bears a variable rate of interest that we believe approximates the market rate of interest for debt with similar credit risk profiles, terms and maturities (Level 2 in the fair value hierarchy). Refer to Note 9 *Debt*.

5. Investments

Marketable Investments

Held-to-Maturity Investments

Marketable investments classified as held-to-maturity consist of the following (in thousands):

As of September 30, 2014		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value
Government-sponsored enterprises	$	151,256	$	188	$	(18)	$	151,426
Corporate notes and bonds		324,802		505		(66)		325,241
Total	$	476,058	$	693	$	(84)	$	476,667
Reported under the following captions on the consolidated balance sheet:								
Current marketable investments	$	270,372						

Noncurrent marketable investments		205,686
	$	476,058

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As of December 31, 2013		Amortized Cost		Gross Unrealized Gains		Gross Unrealized Losses		Fair Value
Government-sponsored enterprises	$	445,939	$	257	$	(77)	$	446,119
Corporate notes and bonds		411,455		300		(163)		411,592
Total	$	857,394	$	557	$	(240)	$	857,711
Reported under the following captions on the consolidated balance sheet:								
Current marketable investments	$	409,645						
Noncurrent marketable investments		447,749						
	$	857,394						

The following table summarizes gross unrealized losses and the length of time marketable investments have been in a continuous unrealized loss position (in thousands):

	As of September 30, 2014				As of December 31, 2013			
		Fair Value		Gross Unrealized Loss		Fair Value		Gross Unrealized Loss
Government-sponsored enterprises:								
Continuous unrealized loss position less than one year	$	13,747	$	(18)	$	76,651	$	(77)
Continuous unrealized loss position greater than one year								
		13,747		(18)		76,651		(77)
Corporate notes and bonds:								
Continuous unrealized loss position less than one year		67,964		(66)		168,669		(163)
Continuous unrealized loss position greater than one year								
		67,964		(66)		168,669		(163)
Total	$	81,711	$	(84)	$	245,320	$	(240)

We attribute gross unrealized losses pertaining to our held-to-maturity securities as of September 30, 2014 and December 31, 2013 to the variability in related market interest rates. We do not intend to sell these securities, nor is it more likely than not that we will be required to sell them prior to the end of their contractual terms. Furthermore, we believe these securities do not expose us to undue market risk or counterparty credit risk. As such, we do not consider these securities to be other than temporarily impaired.

The following table summarizes the contractual maturities of held-to-maturity marketable investments (in thousands):

	September 30, 2014			
		Amortized Cost		Fair Value
Due in less than one year	$	270,372	$	270,695
Due in one to two years		161,066		161,356
Due in three to five years		44,620		44,616
Due after five years				
Total	$	476,058	$	476,667

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Investments Held at Cost

As of September 30, 2014, we maintain in the aggregate, non-controlling equity investments of $83.0 million in privately-held corporations, including a $50.0 million investment in preferred stock of Synthetic Genomics Inc. (SGI), which we purchased in May 2014. We account for these investments under the cost method since we do not have the ability to exercise significant influence over these companies and their fair values are not readily determinable. The fair value of these investments has not been estimated at September 30, 2014, as we have not identified any events or developments indicating that their carrying amounts may be impaired. We include these investments within other assets on our accompanying consolidated balance sheets.

In addition to the SGI investment noted above, we entered into a separate multi-year research and development collaboration agreement whereby SGI will develop engineered primary pig cells with modified genomes for use in our xenotransplantation program, which is primarily focused on lungs. Under this agreement, each party will assume its own research and development costs and SGI may receive royalties and milestone payments from the development and commercialization of organs.

6. Goodwill and Other Intangible Assets

Goodwill and other intangible assets comprise the following (in thousands):

	As of September 30, 2014			As of December 31, 2013		
	Gross	Accumulated Amortization	Net	Gross	Accumulated Amortization	Net
Goodwill (1)	$ 10,362	$	$ 10,362	$ 10,703	$	$ 10,703
Other intangible assets (1):						
Technology, patents and trade names	6,676	(4,049)	2,627	5,049	(3,730)	1,319
Customer relationships and non-compete agreements	4,559	(3,049)	1,510	4,947	(2,886)	2,061
Contract-based	2,020	(2,020)		2,020	(1,988)	32
Total	$ 23,617	$ (9,118)	$ 14,499	$ 22,719	$ (8,604)	$ 14,115

(1) Includes foreign currency translation adjustments.

7. Supplemental Executive Retirement Plan

We maintain the United Therapeutics Corporation Supplemental Executive Retirement Plan (SERP) to provide retirement benefits to certain senior members of our management team. To help fund our expected obligations under the SERP, we maintain the United Therapeutics Corporation Supplemental Executive Retirement Plan Rabbi Trust Document (Rabbi Trust). The balance in the Rabbi Trust was $5.1 million as of September 30, 2014 and December 31, 2013. The Rabbi Trust is irrevocable and SERP participants have no preferred claim on, nor any beneficial ownership interest in, any assets of the Rabbi Trust.

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Net periodic pension cost consists of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Service cost	$ 1,379	$ 1,352	$ 4,138	$ 4,055
Interest cost	592	396	1,775	1,188
Amortization of prior service cost	309	207	925	621
Amortization of net actuarial loss	52	199	158	596
Net pension expense	$ 2,332	$ 2,154	$ 6,996	$ 6,460

Reclassifications related to the SERP from accumulated other comprehensive loss to the statement of operations by line item and the tax impact of these reclassifications is presented below (in thousands):

Component Reclassified from Accumulated Other Comprehensive Loss (1)	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Amortization of prior service cost:				
Research and development	$ 102	$ 79	$ 305	$ 234
Selling, general and administrative	207	128	620	387
Total	309	207	925	621
Amortization of net actuarial loss:				
Research and development	17	75	52	224
Selling, general and administrative	35	124	106	372
Total	52	199	158	596
Total amortization of prior service cost and net actuarial loss:	361	406	1,083	1,217
Tax benefit	(131)	(134)	(384)	(404)
Total, net of tax	$ 230	$ 272	$ 699	$ 813

(1) Refer to Note 12 *Accumulated Other Comprehensive Loss*.

8. Share Tracking Award Plans

We maintain the United Therapeutics Corporation Share Tracking Awards Plan, adopted in June 2008 (2008 STAP) and the United Therapeutics Corporation 2011 Share Tracking Awards Plan, adopted in March 2011 (2011 STAP). We refer to the 2008 STAP and the 2011 STAP collectively as the STAP and awards granted and/or outstanding under either of these plans as STAP awards. STAP awards convey the right to receive in cash an amount equal to the appreciation of our common stock, which is measured as the increase in the closing price of our common stock between the dates of grant and exercise. STAP awards generally vest in equal increments on each anniversary of the grant date over a four-year period and expire on the tenth anniversary of the date of grant.

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The aggregate STAP liability balance was $336.8 million and $305.2 million at September 30, 2014 and December 31, 2013, respectively, of which $34.9 million and $17.2 million, respectively, have been classified as non-current liabilities under the caption other liabilities on our consolidated balance sheets based on their vesting terms.

Estimating the fair value of STAP awards requires the use of certain inputs that can materially impact the determination of fair value and the amount of compensation expense (benefit) we recognize. Inputs used in estimating fair value include the price of our common stock, the expected volatility of the price of our common stock, the risk-free interest rate, the expected term of STAP awards, the expected forfeiture rate and the expected dividend yield. The fair value of the STAP awards is measured each financial reporting period because the awards are settled in cash.

The table below includes the assumptions used to measure the fair value of STAP awards:

	September 30, 2014	September 30, 2013
Expected volatility	34.9%	34.2%
Risk-free interest rate	1.3%	1.1%
Expected term of awards (in years)	3.9	4.1
Expected forfeiture rate	9.9%	9.4%
Expected dividend yield	0.0%	0.0%

A summary of the activity and status of STAP awards is presented below:

	Number of Awards	Weighted-Average Exercise Price	Weighted Average Remaining Contractual Term (in Years)	Aggregate Intrinsic Value (in Thousands)
Outstanding at January 1, 2014	8,734,901	$ 52.75		
Granted	1,564,650	94.65		
Exercised	(1,987,179)	48.23		
Forfeited	(220,811)	62.71		
Outstanding at September 30, 2014	8,091,561	$ 61.69	7.6	$ 541,821
Exercisable at September 30, 2014	2,939,094	$ 52.02	6.1	$ 225,237
Expected to vest at September 30, 2014	4,636,133	$ 67.46	8.5	$ 283,676

The weighted average grant-date fair value of STAP awards granted during the nine-month periods ended September 30, 2014 and September 30, 2013 was $33.61 and $24.70, respectively.

Share-based compensation expense recognized in connection with the STAP is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013
Research and development	$ 82,404	$ 30,463	$ 56,659	$ 58,027
Selling, general and administrative	100,541	29,945	66,530	59,706
Cost of product sales	8,779	1,064	5,432	2,381
Share-based compensation expense before taxes	191,724	61,472	128,621	120,114
Related income tax benefit	(69,596)	(20,593)	(46,689)	(40,238)
Share-based compensation expense, net of taxes	$ 122,128	$ 40,879	$ 81,932	$ 79,876
Share-based compensation capitalized as part of inventory	$ 467	$ 358	$ 1,028	$ 681

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Cash paid to settle STAP awards exercised during the nine-month periods ended September 30, 2014 and September 30, 2013 was $97.9 million and $31.2 million, respectively.

9. Debt

Line of Credit

In September 2013, we entered into a Credit Agreement with Wells Fargo Bank, National Association (Wells Fargo) providing us a $75.0 million revolving loan facility, which could be increased by up to an additional $75.0 million provided certain conditions are met (the 2013 Credit Agreement). At our option, amounts borrowed under the 2013 Credit Agreement bear interest at either the one-month LIBOR rate plus a 0.50 percent margin, or a fluctuating base rate excluding any margin. In addition, we are subject to a monthly commitment fee of 0.06 percent per annum on the average daily unused balance of the facility. Amounts borrowed under the 2013 Credit Agreement are secured by certain of our marketable investments. As of September 30, 2014, we had no outstanding principal balance under the 2013 Credit Agreement. We drew on the revolving loan facility during 2014, in part, to fund share repurchases executed during the second quarter of 2014. The 2013 Credit Agreement does not subject us to any financial covenants. In July 2014, we amended the 2013 Credit Agreement solely to extend its maturity date from September 26, 2014 to September 30, 2015.

Convertible Notes Due 2016

In October 2011, we issued $250.0 million in aggregate principal value 1.0 percent Convertible Senior Notes due September 15, 2016 (Convertible Notes). The Convertible Notes are unsecured, unsubordinated debt obligations that rank equally with all of our other unsecured and unsubordinated indebtedness. We pay interest semi-annually on March 15 and September 15 of each year. The initial conversion price is $47.69 per share and the number of underlying shares used to determine the aggregate consideration upon conversion is approximately 5.2 million shares.

Conversion can occur: (1) any time after June 15, 2016; (2) during any calendar quarter that follows a calendar quarter in which the price of our common stock exceeds 130 percent of the conversion price for at least 20 days during the 30 consecutive trading-day period ending on the last trading day of the quarter; (3) during the ten consecutive trading-day period following any five consecutive trading-day period in which the trading price of the Convertible Notes is less than 95 percent of the closing price of our common stock multiplied by the then current number of shares underlying the Convertible Notes; (4) upon specified distributions to our shareholders; (5) in connection with certain corporate transactions; or (6) in the event that our common stock ceases to be listed on the NASDAQ Global Select Market, the NASDAQ Global Market or the New York Stock Exchange, or any of their respective successors.

The closing price of our common stock exceeded 130 percent of the conversion price of the Convertible Notes for more than 20 trading days during the 30 consecutive trading day period ended September 30, 2014. Consequently, the Convertible Notes are convertible at the election of their holders. As this conversion right is outside of our control, the Convertible Notes are classified as a current liability on our consolidated balance sheet at September 30, 2014. We are required to calculate this contingent conversion provision at the end of each quarterly reporting period. Therefore, the convertibility and classification of our Convertible Notes may change depending on the price of our common stock.

At September 30, 2014, the aggregate conversion value of the Convertible Notes exceeded their par value by $424.4 million using a conversion price of $128.65, the closing price of our common stock on September 30, 2014.

Upon conversion, holders of our Convertible Notes are entitled to receive: (1) cash equal to the lesser of the par value of the notes or the conversion value (the number of shares underlying the Convertible Notes multiplied by the then current conversion price per share); and (2) to the extent the conversion value exceeds the par value of the notes, shares of our common stock. In the event of a change in control, as defined in the indenture under which the Convertible Notes have

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been issued, holders can require us to purchase all or a portion of their Convertible Notes for 100 percent of the notes par value plus any accrued and unpaid interest.

During the three-month period ended September 30, 2014, we received conversion requests representing $101.3 million in principal value of our Convertible Notes. These conversion requests will be settled in October 2014. Based on our current stock price, we expect that the full $101.3 million of principal will be paid in cash to the converting note holders, and that we will be required to issue shares of our common stock. We expect to receive an equal number of shares of our common stock under our note hedge (discussed below under *Convertible Note Hedge and Warrant Transactions*) from Deutsche Bank AG London (DB London). We expect to recognize an estimated $4.0 million extinguishment loss upon settlement of these conversions.

The terms of the Convertible Notes provide for settlement wholly or partially in cash. Consequently, we are required to account for their liability and equity components separately so that the subsequent recognition of interest expense reflects our non-convertible borrowing rate. Accordingly, we estimated the fair value of the Convertible Notes without consideration of the conversion option as of the date of issuance (Liability Component). We recorded the excess of the proceeds received over the estimated fair value of the Liability Component totaling $57.9 million as the conversion option (Equity Component) and recognized a corresponding offset as a discount to the Convertible Notes to reduce their net carrying value. We reclassified a portion of the Equity Component equal to the unamortized discount as of September 30, 2014 to temporary equity because one of the contingent conversion criteria had been met at September 30, 2014, as disclosed above. Refer to Note 10 *Temporary Equity*. We are amortizing the debt discount over the five-year period ending September 15, 2016 (the expected life of the Liability Component) using the interest method and an effective rate of interest of 6.7 percent, which corresponded to our estimated non-convertible borrowing rate at the date of issuance.

Interest expense incurred in connection with our convertible notes consisted of the following (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	**2013**	**2014**	**2013**
Contractual coupon rate of interest	$ 582	$ 625	$ 1,832	$ 1,875
Discount amortization	2,989	2,801	8,856	8,300
Interest expense convertible notes	$ 3,571	$ 3,426	$ 10,688	$ 10,175

Components comprising the carrying value of the Convertible Notes include the following (in thousands):

	September 30, 2014	**December 31, 2013**
Principal balance	$ 250,000	$ 250,000
Discount, net of accumulated amortization of $32,639 and $23,783	(25,299)	(34,155)
Carrying amount	$ 224,701	$ 215,845

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Convertible Note Hedge and Warrant Transactions

In connection with the issuance of our Convertible Notes, we entered into separate convertible note hedge and warrant transactions with DB London to reduce the potentially dilutive impact of the conversion of our convertible notes. Pursuant to the convertible note hedge, we purchased call options to acquire up to approximately 5.2 million shares of our common stock with a strike price of $47.69. The call options become exercisable upon conversion of the Convertible Notes, and will terminate upon the maturity of the Convertible Notes or the first day the Convertible Notes are no longer outstanding, whichever occurs first. We also sold DB London warrants to acquire up to approximately 5.2 million shares of our common stock with a strike price of $67.56. The warrants will expire incrementally on a series of expiration dates subsequent to the September 15, 2016 maturity date of our Convertible Notes. Both the convertible note hedge and warrant transactions will be settled on a net-share basis. If the conversion price of our Convertible Notes is between the strike prices of the call options and warrants on the expiration dates of the warrants, our shareholders will not experience any dilution in connection with the conversion of our Convertible Notes; however, to the extent that the price of our common stock exceeds the strike price of the warrants on any or all of the series of related incremental expiration dates, we will be required to issue shares of our common stock to DB London.

Mortgage Financing

In December 2010, we entered into a Credit Agreement with Wells Fargo and Bank of America, N.A., pursuant to which we obtained a $70.0 million mortgage loan (the 2010 Credit Agreement). The 2010 Credit Agreement matures in December 2014 and is secured by certain of our facilities in Research Triangle Park, North Carolina and Silver Spring, Maryland. The outstanding debt bears a floating rate of interest per annum based on the one-month LIBOR, plus a credit spread of 3.75 percent, or approximately 3.90 percent as of September 30, 2014. We have the option to change the rate of interest charged on the loan to 2.75 percent plus the greater of: (1) Wells Fargo s prime rate, or (2) the federal funds effective rate plus 0.05 percent, or (3) LIBOR plus 1.0 percent. We can prepay the loan balance without being subject to a prepayment premium or penalty. As of September 30, 2014, the principal balance under the 2010 Credit Agreement was $66.5 million and is included within line of credit and mortgages payable current as the outstanding balance will be due in December 2014. The 2010 Credit Agreement contains financial covenants, and as of September 30, 2014, we were in compliance with these covenants.

10. Temporary Equity

Temporary equity includes securities that: (1) have redemption features that are outside our control; (2) are not classified as an asset or liability; (3) are excluded from permanent stockholders equity; and (4) are not mandatorily redeemable. Amounts included in temporary equity relate to securities that are redeemable at a fixed or determinable price.

Components comprising the carrying value of temporary equity include the following (in thousands):

	September 30, 2014	**December 31, 2013**
Reclassification of Equity Component (1)	$ 25,298	$ 34,155
Common stock subject to repurchase (2)	10,882	10,882
Total	$ 36,180	$ 45,037

(1) Represents the reclassification of the Equity Component equal to the unamortized debt discount of our Convertible Notes as of September 30, 2014 and December 31, 2013 from additional paid-in capital to temporary equity as our Convertible Notes were convertible at the election of their holders as noted above in Note 9 *Debt Convertible Notes Due 2016*.

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(2) In connection with our amended 2007 agreement with Toray Industries Inc. (Toray), we issued 400,000 shares of our common stock and provided Toray the right to request that we repurchase the shares at a price of $27.21 per share.

11. Stockholders Equity

Earnings Per Common Share

Basic earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period. Diluted earnings per share is computed by dividing net income by the weighted average number of shares of common stock outstanding during the period, adjusted for the potential dilutive effect of other securities if such securities were converted or exercised.

The components of basic and diluted earnings per common share comprised the following (in thousands, except per share amounts):

	Three Months Ended September 30, 2014	Three Months Ended September 30, 2013	Nine Months Ended September 30, 2014	Nine Months Ended September 30, 2013
Net (loss) income (numerator)	$ (25,237)	$ 62,685	$ 224,139	$ 204,874
Denominator:				
Weighted average outstanding shares basic	47,297	50,014	48,427	50,007
Effect of dilutive securities (1):				
Convertible notes (2)		1,822	2,753	1,389
Warrants		397	1,715	
Stock options and employee stock purchase plan		1,455	1,465	1,174
Weighted average shares diluted	47,297	53,688	54,360	52,570
(Loss) earnings per common share:				
Basic	$ (0.53)	$ 1.25	$ 4.63	$ 4.10
Diluted	$ (0.53)	$ 1.17	$ 4.12	$ 3.90
Stock options and warrants excluded from calculation (2)	15,589	10,088	9,769	10,485

(1) Calculated using the treasury stock method.

(2) Certain stock options and warrants were excluded from the computation of diluted earnings per share because their impact would be anti-dilutive. Under our convertible note hedge agreement, we are entitled to receive shares required to be issued to investors upon conversion of our Convertible Notes. Since related shares used to compute dilutive earnings per share would be anti-dilutive, they have been excluded from the calculation above.

Stock Option Plan

We may grant stock options to employees and non-employees under our equity incentive plan. We estimate the fair value of stock options using the Black-Scholes-Merton valuation model, which requires us to make certain assumptions that can materially impact the estimation of fair value and related compensation expense. These assumptions used to estimate fair value include the expected volatility of our common stock, the risk-free interest rate, the expected term of stock option awards and

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the expected dividend yield. We did not grant any stock options during the three- and nine-month periods ended September 30, 2014 and 2013.

A summary of the activity and status of employee stock options during the nine-month period ended September 30, 2014 is presented below:

	Number of Options		Weighted-Average Exercise Price	Weighted Average Remaining Contractual Term (Years)		Aggregate Intrinsic Value (in thousands)
Outstanding at January 1, 2014	4,749,449	$	56.06			
Granted						
Exercised	(1,129,797)		33.22			
Forfeited	(218)		11.35			
Outstanding and exercisable at September 30, 2014	3,619,434	$	63.20	5.7	$	236,908

Total share-based compensation expense related to employee stock options is as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2014	2013	2014	2013