

FOREST LABORATORIES INC
Form 10-Q
February 07, 2013

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the Quarterly Period Ended December 31, 2012

- 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: 1-5438

FOREST LABORATORIES, INC.
(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction of
incorporation or organization)

11-1798614
(I.R.S. Employer
Identification No.)

909 Third Avenue
New York, New York
(Address of principal executive offices)

10022-4731
(Zip Code)

(212) 421-7850
(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 No

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

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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. (Check one):

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting
company

(Do not check if a 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 No

Number of shares outstanding of Registrant's Common Stock as of February 6, 2013: 266,284,246

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PART I - FINANCIAL INFORMATION

Item 1. Financial Statements

FOREST LABORATORIES, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(Unaudited)

(In thousands)	December 31, 2012	March 31, 2012
Assets		
Current assets:		
Cash (including cash equivalent investments of \$904,062 at December 31, 2012 and \$1,576,922 at March 31, 2012)	\$ 948,903	\$ 1,579,515
Marketable securities	771,002	847,555
Accounts receivable, less allowance for doubtful accounts of \$2,020 at December 31, 2012 and \$2,290 at March 31, 2012	397,909	471,784
Inventories, net	381,846	298,118
Deferred income taxes	267,969	246,451
Other current assets	109,226	142,772
Total current assets	2,876,855	3,586,195
Non-current assets:		
Marketable securities and investments	1,251,057	723,367
Property, plant and equipment, net	376,045	360,020
Other assets:		
Goodwill	713,091	713,091
License agreements, product rights and other intangibles, less accumulated amortization of \$296,586 at December 31, 2012 and \$222,690 at March 31, 2012	2,155,678	2,104,048
Other assets	112,584	5,034
Total assets	\$ 7,485,310	\$ 7,491,755

See notes to condensed consolidated financial statements.

FOREST LABORATORIES, INC. AND SUBSIDIARIES
Condensed Consolidated Balance Sheets
(Unaudited)

(In thousands, except for par values)	December 31,	
	2012	March 31, 2012
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 77,582	\$ 162,574
Accrued expenses and other liabilities	868,408	766,735
Total current liabilities	945,990	929,309
Long-term liabilities:		
Income tax liabilities	573,934	570,417
Contingent acquisition liabilities	25,219	25,219
Deferred tax liabilities	272,251	289,993
Total liabilities	1,817,394	1,814,938
Contingencies (Note 11)		
Stockholders' equity:		
Preferred stock, \$1.00 par; shares authorized 1,000; no shares issued or outstanding		
Common stock, \$.10 par; shares authorized 1,000,000; issued 429,983 shares at December 31, 2012 and 428,746 shares at March 31, 2012	42,998	42,875
Additional paid-in capital	1,775,466	1,700,734
Retained earnings	9,009,901	9,087,447
Accumulated other comprehensive income (loss)	1,697	(2,934)
Treasury stock, at cost (163,882 shares at December 31, 2012 and 163,125 shares at March 31, 2012)	(5,162,146)	(5,151,305)
Total stockholders' equity	5,667,916	5,676,817
Total liabilities and stockholders' equity	\$ 7,485,310	\$ 7,491,755

See notes to condensed consolidated financial statements.

FOREST LABORATORIES, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Operations
(Unaudited)

(In thousands, except per share amounts)	Three Months Ended		Nine Months Ended	
	December 31,		December 31,	
	2012	2011	2012	2011
Net sales	\$ 677,967	\$ 1,161,254	\$ 2,121,750	\$ 3,395,639
Contract revenue	38,314	34,149	158,426	108,367
Interest and other income	6,409	13,918	24,278	26,325
	722,690	1,209,321	2,304,454	3,530,331
Costs and expenses:				
Cost of sales	153,311	262,732	471,257	780,513
Selling, general and administrative	428,380	396,054	1,185,578	1,142,788
Research and development	325,290	191,269	723,295	583,043
	906,981	850,055	2,380,130	2,506,344
Income (loss) before income tax	(184,291)	359,266	(75,676)	1,023,987
Income tax expense (benefit)	(30,683)	80,830	1,870	237,601
Net income (loss)	\$ (153,608)	\$ 278,436	\$ (77,546)	\$ 786,386
Net income (loss) per common share:				
Basic	\$ (0.58)	\$ 1.04	\$ (0.29)	\$ 2.86
Diluted	\$ (0.58)	\$ 1.04	\$ (0.29)	\$ 2.85
Weighted average number of common shares outstanding:				
Basic	266,018	267,397	266,967	275,400
Diluted	266,018	267,604	266,967	275,867

See notes to condensed consolidated financial statements.

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FOREST LABORATORIES, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Comprehensive Income (Loss)
(Unaudited)

(In thousands)	Three Months Ended December 31,		Nine Months Ended December 31,	
	2012	2011	2012	2011
Net income (loss)	\$ (153,608)	\$ 278,436–	\$ (77,546)	\$ 786,386
Other comprehensive income (loss):				
Foreign currency translation gains (losses)	2,933	(16,148)	(3,569)	(21,264)
Pension liability adjustment, net of tax	108	(9)	3,468	2,373
Unrealized gains (losses) on securities:				
Unrealized holding gains (losses) arising during the period, net of tax	3,937	2,312	4,732	(5,957)
Other comprehensive income (loss)	6,978	(13,845)	4,631	(24,848)
Comprehensive income (loss)	\$ (146,630)	\$ 264,591–	\$ (72,915)	\$ 761,538

See notes to condensed consolidated financial statements.

FOREST LABORATORIES, INC. AND SUBSIDIARIES
Condensed Consolidated Statements of Cash Flows
(Unaudited)

(In thousands)	Nine Months Ended	
	December 31,	
	2012	2011
Cash flows from operating activities:		
Net income (loss)	\$ (77,546)	\$ 786,386
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	34,496	30,540
Amortization	73,695	56,296
Stock-based compensation expense	53,259	47,411
Deferred income tax benefit	(39,260)	(30,969)
Net change in operating assets and liabilities:		
Decrease (increase) in:		
Accounts receivable, net	73,875	(76,304)
Inventories, net	(83,728)	38,600
Other current assets	33,546	53,048
Increase (decrease) in:		
Accounts payable	(84,992)	(84,212)
Accrued expenses	101,673	89,186
Income tax liabilities	3,517	87,199
Other	1,766	3,805
Net cash provided by operating activities	90,301	1,000,986
Cash flows from investing activities:		
Purchase of property, plant and equipment	(50,557)	(49,927)
Purchase of marketable securities	(2,982,108)	(1,471,192)
Redemption of marketable securities	2,526,325	2,128,767
Acquisitions	--	(1,262,651)
Purchase of trademarks	(125,000)	(40,747)
Other investing activities	(108,077)	--
Net cash used in investing activities	(739,417)	(695,750)
Cash flows from financing activities:		
Net proceeds from common stock options exercised by employees under stock option plans	19,729	6,670
Tax benefit related to stock-based compensation	1,867	39
Treasury stock transactions	(10,841)	(859,382)
Net cash provided by (used in) financing activities	10,755	(852,673)
Effect of exchange rate changes on cash	7,749	(19,529)
Decrease in cash and cash equivalents	(630,612)	(566,966)

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Cash and cash equivalents, beginning of period	1,579,515	2,137,838
Cash and cash equivalents, end of period	\$ 948,903	\$ 1,570,872
Supplemental disclosures of cash flow information:		
Cash paid for income taxes	\$ 49,361	\$ 164,794

See notes to condensed consolidated financial statements.

FOREST LABORATORIES, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Unaudited)

1. Basis of presentation:

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with accounting principles generally accepted in the United States (GAAP) for interim financial information, Accounting Standards Codification (ASC) Topic 270-10 and with the instructions to Form 10-Q. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. In management's opinion, all adjustments considered necessary for a fair presentation have been included in the interim periods presented and all adjustments are of a normal recurring nature. The Company has evaluated subsequent events up to the date of this filing. Operating results for the three and nine-month periods ended December 31, 2012 are not necessarily indicative of the results that may be expected for the year ending March 31, 2013. When used in these notes, the terms "Forest" or "the Company" mean Forest Laboratories, Inc. The March 31, 2012 condensed balance sheet data was derived from audited financial statements, but does not include all disclosures required by GAAP. You should read these unaudited interim condensed consolidated financial statements in conjunction with the consolidated financial statements and footnotes thereto incorporated by reference in the Company's Annual Report on Form 10-K for the year ended March 31, 2012.

New Accounting Standards

In June 2011, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2011-05, Comprehensive Income: Presentation of Comprehensive Income. This ASU amends FASB ASC Topic 220, Comprehensive Income, to require an entity to present the total of comprehensive income, the components of net income and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In December 2011, the FASB issued ASU 2011-12 which amends ASU 2011-05 to defer only those changes in ASU 2011-05 that relate to the presentation of reclassification adjustments out of accumulated other comprehensive income. These standards became effective for the Company on April 1, 2012. The adoption of these standards did not have a significant impact on the Company's financial statements.

2. Accounts receivable:

Accounts receivable, net, consists of the following:

(In thousands)

	December 31, 2012	March 31, 2012
Trade	\$ 324,055	\$ 401,902
Other	73,854	69,882
	\$ 397,909	\$ 471,784

FOREST LABORATORIES, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Unaudited)

3. Inventories:

Inventories, net of reserves for obsolescence, consist of the following:

(In thousands)

	December 31,	
	2012	March 31, 2012
Raw materials	\$ 114,045	\$ 93,037
Work in process	4,708	10,077
Finished goods	263,093	195,004
	\$ 381,846	\$ 298,118

4. Fair value measurements:

The following table presents the level within the fair value hierarchy at which the Company's financial assets are carried at fair value and measured on a recurring basis:

(In thousands)

Description	Fair value at December 31, 2012	Quoted prices in active markets for identical assets (Level 1)	Significant other observable market inputs (Level 2)	Unobservable market inputs (Level 3)
Money market accounts	\$ 842,772	\$ 842,772		
Municipal bonds and notes	62,051		\$ 62,051	
Commercial paper	225,219	70,556	154,663	
Variable rate demand notes	6,800		6,800	
Auction rate securities	3,273			\$ 3,273
Certificates of deposit	124,783	15,973	108,810	
Corporate bonds	1,423,070		1,423,070	
Government agency bonds	215,070		215,070	

Description	Fair value at March 31, 2012	Quoted prices in active markets for	Significant other observable market	Unobservable market inputs (Level 3)
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		identical assets (Level 1)	inputs (Level 2)	
Money market accounts	\$ 1,059,868	\$ 938,526	\$ 121,342	
Municipal bonds and notes	69,613		69,613	
Commercial paper	556,794	284,981	271,813	
Variable rate demand notes	4,000		4,000	
Floating rate notes	467,259	467,259		
Auction rate securities	25,089			\$ 25,089
Certificates of deposit	215,801	87,904	127,897	
Corporate bonds	568,775		568,775	
Government agency bonds	152,916		152,916	

FOREST LABORATORIES, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Unaudited)

The Company determined fair value based on a market approach using quoted market values, significant other observable inputs for identical or comparable assets or liabilities, or discounted cash flow analyses. As of December 31, 2012, the Company determined the value of the auction rate securities portfolio based upon a discounted cash flow model. The assumptions used in the valuation model include estimates for interest rates, timing and amount of cash flows, and expected holding periods for the auction rate securities.

The following table presents a reconciliation of Level 3 investments measured at fair value on a recurring basis using unobservable inputs:

(In thousands)

	Nine months ended December 31, 2012
Balance at beginning of period	\$ 25,089
Sales	(21,064)
Unrealized loss	(752)
Balance at end of period	\$ 3,273

There were no purchases of Level 3 investments during the nine-month period ended December 31, 2012. The Company recorded sales of \$21.1 million of its Level 3 auction rate securities for the nine-month period ended December 31, 2012. In conjunction with these sales, the Company recognized a gain of \$0.2 million.

In addition to the above, the Company also has Level 3 fair value measurements related to the Clinical Data, Inc. (Clinical Data) acquisition; see Note 12 for further information.

The majority of the Company's non-financial assets and liabilities are not required to be carried at fair value on a recurring basis. However, the Company is required on a non-recurring basis to use fair value measurements when analyzing asset impairment as it relates to goodwill, license agreements, product rights and other intangible assets and long-lived assets. The carrying amount of cash, accounts receivable, loans receivable and accounts payable and other short-term financial instruments approximate their fair value due to their short-term nature.

FOREST LABORATORIES, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Unaudited)

5. Marketable securities:

Available-for-sale debt securities consist of the following:

(In thousands)	Estimated fair value	December 31, 2012	
		Gains in accumulated other comprehensive income	Losses in accumulated other comprehensive income
Current:			
Municipal bonds and notes	\$ 48,111	\$ 32	
Government agency bonds	79,344	168	\$ (1)
Commercial paper	169,929	74	
Certificates of deposit	87,566	105	(3)
Corporate bonds	386,052	756	(229)
Total current securities	771,002	1,135	(233)
Non-current:			
Municipal bonds and notes	13,940	11	(6)
Government agency bonds	135,726	450	(23)
Certificates of deposit	31,217	218	
Corporate bonds	1,037,018	5,410	(5,309)
Auction rate securities	3,273		(752)
Variable rate demand notes	6,800		
Total non-current securities	1,227,974	6,089	(6,090)
Total available-for-sale debt securities	\$ 1,998,976	\$ 7,224	\$ (6,323)

FOREST LABORATORIES, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Unaudited)

(In thousands)	Estimated fair value	March 31, 2012	
		Gains in accumulated other comprehensive income	Losses in accumulated other comprehensive income
Current:			
Municipal bonds and notes	\$ 33,723	\$ 52	
Government agency bonds	92,829	123	
Commercial paper	239,393	334	\$ (70)
Certificates of deposit	91,819	320	
Corporate bonds	210,852	76	(79)
Floating rate notes	178,939	281	(22)
Total current securities	847,555	1,186	(171)
Non-current:			
Municipal bonds and notes	35,890	45	
Government agency bonds	60,087	185	
Commercial paper	14,682	111	
Corporate bonds	305,697	779	(82)
Auction rate notes	25,089		
Floating rate notes	254,193		(10,547)
Total non-current securities	695,638	1,120	(10,629)
Total available-for-sale debt securities	\$ 1,543,193	\$ 2,306	\$ (10,800)

Proceeds from the sales of available-for-sale debt securities were \$2.5 billion and \$2.1 billion for the nine months ended December 31, 2012 and December 31, 2011, respectively. Gross realized gains on those sales were \$1.1 million and \$3.7 million, respectively. For purposes of determining gross realized gains and losses, the cost of the securities is based on average cost. A net unrealized holding gain of \$0.9 million at December 31, 2012 and a net unrealized holding loss of \$8.5 million at March 31, 2012 on available-for-sale debt securities have been included in the 'Accumulated other comprehensive income (loss)' caption in the Balance Sheet. The preceding tables do not include the Company's investment in Ironwood Pharmaceuticals, Inc. (Ironwood) of \$23.1 million and \$27.7 million at December 31, 2012 and March 31, 2012, respectively, which is held at fair market value based on the quoted market price for the related security.

FOREST LABORATORIES, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Unaudited)

Contractual maturities of available-for-sale debt securities at December 31, 2012 are as follows:

(In thousands)

	Estimated fair value
Within one year	\$ 771,002
1-5 years	1,204,405
5-10 years	3,994
After 10 years	19,575
	\$ 1,998,976

Actual maturities may differ from stated maturities because some borrowers have the right to call or prepay obligations with or without call penalties.

The Company invests funds in variable rate demand notes that have major bank liquidity agreements, municipal bonds and notes, government agency bonds, commercial paper, corporate bonds, certificates of deposit, auction rate securities and floating rate notes. Certain securities are subject to a hard-put option(s) where the principal amount is contractually assured by the issuer and any resistance to the exercise of these options would be deemed as a default by the issuer. Such a potential default would be reflected in the issuer's respective credit rating, for which the Company maintains investment grade requirements pursuant to its corporate investment guidelines. While the Company believes its investments that have net unrealized losses are temporary, declines in the value of these investments may be deemed other-than-temporary if the credit and capital markets were to deteriorate in future periods. The Company has the ability and intends to hold these investments until a recovery of fair value, which may be at maturity. Currently, the Company does not consider these investments to be other-than-temporarily impaired and continues to monitor global market conditions to minimize the uncertainty of impairments in future periods.

6. License and collaboration agreements:

On November 14, 2012, the Company announced an agreement with Adamas Pharmaceuticals, Inc. (Adamas) for the development and commercialization of a fixed dosed combination (FDC) of Namenda XR™ (memantine HCl extended release) and donepezil HCl which will be a daily therapy for the treatment of moderate to severe dementia of the Alzheimer's type. Pursuant to the agreement, the Company made an upfront payment of \$65 million during the quarter ended December 31, 2012 which was recorded in Research and development expense (R&D). The Company may pay up to \$95 million in future milestones. The Company will have exclusive commercialization rights for this FDC in the United States.

The Company received U.S. Food and Drug Administration (FDA) approval for Tudorza™ Pressair™ (aclidinium bromide inhalation powder) in July 2012, for the long-term maintenance treatment of bronchospasm associated with chronic obstructive pulmonary disease (COPD), including chronic bronchitis and emphysema. The Company licensed rights to aclidinium in the United States through an agreement with Almirall, S.A. (Almirall), pursuant to which the Company made a milestone payment of \$40 million which was due upon FDA approval. The milestone payment was capitalized as an intangible asset and will be amortized over the life of the patent for Tudorza Pressair.

FOREST LABORATORIES, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Unaudited)

On June 1, 2012, the Company announced an agreement with Nabriva for the development of Nabriva's novel antibacterial agent, BC-3781. Pursuant to the agreement, the Company provided funding of \$25 million to Nabriva during July 2012, and will conduct, in collaboration with Nabriva, certain development activities related to BC-3781 over the twelve month period following the execution of the agreement. During the twelve-month period, the Company has the exclusive right to acquire Nabriva. The Company's decision to acquire Nabriva will be dependent upon certain contingencies. The Company recorded an asset of \$25 million in connection with this agreement which is included within the 'Other assets' caption in the Balance Sheet.

Ironwood collaboration agreement

In September 2007, the Company entered into a collaboration agreement with Ironwood to jointly develop and commercialize LinzessTM (linaclotide) for the treatment of irritable bowel syndrome with constipation (IBS-C) and chronic idiopathic constipation (CIC) (the Ironwood collaboration agreement). Under the terms of the Ironwood collaboration agreement, the Company shares equally with Ironwood all profits and losses from the development and sale of linaclotide in the U.S. In addition, Forest obtained exclusive rights to the linaclotide license in Canada and Mexico, for which the Company will pay royalties to Ironwood based on net sales.

The Company made non-refundable, up-front payments totaling \$70 million to Ironwood. The agreement also included contingent milestone payments as well as a contingent equity investment based on the achievement of specific clinical and commercial milestones. As of December 31, 2012, payments totaling \$230 million, relating mostly to developmental milestones, have been made. The Company may be obligated to pay up to an additional \$180 million if further milestones are achieved. The contingent equity investment required the Company to purchase \$25 million of Ironwood's convertible preferred stock when a specific clinical milestone was met. This investment is recorded at fair value as an investment. The fair value of the investment at December 31, 2012 is \$23.1 million.

In August 2012, the FDA approved Linzess as a once-daily treatment for adult men and women suffering from IBS-C or CIC. Pursuant to the Ironwood collaboration agreement, the Company made a milestone payment of \$85 million to Ironwood which was due upon FDA approval. The milestone payment was capitalized as an intangible asset and will be amortized over the life of the patent for Linzess.

For the three and nine-month periods ended December 31, 2012, Linzess sales in the U.S. totaled \$19.2 million.

Based on the nature of the arrangement (including its contractual terms), the nature of the payments and applicable guidance, the Company records receipts from and payments to Ironwood in two pools; the Development pool which consists of R&D expenses and the Commercialization pool which consists of revenue, cost of sales and selling, general and administrative expenses. The net payment or receipt from Ironwood for the Commercialization pool is recorded in Selling, general and administrative expense (SG&A) and the net payment or receipt for the Development pool is recorded in R&D.

FOREST LABORATORIES, INC. AND SUBSIDIARIES
Notes to Condensed Consolidated Financial Statements
(Unaudited)

The following illustrates activity related to the Ironwood collaboration agreement for the periods presented:

(In thousands)	Three months ended December		Nine months	
	2012	31, 2011	2012	31, 2011
Revenue				
Net Sales of Linzess	\$ 19,227	\$		