AMERICAN SUPERCONDUCTOR CORP /DE/
Form 10-Q
August 09, 2007
Table of Contents

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

x **Quarterly Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended: June 30, 2007

¨ **Transition Report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
Commission File Number: 0-19672

American Superconductor Corporation

(Exact name of registrant as specified in its charter)

Delaware	**04-2959321**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

Two Technology Drive

Westborough, Massachusetts 01581

(Address of principal executive offices, including zip code)

(508) 836-4200

(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 x NO ¨

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

Large accelerated filer ¨ Accelerated filer x Non-accelerated filer ¨

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

Class	Outstanding as of August 6, 2007
Common Stock, par value $0.01 per share	40,786,559

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

INDEX

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

CONDENSED CONSOLIDATED BALANCE SHEETS

	June 30, 2007 (Unaudited)	March 31, 2007
	(In thousands)	
ASSETS		
Current assets:		
Cash and cash equivalents	$ 15,142	$ 15,925
Marketable securities	15,343	19,399
Accounts receivable, net	21,149	18,053
Inventory	6,629	6,853
Prepaid expenses and other current assets	2,552	1,505
Deferred tax assets	311	514
Total current assets	61,126	62,249
Property, plant and equipment, net	50,537	49,928
Assets held for sale	1,563	2,171
Goodwill	7,935	5,126
Other intangibles, net	14,166	12,849
Other assets	93	110
Total assets	$ 135,420	$ 132,433
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable and accrued expenses	$ 20,824	$ 23,532
Deferred revenue and customer deposits	7,681	3,775
Total current liabilities	28,505	27,307
Non-current liabilities:		
Deferred revenue and customer deposits	814	867
Deferred tax liabilities	2,422	2,518
Other non-current liabilities	94	120
Total liabilities	31,835	30,812
Commitments and contingencies		
Stockholders' equity:		
Common stock	359	350
Additional paid-in capital	497,666	486,194
Deferred contract costs - warrant	(12)	(13)
Accumulated other comprehensive income	280	145
Accumulated deficit	(394,708)	(385,055)
Total stockholders' equity	103,585	101,621
Total liabilities and stockholders' equity	$ 135,420	$ 132,433

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

	Three months ended June 30,	
	2007	2006
	(In thousands, except per share data)	
Revenues	$ 19,769	$ 14,046
Costs and expenses:		
Costs of revenue	16,187	13,925
Research and development	4,214	4,063
Selling, general and administrative	6,118	3,496
Amortization of acquisition related intangibles	1,162	
Restructuring and impairments	818	
Total costs and expenses	28,499	21,484
Operating loss	(8,730)	(7,438)
Interest income	346	678
Other income (expense), net	(1,014)	37
Loss before income tax provision	(9,398)	(6,723)
Income tax expense	255	
Net loss	$ (9,653)	$ (6,723)
Net loss per common share		
Basic and Diluted	$ (0.27)	$ (0.20)
Weighted average number of common shares outstanding		
Basic and Diluted	35,268	32,805

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS

	For the three months ended June 30,	
	2007	2006
	(In thousands)	
Net loss	$ (9,653)	$ (6,723)
Other comprehensive income		
Foreign currency translation	126	(1)
Unrealized gains on investments	9	44
Other comprehensive income	135	43
Comprehensive loss	$ (9,518)	$ (6,680)

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

UNAUDITED CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

	For the three months ended June 30,	
	2007	2006
	(In thousands)	
Cash flows from operating activities:		
Net loss	$ (9,653)	$ (6,723)
Adjustments to reconcile net loss to net cash used in operations:		
Depreciation and amortization	2,310	1,068
Stock-based compensation expense	1,077	780
Stock-based compensation expense - non-employee	83	33
Impairment charges on long-lived assets	607	
Inventory write-down charges	933	
Re-valuation of warrant	986	(35)
Change in deferred income taxes	85	
Other non-cash items	8	20
Changes in operating asset and liability accounts, excluding the effect of acquisition:		
Accounts receivable	(2,694)	(6,973)
Inventory	(179)	1,190
Prepaid expenses and other current assets	(352)	(69)
Accounts payable and accrued expenses	(4,722)	1,207
Deferred revenue	3,247	1,661
Net cash used in operating activities	(8,264)	(7,841)
Cash flows from investing activities:		
Purchase of property, plant and equipment	(1,479)	(2,781)
Proceeds from the sale of property, plant and equipment		47
Purchase of marketable securities	(11,977)	(17,866)
Proceeds from the maturity of marketable securities	16,042	6,089
Increase in restricted cash	(674)	
Acquisition costs, net of cash acquired in acquisition of Power Quality Systems, Inc.	(102)	
Purchase of intangible assets	(329)	(239)
Decrease in other assets	17	3
Net cash provided by (used in) investing activities	1,498	(14,747)
Cash flows from financing activities:		
Proceeds from issuances of common stock, net	5,971	491
Net cash provided by financing activities	5,971	491
Effect of exchange rate changes on cash and cash equivalents	12	
Net decrease in cash and cash equivalents	(783)	(22,097)
Cash and cash equivalents at beginning of period	15,925	35,171
Cash and cash equivalents at end of period	$ 15,142	$ 13,074
Supplemental schedule of cash flow information:		
Issuance of common stock in connection with the purchase of Power Quality Systems, Inc.	$ 4,349	

The accompanying notes are an integral part of the unaudited condensed consolidated financial statements.

6

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

1. Description of the Business and Basis of Presentation

American Superconductor Corporation (the Company or AMSC) was founded on April 9, 1987. The Company is an energy technologies company, offering an array of solutions based on two proprietary technologies: programmable power electronic converters and high temperature superconductor (HTS) wires. The Company s products, services and system-level solutions enable cleaner, more efficient and more reliable generation, delivery and use of electric power. The programmability and scalability of the Company s power electronic converters differentiate them from most competitive offerings. The two primary markets the Company serves are the wind energy market and the power transmission and distribution or power grid market. The Company operates in two business segments AMSC Power Systems and AMSC Superconductors.

These unaudited condensed consolidated financial statements of the Company have been prepared in accordance with the Securities and Exchange Commission s (SEC) instructions to Form 10-Q. Certain information and footnote disclosures normally included in the financial statements prepared in accordance with accounting principles generally accepted in the United States have been condensed or omitted pursuant to those instructions. The year-end condensed balance sheet data was derived from audited financial statements but does not include all disclosures required by accounting principles generally accepted in the United States of America. The unaudited condensed consolidated financial statements, in the opinion of management, reflect all adjustments (consisting of normal recurring adjustments) necessary for a fair statement of the results for the interim periods ended June 30, 2007 and 2006 and the financial position at June 30, 2007. The unaudited condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions are eliminated in consolidation.

The results of operations for the interim period are not necessarily indicative of the results of operations to be expected for the fiscal year. The Company suggests that these interim condensed consolidated financial statements be read in conjunction with the audited consolidated financial statements for the fiscal year ended March 31, 2007 which are contained in the Company s Annual Report on Form 10-K filed with the SEC on June 14, 2007.

2. Stock-Based Compensation

The Company accounts for its stock-based compensation under the fair value recognition provisions of Statement of Financial Accounting Standards (SFAS) No. 123(R), Share-Based Payments. The following table summarizes stock-based compensation expense under SFAS 123(R) by financial statement line for the three months ended June 30, 2007 and June 30, 2006, respectively (in thousands):

	Three months ended June 30,	
	2007	2006
Costs of revenue	$ 97	$ 72
Research and development	254	226
Selling, general and administrative	726	482
Total stock-based compensation expense	$ 1,077	$ 780

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The total unrecognized compensation cost for unvested stock-based compensation awards outstanding, net of forfeitures, was $8.0 million at June 30, 2007. This expense will be recognized over a weighted average expense period of 1.7 years.

The assumptions used in the Black-Scholes valuation model for stock options granted during the three months ended June 30, 2007 and 2006 are as follows:

	Three months ended June 30,	
	2007	2006
Expected volatility	57.4%	53.3%
Risk-free interest rate	4.9%	5.1%
Expected life (years)	5.3	5.8
Dividend yield	None	None

The expected volatility rate was estimated based on an equal weighting of the historical volatility of the Company s common stock and the implied volatility of the Company s traded options. The expected term was estimated based on an analysis of the Company s historical experience of exercise, cancellation, and expiration patterns. The risk-free interest rate is based on five-year U.S. Treasury rates. The Company has applied an annual forfeiture rate of 13.79% as of June 30, 2007. This analysis is re-evaluated periodically and the forfeiture rate is adjusted as necessary.

On August 3, 2007, the Company s stockholders approved two new stock plans; the 2007 Stock Incentive Plan (3,000,000 shares) and the 2007 Director Stock Plan (300,000 shares).

3. Computation of Net Loss per Common Share

Basic earnings per share (EPS) is computed by dividing net earnings (loss) by the weighted average number of common shares outstanding for the period. Diluted EPS is computed by dividing the net earnings (loss) available to common stockholders by the weighted average number of common shares and dilutive common equivalent shares outstanding during the period, calculated using the treasury stock method. Common equivalent shares include the effect of restricted stock and the exercise of stock options and warrants. For the three months ended June 30, 2007 and 2006, common equivalent shares of 4.6 million were not included in the calculation of diluted EPS as they were considered anti-dilutive.

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

The following table reconciles the numerators and denominators of the earnings per share calculation for the three months ended June 30, 2007 and 2006 (in thousands, except per share data):

	Three months ended June 30, 2007	2006
Numerator:		
Net loss	$ (9,653)	$ (6,723)
Denominator:		
Weighted-average shares of common stock outstanding	35,593	32,968
Weighted-average shares subject to repurchase	(325)	(163)
Shares used in per-share calculation basic and diluted	35,268	32,805
Net loss per common share basic and diluted:	$ (0.27)	$ (0.20)

4. Inventory

The components of inventory are as follows (in thousands):

	June 30, 2007	March 31, 2007
Raw materials	$ 1,172	$ 759
Work-in-progress	3,446	2,694
Finished goods	2,006	2,227
Deferred program costs	5	1,173
Net inventory	$ 6,629	$ 6,853

Deferred program costs of $1.2 million as of March 31, 2007 primarily represent $1.1 million of costs incurred in excess of funding on a Department of Energy (DOE) sponsored program to install an HTS power cable in the transmission grid of the Long Island Power Authority (LIPA). These program costs were inventoried because future funding sufficient to recover these deferred costs was deemed probable. In May 2007, DOE awarded the Company a contract modification of $4.0 million to cover additional subcontractor costs on the LIPA project which increased the contract ceiling to $27.5 million and the deferred program costs were expensed.

During the quarter ended June 30, 2007, the Company wrote off $0.9 million of finished goods related to the SuperVAR synchronous condenser the Company had planned to ship to a customer during the year. This write-off was due to management s decision to cease investing in this technology and the customer s agreement to terminate the contract. The write-off was included in Costs of revenue for the AMSC Superconductors business unit.

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Finished goods inventory includes the cost of products shipped to customers on contracts for which revenue is deferred until final customer acceptance.

5. Income Taxes

The Company recorded income tax expense of $0.3 million for the three months ended June 30, 2007 primarily related to foreign taxes. The Company has provided a valuation allowance against all current or deferred income tax assets because of the net operating losses incurred by the Company since its inception.

The Company accounts for income taxes in accordance with SFAS No. 109, Accounting for Income Taxes. Deferred income taxes are recognized for the tax consequences in future years of differences between the tax bases of assets and liabilities and their financial reporting amounts at each fiscal year end based on enacted tax laws and statutory tax rates applicable to the periods in which the differences are expected to affect taxable income. Valuation allowances are established when necessary to reduce net deferred tax assets to the amount expected to be realized. The Company has provided a valuation allowance against its U.S. current and deferred income tax assets because of the net operating losses incurred by the Company since its inception.

The Company adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48) on April 1, 2007. FIN 48 prescribes the recognition and measurement of a tax position taken or expected to be taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. The Company performed a comprehensive review of its tax positions in accordance with recognition standards established by FIN 48. In this regard, an uncertain tax position represents the company s expected treatment of a tax position taken in a filed tax return, or planned to be taken in a future tax return, that has not been reflected in measuring income tax expense for financial reporting purposes. As a result of this review, the Company does not believe that it has included any uncertain tax positions in its federal tax return or any of the state or foreign income tax returns it is currently filing or has filed. At the adoption date of April 1, 2007 and June 30, 2007, the Company had no unrecognized tax benefits. The Company recognizes interest and penalties related to uncertain tax positions in income tax expense. As of the adoption date of April 1, 2007 and June 30, 2007, the Company had no accrued interest related to uncertain tax positions. The Company files federal, state and foreign income tax returns. Major tax jurisdictions include the U.S. and Austria. All years from 1991 to the current year remain open and subject to examination in the United States and all years from 2002 to the current year remain open and subject to examination in Austria.

6. Commitments and Contingencies

In April 2005, the Company issued to TM Capital a common stock purchase warrant for 0.2 million shares of the Company's common stock, exercisable for a five-year term, with an

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

exercise price of $9.50 per share (the "Warrant"). The accrued warrant cost will continue to be classified as a current liability in accordance with Emerging Issues Task Force (EITF) Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company's Own Stock , until such time as the Warrant is exercised or forfeited, and will be marked-to-market based primarily on the current price and expected volatility of the Company s common stock as of the end of each reporting period. The Warrant was re-valued at $2.4 million as of June 30, 2007, resulting in a loss of $1.0 million for the three months ended June 30, 2007 (reported in Other income (expense) in the Condensed Consolidated Statements of Operations), compared to the March 31, 2007 warrant valuation of $1.4 million. The following Black-Scholes assumptions were used:

	June 30, 2007	March 31, 2007
Expected volatility	49.2%	49.9%
Risk-free interest rate	4.5%	4.8%
Expected life (years)	2.8	3.0

In September 2001, the Company entered into a standby letter of credit arrangement with a financial institution to provide a guarantee for rent of $1.0 million for the Two Technology Drive facility in Westborough, Massachusetts. The letter of credit amount was reduced to $0.8 million at June 1, 2005 and was reduced to $0.5 million at June 1, 2007. This letter of credit will expire on July 31, 2009.

As of March 31, 2007, the Company had an outstanding performance bond in the form of a bank guarantee for 0.1 million (approximately $0.1 million) issued on behalf of the Company s Windtec subsidiary in connection with a contract to provide power electronics for a Chinese customer. This performance bond expired on June 30, 2007. A new performance bond was issued for 0.9 million (approximately $1.1 million) on April 25, 2007. The performance bond expires in December 2007. In the event that the payment is made in accordance with the requirements of the performance bond, the Company would record a charge to Costs of revenue. To secure the performance bond, the Company has 0.5 million (approximately $0.7 million) in restricted cash classified as prepaid expenses and other current assets.

The Company also has an unused line of credit of 0.7 million (or approximately $0.9 million) which is available until August 31, 2007, after which the amount available decreases to 0.6 million (or approximately $0.8 million) and is available until June 30, 2010.

Product Warranty

The Company generally provides a one-year warranty on its power electronic converters, commencing upon installation. A provision is recorded upon revenue recognition to Costs of revenue for estimated warranty expense based on historical experience.

Product warranty activity was as follows (in thousands):

	Three months ended June 30,	
	2007	2006
Balance at beginning of period	$ 1,582	$ 563
Accruals for warranties	523	169
Settlements and adjustments relating to pre-existing warranties	(523)	(150)
Balance at end of period	$ 1,582	$ 582

11

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

7. Cost-Sharing Arrangements

The Company has entered into several cost-sharing arrangements with various agencies of the United States government. Funds paid to the Company under these agreements are not reported as revenues but are used to directly offset the Company s R&D and SG&A expenses, and to purchase capital equipment. The Company incurred costs offset by funding received under these agreements of $1.4 million and $0.6 million, respectively, for the three months ended June 30, 2007, and $1.7 million and $0.7 million, respectively, for the three months ended June 30, 2006. At June 30, 2007, total funding received to date under these agreements was $23.8 million.

8. Acquisitions

Acquisition of Power Quality Systems, Inc.

On April 27, 2007, the Company acquired Power Quality Systems, Inc. (PQS) for $4.5 million as described below. Located in Pennsylvania, PQS offers reactive compensation products known as Static VAR Compensators, or SVCs, based on its proprietary thyristor switch technology. These products enhance the reliability of power transmission and distribution grids and improve the quality of power for manufacturing operations. PQS is being integrated into the AMSC Power Systems business unit. The acquisition has been accounted for under the purchase method of accounting in accordance with SFAS No. 141, Business Combinations, (SFAS No. 141). The Company allocated the purchase price to the assets acquired and liabilities assumed at their estimated fair values as of the date of acquisition. The excess of the purchase price of $2.8 million paid by the Company over the estimated fair value of net assets acquired has been recorded as goodwill. Goodwill represents the value associated with the acquired workforce and synergies related to the merger of the two companies. The Company estimated the fair value of the intangible assets at $2.3 million, which consists of contractual relationships and backlog of $0.1 million, customer relationships of $0.6 million and core-technology and know-how of $1.6 million.

Pursuant to the Merger Agreement, the Company acquired all of the issued and outstanding shares of PQS, for which the Company issued 295,329 shares of the Company s common stock. The Company valued the acquisition at $4.3 million (excluding acquisition costs) using a value of $14.73 per share, which represents the five-day average closing price of the common stock from the two trading days before through two trading days after the signing of the Merger

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

Agreement and the public announcement of the acquisition. The shares are subject to a lockup agreement whereby the former owners of PQS may sell only a certain number of shares per year through April 2009. While the former owners of PQS have not been employed by the Company subsequent to the acquisition, all key PQS engineering personnel remain employed by the Company. The all-stock transaction also includes an earn-out opportunity with the potential for up to an additional 0.5 million shares of Company common stock to be issued to PQS s former owners based on the achievement of certain order growth targets for existing PQS products for the fiscal years ending March 2008 and 2009. This potential contingent consideration, if and when earned, will be recorded as additional goodwill based on the current fair value of the Company s common stock at the time of issuance. As a result of this transaction, PQS is a wholly-owned subsidiary of the Company.

The results of PQS s operations are included in the Company s consolidated results from the date of acquisition of April 27, 2007. Assuming the acquisition of PQS had occurred on April 1, 2007 and 2006, the impact on the consolidated results of the Company would not have been significant.

Unaudited Pro Forma Operating Results for the Acquisition of Windtec Consulting GmbH

On January 5, 2007, the Company acquired Windtec Consulting GmbH, a corporation incorporated according to the laws of Austria (Windtec). The following table presents the unaudited pro forma consolidated results of operations of the Company for the three months ended June 30 2006, as if the acquisition of Windtec Consulting GmbH was completed as of April 1, 2006 (in thousands).

Revenues	$ 15,931
Net loss	(7,477)
Basic and diluted loss per common share amounts:	
Net loss	$ (0.22)

The pro forma amounts include the historical operating results of the Company and Windtec Consulting GmbH with appropriate adjustments that give effect to depreciation, amortization and accretion, interest expense, income taxes, and certain conforming accounting policies of the Company. The pro forma amounts are not necessarily indicative of the operating results that would have occurred if the acquisition and related transactions had been completed at the beginning of the applicable periods presented. In addition, the pro forma amounts are not necessarily indicative of operating results in future periods.

9. Restructuring and Impairments

Restructuring

On March 26, 2007, the Company s Board of Directors approved a restructuring plan (the Plan) to reduce future operating costs and to transition its high temperature superconductor

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

products to the manufacturing stage by consolidating the Company s AMSC Wires, SuperMachines and Power Electronic Systems business segments into two operating segments: AMSC Superconductors and AMSC Power Systems. The Company consolidated its manufacturing operations by closing one of its two Westborough, Massachusetts facilities, moving its operations from that facility into its Devens, Massachusetts plant, and by reducing headcount by 37 employees.

The Company s aggregate restructuring charges associated with the Plan were $0.7 million. The restructuring charge was allocated to the AMSC Superconductors operating segment. Of this total, $0.5 million of the restructuring charges were incurred during the quarter ended March 31, 2007 and $0.2 million were incurred during the quarter ended June 30, 2007.

The following table summarizes the activity during the three months ended June 30, 2007 related to this restructuring (in thousands):

	Severance and Benefits	Excess Facility	Total
Balance at March 31, 2007	$ 370	$ 93	$ 463
Restructuring charge	211		211
Cash payments	(467)	(46)	(513)
Balance at June 30, 2007	$ 114	$ 47	$ 161

Impairments

As of March 31, 2007, the Company reclassified its previously impaired first generation wire manufacturing equipment from Property, Plant and Equipment to Assets held for sale . The estimated salvage value of these assets was $2.2 million as of March 31, 2007. A public auction for the sale of these assets was held in June 2007 and the Company is currently negotiating private sales to interested parties for the remaining equipment. Based on the recent results of the auction and our work to sell through private sales, we have determined that an additional impairment charge of $0.6 million was required during the quarter ended June 30, 2007 to write down the value to its net realizable value.

10. Business Segment Information

On March 26, 2007, in connection with the Board of Director s approval of the restructuring plan, the Company began operating and reporting its financial results in two reportable business segments; AMSC Superconductors and AMSC Power Systems. Accordingly, the Company has recast its prior-year business segment financial information to conform to the new segment presentation.

AMSC Power Systems supplies power electronic systems used in wind turbines; produces products to increase electrical grid capacity and reliability and to regulate wind farm

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

voltage for the electrical grid; and licenses proprietary wind energy system designs to manufacturers of such systems and provides consulting services to the wind industry through its Windtec subsidiary.

AMSC Superconductors focuses on the manufacturing of HTS wire and coils; the design and development of HTS products, such as power cables, fault current limiters and motors; and the management of large-scale HTS projects, such as HTS power cable system design, manufacturing and installation.

The operating results for the two business segments are as follows (in thousands):

	Three months ended June 30, 2007	2006
Revenues		
AMSC Power Systems	$ 14,369	$ 3,548
AMSC Superconductors	5,400	10,498
Total	$ 19,769	$ 14,046

	Three months ended June 30, 2007	2006
Operating loss		
AMSC Power Systems	$ (616)	$ (711)
AMSC Superconductors	(6,450)	(5,520)
Unallocated corporate expenses	(1,664)	(1,207)
Total	$ (8,730)	$ (7,438)

Total assets for the two business segments are as follows (in thousands):

	June 30, 2007	March 31, 2007
AMSC Power Systems	$ 45,375	$ 32,911
AMSC Superconductors	59,560	64,198
Cash and marketable securities	30,485	35,324
Total	$ 135,420	$ 132,433

The accounting policies of the business segments are the same as those for the consolidated Company, except that certain corporate expenses which the Company does not believe are specifically attributed or allocable to any of the two business segments have been excluded from the segment operating loss. Corporate unallocated expenses include stock-based compensation expense of $1.1 million and $0.8 million for the three months ended June 30, 2007 and 2006, respectively. Corporate unallocated expenses also include the rent and occupancy costs associated with the unoccupied portion of the Company s Westborough, Massachusetts corporate headquarters.

11. New Accounting Pronouncements

In February 2007, the FASB Issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115. This

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS (Continued)

(Unaudited)

standard permits entities to choose to measure many financial instruments and certain other items at fair value and provides the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This standard is effective for fiscal years beginning after November 15, 2007. The Company is currently evaluating the provisions of SFAS No. 159.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements . SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS No. 157 does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with earlier adoption permitted. The provisions of SFAS No. 157 should be applied prospectively as of the beginning of the fiscal year in which it is initially applied, with limited exceptions. The Company is currently evaluating the provisions of SFAS No. 157.

12. Subsequent Events

On July 25, 2007, the Company completed a public offering of 4.7 million shares of its common stock at $21.25 per share. Net proceeds from the offering (after deducting underwriting discounts and commissions, but before deducting offering expenses) were $94.3 million.

Table of Contents

AMERICAN SUPERCONDUCTOR CORPORATION

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

Executive Overview

American Superconductor Corporation was founded in 1987. We are a leading energy technologies company, offering an array of solutions based on two proprietary technologies: programmable power electronic converters and high temperature superconductor (HTS) wires. Our products, services and system-level solutions enable cleaner, more efficient and more reliable generation, delivery and use of electric power. The programmability and scalability of our power electronic converters differentiate them from most competitive offerings. Our HTS wires carry 150 times the electrical current of comparably sized copper wire. The two primary markets we serve are the wind energy market and the power transmission and distribution or power grid market.

Our HTS wire addresses constraints on the power grid by increasing the electric current carrying capacity of the transmission cables comprising these power grids and by providing current limiting functionality in cables and standalone devices. In addition, our HTS wire, when incorporated into primary electrical equipment such as motors and generators, can provide increased manufacturing and operating savings due to a significant reduction in the size and weight of this equipment. Also, our power electronic converters increase the quantity, quality and reliability of electric power that is transmitted by electric utilities or consumed by large industrial entities.

Our products are in varying stages of commercialization. Our power electronic converters have been sold commercially, as part of integrated systems, to utilities, manufacturers and wind farm developers, owners and operators since 1999. We began production of our first generation, or 1G HTS wire in 2003, although its principal applications (power cables, fault current limiters, rotating machines and specialty magnets) are currently in the prototype stage. Some of these prototypes are funded by U.S. government contracts, primarily with the Department of Defense (DOD) and Department of Energy (DOE).

In April 2003, we were selected by the DOE as the prime contractor to install a half-mile long, 600 MW, 138 kilo-Volt (kV) HTS cable system in the power grid of Long Island Power Authority (LIPA). The site for the LIPA 138kV HTS cable system in Hauppauge, New York has now been fully prepared, the cryogenics system has been completed and is operating, the cables have been manufactured and underground installation began in the spring of 2007. Commissioning of the cable system is scheduled for the fall of 2007. We view this as a key milestone in the eventual commercialization of HTS wire. In March 2007, the DOE released the remaining incremental funding up to the then-current authorized contract ceiling of $23.5 million. In May 2007, the DOE awarded us a contract modification of $4.0 million to cover subcontractor cost growth on the LIPA project, increasing the contract ceiling to $27.5 million. On March 31, 2007, as a result of this contract modification being anticipated, we inventoried costs of $1.1 million incurred in excess of the then-current contract ceiling of $23.5 million as management deemed that future funding sufficient to cover these deferred costs was probable. These inventoried costs as of March 31, 2007, were recorded as costs of revenue and the corresponding revenue was recognized in the quarter ended June 30, 2007.

Table of Contents

We are currently in the process of converting our pre-pilot production line for 344 superconductors, our brand name for what is generically known as second generation or 2G HTS wire, into a full-scale manufacturing line, which we expect will have an initial gross production capacity of approximately 720,000 meters of 344 superconductors per year in December 2007.

On July 25, 2007, we completed a public offering of 4.7 million shares of our common stock at $21.25 per share. Net proceeds from the offering (after deducting underwriting discounts and commissions, but before deducting offering expenses) were $94.3 million.

Our cash requirements depend on numerous factors, including successful completion of our product development activities, ability to commercialize our product prototypes, rate of customer and market adoption of our products and the continued availability of U.S. government funding during the product development phase. Significant deviations to our business plan with regard to these factors, which are important drivers to our business, could have a material adverse effect on our operating performance, financial condition, and future business prospects. We expect to pursue the expansion of our operations through internal growth and potential strategic alliances and acquisitions. In addition, we expect to require approximately $12.0 million to $14.0 million in capital investment by December 2007 for the completion of the initial manufacturing line for our 344 superconductors, of which approximately $10.1 million has been spent on a cumulative basis through June 30, 2007.

On January 5, 2007, we completed the acquisition of Windtec Consulting GmbH (Windtec). Windtec is an Austria-based designer and licensor of wind energy systems and a provider of wind turbine electrical components. Windtec is now a wholly-owned subsidiary and is operated by our AMSC Power Systems business unit. The Windtec purchase price was 1.3 million shares of our common stock, valued at approximately $13.1 million based on a five-day average stock price of $10.08 per share at the time of signing the definitive acquisition agreements and public announcement of the acquisition on November 28, 2006. The shares are subject to a lockup whereby the former sole owner and founder of Windtec may sell only a certain number of shares per year through January 2010. The all-stock transaction also includes an earn-out opportunity with the potential for the issuance of up to an additional 1.4 million shares of our common stock to be granted to the former owner and founder based on the achievement by Windtec of certain revenue growth targets for the years ending March 31, 2008 through March 31, 2011. Beginning on January 5, 2007, Windtec s results of operations are included in our consolidated financial statements.

On April 27, 2007, we acquired Power Quality Systems, Inc. (PQS), a Pennsylvania corporation. Pursuant to the Merger Agreement, we acquired all of the issued and outstanding shares of PQS, for which we issued 295,329 shares of our common stock. We valued the acquisition at approximately $4.3 million (excluding acquisition costs) using a value of $14.73 per share, which represents the five-day average closing price of the common stock from the two trading days before through two trading days after the signing of the Merger Agreement and the public announcement of the acquisition. The shares are subject to a lockup agreement whereby the former owners of PQS

Table of Contents

may sell only a certain number of shares per year through April 2009. While the former owners have not been employed by us subsequent to the acquisition, all key PQS engineering personnel are employed by us. The all-stock transaction also includes an earn-out opportunity with the potential for up to an additional 475,000 shares of our common stock to be issued to PQS's former owners based on the achievement of certain order growth targets for existing PQS products for the fiscal years ending March 2008 and 2009. This potential contingent consideration, if and when earned, will be recorded as additional goodwill based on the fair value of our common stock at the time of issuance. As a result of this transaction, PQS is a wholly-owned subsidiary and is operated by AMSC Power Systems.

The results of PQS s operations are included in our consolidated results from the date of acquisition of April 27, 2007.

Critical Accounting Policies and Estimates

The preparation of consolidated financial statements requires that we make estimates and judgments that affect the reported amounts of assets, liabilities, revenue and expenses, and related disclosure of contingent assets and liabilities. We base our estimates on historical experience and various other assumptions that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ under different assumptions or conditions.

Our accounting policies that involve the most significant judgments and estimates are as follows:

Revenue;

Long-lived assets;

Inventory;

Income taxes;

Goodwill; and

Acquisition accounting

Revenue. For certain arrangements, such as prototype development contracts and certain product sales, we record revenues using the percentage-of-completion method, measured by the relationship of costs incurred to total estimated contract costs. We use the percentage-of-completion revenue recognition method when a purchase arrangement meets all of the criteria in

Table of Contents

Statement of Position 81-1. Percentage-of-completion revenue recognition accounting is predominantly used on long-term prototype development contracts with the U.S. government, such as the 36.5 MW motor contract with the U.S. Navy. We follow this method since reasonably dependable estimates of the revenues and costs applicable to various stages of a contract can be made. However, the ability to reliably estimate total costs at completion is challenging, especially on long-term prototype development contracts, and could result in future changes in contract estimates. Since many contracts extend over a long period of time, revisions in scope and cost and funding estimates during the progress of work have the effect of adjusting earnings applicable to prior-period performance in the current period. Recognition of contract revenues and profit or loss are subject to revisions as the contract work progresses to completion. Revisions in profit or loss estimates are charged to income in the period in which the facts that give rise to the revision become known. During the quarter ended June 30, 2007 we recorded an additional $0.3 million related to subcontractor claims to close-out subcontracts related to the Navy 36.5MW motor in addition to the $3.1 million loss recorded in the prior year ended March 31, 2007, as a result of cost overruns and changes in estimates. As of June 30, 2007 we recorded an estimated loss of $3.4 million related to the Navy 36.5 MW motor program. The motor was delivered to the Navy in June 2007.

We recognize revenue for other product sales upon customer acceptance, which can occur at the time of delivery, installation, or post-installation, where applicable, provided persuasive evidence of an arrangement exists, delivery has occurred, the sales price is fixed or determinable and the collectibility is reasonably assured. For multiple-element arrangements, we use the residual method to allocate value to each undelivered item. Under the residual method, each undelivered item is allocated value based on verifiable objective evidence of fair value for that item and the remainder of the total arrangement price is allocated to the delivered items. For a delivered item to be considered a separate unit, the delivered item must have value to the customer on a standalone basis, there must be objective and reliable evidence of fair value of the undelivered items in the arrangement and the delivery or performance of the undelivered items must be considered probable and substantially within our control. We do not provide our customers with contractual rights of return for any of our products. When other significant obligations remain after products are delivered, revenue is recognized only after such obligations are fulfilled. The determination of what constitutes a significant post-delivery performance obligation (if any post-delivery performance obligations exist) is the primary subjective consideration we systemically evaluate in the context of each product shipment in order to determine whether to recognize revenue on the order or to defer the revenue until all post-delivery performance obligations have been completed.

Revenues associated with consulting, training and other similar services are recognized as the services are performed. Royalty revenue is recognized as the royalties are earned.

Customer deposits received in advance of revenue recognition are recorded as deferred revenue until customer acceptance is received. Deferred revenue also represents the amount billed to and/or collected from commercial and government customers on contracts which permit billings to occur in advance of contract performance/revenue recognition.

Table of Contents

Long-Lived Assets. We periodically evaluate our long-lived assets consisting principally of fixed assets and intangible assets for potential impairment under Statement of Financial Accounting Standards (SFAS) No. 144, Accounting for the Impairment or Disposal of Long-Lived Assets. We perform these evaluations whenever events or circumstances suggest that the carrying amount of an asset or group of assets is not recoverable. Our judgments regarding the existence of impairment indicators are based on market and operational performance. Indicators of potential impairment include:

- a significant change in the manner in which an asset is used;
- a significant decrease in the market value of an asset;
- a significant adverse change in its business or the industry in which it is sold;
- a current period operating cash flow loss combined with a history of operating or cash flow losses or a projection or forecast that demonstrates continuing losses associated with the asset; and
- significant advances in our technologies that require changes in our manufacturing process.

If we believe an indicator of potential impairment exists, we test to determine whether impairment recognition criteria in SFAS No. 144 have been met. To analyze a potential impairment, we project undiscounted future cash flows expected to result from the use and eventual disposition of the asset or primary asset in the asset group over its remaining useful life. If these projected cash flows are less than the carrying amount, an impairment loss is recognized in the Consolidated Statements of Operations based on the difference between the carrying value of the asset or asset group and its fair value, less any disposition costs. Evaluating the impairment requires judgment by our management to estimate future operating results and cash flows. If different estimates were used, the amount and timing of asset impairments could be affected.

Inventory. We write down inventory for estimated obsolescence or unmarketable inventory in an amount equal to the difference between the cost of the inventory and the estimated realizable value based upon assumptions of future demand and market conditions. If actual market conditions are less favorable than those projected, additional inventory write-downs may be required. Program costs may be deferred and recorded as inventory on contracts on which costs are incurred in excess of funding, if future funding is deemed probable.

During the year ended March 31, 2007, we wrote off $0.9 million of inventoried costs related to a SuperVAR synchronous condenser (SVAR) due to technical issues with the unit. During the quarter ended June 30, 2007, we wrote off an additional $0.9 million of inventoried costs related to a second SVAR unit we had planned to ship to a customer during the year. The second SVAR write-off was due to our decision to cease investing in this technology and the customer s agreement to terminate the contract for both units. Both write-offs were included in Costs of revenue for the AMSC Superconductors business unit.

Table of Contents

During the year ended March 31, 2006, we wrote down $1.6 million of 1G HTS wire inventory to its estimated net realizable value based on analysis of existing backlog and anticipated demand for our 1G wire. Any future sales of previously written-down inventory will result in the recognition of revenue with no corresponding costs of revenue, which when sold will have a positive impact on our gross margin. During the first quarter of this fiscal year, we realized sales of 1G HTS wire on previously written-down inventory. Approximately 9,000 meters of previously written-down 1G HTS wire was sold for $0.2 million with related costs of revenue of less than $0.1 million. As of June 30, 2007, we had 1G HTS wire inventory with an original cost basis of $3.1 million that has been written down to estimated scrap value of $1.0 million.

Income taxes. In accordance with applicable accounting standards, we regularly assess our ability to realize our deferred tax assets. Assessments of the realization of deferred tax assets require that management consider all available evidence, both positive and negative, make significant judgments about many factors, including the amount and likelihood of future taxable income. Based on all the available evidence, we have recorded a valuation allowance to reduce our U.S. deferred tax assets to the amount that is more likely than not to be realizable due to the taxable losses incurred by us since our inception. Under current federal law, the utilization of the net operating loss and research and development and other tax credit carryforwards may be subject to limitations due to changes in ownership.

We adopted the provisions of FASB Interpretation No. 48, Accounting for Uncertainty in Income Taxes an interpretation of FASB Statement No. 109 (FIN 48) on April 1, 2007. FIN 48 prescribes the recognition and measurement of a tax position taken or expected to be taken in a tax return. It also provides guidance on derecognition, classification, interest and penalties, accounting in interim periods, disclosure and transition. We performed a comprehensive review of our tax positions in accordance with recognition standards established by FIN 48. In this regard, an uncertain tax position represents the company s expected treatment of a tax position taken in a filed tax return, or planned to be taken in a future tax return, that has not been reflected in measuring income tax expense for financial reporting purposes. As a result of this review, we do not believe that it has included any uncertain tax positions in our federal tax return or any of the state or foreign income tax returns we are currently filing or have filed. At the adoption date of April 1, 2007 and June 30, 2007, we had no unrecognized tax benefits. We recognize interest and penalties related to uncertain tax positions in income tax expense. As of the adoption date of April 1, 2007 and June 30, 2007, we had no accrued interest related to uncertain tax positions. We file federal, state and foreign income tax returns. Major tax jurisdictions include the U.S. and Austria. All years from 1991 to the current year remain open and subject to examination in the United States and all years from 2002 to the current year remain open and subject to examination in Austria.

Goodwill. Goodwill represents the excess of cost over net assets of acquired businesses that are consolidated. In accordance with SFAS No. 142, Goodwill and Other Intangible Assets, goodwill is not amortized. In lieu of amortization, we perform an impairment review of our goodwill at least annually or when events and changes in circumstances indicate the need for such a detailed impairment analysis. Goodwill is considered impaired when the carrying value of

Table of Contents

a reporting unit exceeds its estimated fair value. In assessing the recoverability of goodwill, we make assumptions regarding estimated future cash flows and other factors to determine the fair value of the reporting unit. To date, we have determined that goodwill is not impaired, but we could in the future determine that goodwill is impaired, which would result in a charge to earnings.

Acquisition accounting. We account for acquisitions under the purchase method of accounting in accordance with SFAS No. 141, Business Combinations. We allocate the purchase price to the assets acquired and liabilities assumed based on their estimated fair values as of the date of acquisition. The excess of the purchase price paid by us over the estimated fair value of identifiable net assets acquired is recorded as goodwill.

Results of Operations

We have two reportable business segments AMSC Power Systems and AMSC Superconductors. On March 26, 2007, in connection with the Board of Directors approval of the restructuring plan, we began operating and reporting our financial results to the Chief Executive Officer in two reportable business segments: AMSC Superconductors and AMSC Power Systems. Accordingly, we recast our prior year business segment financial information to conform to the new segment presentation.

AMSC Power Systems supplies power electronic systems used in wind turbines; produces products to increase electrical grid capacity and reliability and to regulate wind farm voltage for the electrical grid; and licenses proprietary wind energy system designs to manufacturers of such systems and provides consulting services to the wind industry through its Windtec subsidiary.

During the fourth quarter of the year ended March 31, 2007, we acquired Windtec and integrated the business into our AMSC Power Systems business unit. Results of Windtec s operations are included in our consolidated results from the date of acquisition on January 5, 2007.

During the first fiscal quarter ended June 30, 2007, we acquired PQS and integrated the business into our AMSC Power Systems business unit. Results of PQS s operations are included in our consolidated results from the date of acquisition on April 27, 2007.

AMSC Superconductors focuses on the manufacturing of HTS wire and coils; the design and development of HTS products, such as power cables, fault current limiters and motors; and the management of large-scale HTS projects, such as HTS power cable system design, manufacturing and installation.

Revenues

Total revenues increased to $19.8 million in the quarter ended June 30, 2007 from $14.0 million for the same quarter of the prior year, an increase of $5.8 million, or 41%. Our revenues are summarized as follows (in thousands):

	Three months ended June 30,	
	2007	2006
Revenues		
AMSC Power Systems	$ 14,369	$ 3,548
AMSC Superconductors	5,400	10,498
Total	$ 19,769	$ 14,046

Table of Contents

The $5.8 million increase in total revenues was the result of an increase of $10.9 million in the AMSC Power Systems business unit, partially offset by a $5.1 million decrease in revenues in the AMSC Superconductors business unit.

Revenues in our AMSC Power Systems, which consist of revenues from D-VAR, PQ-IVR, PQ-SVC, SVC, and PowerModule product sales, service contracts, consulting arrangements and wind energy system prototype development contracts, increased by $10.9 million or 305% to $14.4 million for the quarter ended June 30, 2007 from $3.5 million for the quarter ended June 30, 2006. The increase was primarily the result of higher revenues generated by the Windtec acquisition completed on January 5, 2007, which contributed approximately $6.8 million of additional revenue in the quarter ended June 30, 2007. In addition, we achieved higher PowerModule sales of $2.0 million over the prior year as a result of the PM1000 system shipments to a Windtec customer in China. D-VAR system sales contributed $1.5 million towards the growth during the quarter ended June 30, 2007. There was additional revenue growth as a result of the PQS acquisition on April 27, 2007, which contributed $0.5 million in the quarter ended June 30, 2007.

Revenues in our AMSC Superconductors business unit, which consist of contract revenues, HTS wire sales, the DOE-sponsored project to install an HTS power cable in the transmission grid of LIPA, and prototype development contract revenues primarily related to the work performed on the firm-fixed-price contract for the U.S. Navy s 36.5 MW motor, decreased by $5.1 million or 49% to $5.4 million for the quarter ended June 30, 2007 from $10.5 million for the quarter ended June 30, 2006. This decrease was primarily attributable to a $7.7 million decrease in 36.5 MW motor program revenues due to a lower level of work performed on the motor program as the motor was delivered to the Navy during the quarter ended June 30, 2007. The decrease in revenue primarily attributable to the Navy 36.5 MW motor was partially offset by a $2.6 million increase in LIPA project revenues.

On April 26, 2006, a contract modification from the Navy on the 36.5 MW motor program was received that provided $13.3 million in additional funding, thereby increasing the contract value to $90.2 million and converting it from a cost-plus-incentive-fee contract to a firm-fixed-price contract. Revenues on this program are recognized on a percentage-of-completion basis and, as such, are subject to adjustments when estimates to complete the program are revised. The revenue decrease of $7.7 million from the prior-year quarter related to the 36.5 MW motor

Table of Contents

program is due to a lower level of work performed on the motor program in the quarter ended June 30, 2007 as the program neared completion with the delivery of the motor to the Navy on June 13, 2007. During July 2007, we completed this contract. Of the $13.3 million of additional funding received in April 2006, $1.2 million was recognized as revenue in the quarter ended June 30, 2007, $12.0 was recognized in the fiscal year ended March 31, 2007, and $0.1 million is expected to be recognized as revenue in the quarter ending September 30, 2007 as we have completed this contract.

On October 13, 2006, we signed a cost-plus-fixed-fee contract valued at $5.3 million with the U.S. Naval Sea Systems Command (NAVSEA) for the design and optimization of HTS ship propulsion motors and power electronic drives. The first $1.9 million of incremental funding has been allotted for the initial stage of this contract, which is expected to be completed in the next six months. We recognized $0.3 million of revenue during the quarter ended June 30, 2007 on this contract under the percentage-of-completion method. We are pursuing additional contracts for HTS motors and generators with the U.S. Navy and our strategic business alliance partner, Northrop Grumman Marine Systems, among others. However, we expect revenues related to motors to be significantly lower in the year ending March 31, 2008 compared to the year ended March 31, 2007 as we delivered the 36.5 MW motor in June 2007 and completed the final phase of the $90.2 million Navy contract.

LIPA project revenues increased by $2.6 million to $3.2 million for the quarter ended June 30, 2007 from $0.5 million for the quarter ended June 30, 2006 due to funding limitations in place during the same quarter of the prior year from the DOE. In May 2007, the DOE awarded a contract modification of $4.0 million to cover subcontractor cost growth on the LIPA project, increasing the contract ceiling to $27.5 million. On March 31, 2007, as a result of this contract modification being anticipated, we inventoried costs of $1.1 million in excess of the then-current contract ceiling of $23.5 million as management deemed that future funding sufficient to cover these deferred costs was probable. The deferred program costs consisted primarily of materials, labor, overhead, and subcontractor costs. As a result of the DOE awarded contract modification in May 2007, these deferred program costs that were inventoried as of March 31, 2007 were recorded as costs of revenue and the corresponding revenue was recognized in the quarter ended June 30, 2007. As of June 30, 2007 we have backlog of $0.8 million related to this project which we expect to recognize as revenue in the quarter ending September 30, 2007. We expect to complete this project in the fall of 2007.

We anticipate that we will realize additional HTS cable project revenues in the year ending March 31, 2008 from the Project Hydra contract with Consolidated Edison, Inc., which is being funded by the Department of Homeland Security (DHS) and was announced on May 21, 2007. DHS is expected to invest up to a total of $25.0 million in the development of a new high temperature superconductor power grid technology to enable Secure Super Grids™. Secure Super Grids utilize customized HTS wires, HTS power cables and ancillary controls to deliver more power through the grid while also being able to suppress power surges that can disrupt service. On May 18, 2007, we signed a letter contract valued at $1.7 million, of which DHS provided initial funding of $1.1 million, to commence work on this project. We recognized $0.2 million in revenue related to the Hydra project during the quarter ended June 30, 2007. Final contract terms and conditions for this three-year project were expected to be completed within 90

Table of Contents

days of the letter contract; however, we may experience delays in the signing of the full contract as terms and conditions for this multi-party contract are being negotiated. Consolidated Edison and Southwire Company are expected to be subcontractors to us.

Wire sales to other customers decreased by $0.2 million to $0.3 million in the quarter ended June 30, 2007, compared to $0.5 million in the quarter ended June 30, 2006, as a result of lower 1G HTS wire demand as we transition to manufacturing 344 superconductors. We expect wire sales to other customers and contract revenues to remain relatively flat in the year ending March 31, 2008. We are in the process of installing, testing, and qualifying capital equipment for manufacturing our 344 superconductors, the sales of which are currently constrained by limited manufacturing capacity. We expect to sell limited quantities of 344 superconductors wire while we expand our manufacturing line. We expect to have an annual gross capacity of 720,000 meters of wire at the end of calendar year 2007. We expect to continue to meet near-term customer demand for HTS wire from the approximately 269,000 meters of 1G HTS wire remaining in inventory, of which approximately 170,000 meters remained available for sale as of June 30, 2007.

Cost-sharing funding

In addition to reported revenues, we also received funding of $0.6 million for the quarter ended June 30, 2007 under U.S. government cost-sharing agreements with the U.S. Air Force and DOE, compared to $0.7 million for the quarter ended June 30, 2006, a decrease of $0.1 million. The decrease in cost-sharing funding is primarily due to the DOE Wire Initiative program nearing completion. All of our cost-sharing agreements provide funding in support of development work on 344 superconductors being done in the AMSC Superconductors business unit. We anticipate that a portion of our funding in the future will continue to come from cost-sharing agreements as we continue to develop joint programs with government agencies. Backlog as of June 30, 2007 relating to cost-sharing agreements was at $2.3 million. As required by government contract accounting guidelines, funding from government cost-sharing agreements is recorded as an offset to research and development and selling, general and administrative expenses, rather than as revenue.

Costs of Revenue

Costs of revenue increased by $2.3 million to $16.2 million for the quarter ended June 30, 2007, compared to $13.9 million for the same quarter of the prior year. This increase was directly related to a higher level of D-VAR and PowerModule system shipments by AMSC Power Systems. The increase of $7.4 million in AMSC Power Systems costs of revenue was partially offset by a decrease of $5.1 million in costs of revenue in AMSC Superconductors primarily as a result of the lower level of externally-funded work performed on the 36.5MW motor program compared to the prior year.

Table of Contents

Operating Expenses

Research and development

A portion of our R&D expenditures related to externally funded development contracts has been classified as costs of revenue (rather than as R&D expenses). Additionally, a portion of R&D expenses was offset by cost-sharing funding. Our R&D expenditures are summarized as follows (in thousands):

	Three Months Ended June 30,	
	2007	2006
R&D expenses per Consolidated Statements of Operations	$ 4,214	$ 4,063
R&D expenditures classified as Costs of revenue	5,973	8,643
R&D expenditures offset by cost-sharing funding	321	386
Aggregated R&D expenses	$ 10,508	$ 13,092

R&D expenses (exclusive of amounts classified as costs of revenue and amounts offset by cost-sharing funding) increased to $4.2 million in the quarter ended June 30, 2007 from $4.1 million for the same quarter last year. This decrease was primarily a result of a higher level of internally funded spending at AMSC Power Systems as a result of the recent acquisitions of Windtec and PQS, partially offset by a lower level of internally funded spending in AMSC Superconductors as a result of the re-alignment of the AMSC Wires and SuperMachines business units in March 2007. Aggregated R&D expenses, which include amounts classified as costs of revenue and amounts offset by cost-sharing funding, decreased by $2.6 million to $10.5 million in the quarter ended June 30, 2007 from $13.1 million for the same quarter last year. This decrease was primarily a result of the lower level of externally funded program costs on the 36.5MW motor program and the reduction in workforce as a result of the re-alignment of the AMSC Wires and SuperMachines business units in March 2007, partially offset by the recent acquisitions of Windtec and PQS.

Selling, general, and administrative

A portion of the SG&A expenditures related to externally funded development contracts has been classified as costs of revenue (rather than as SG&A expenses). Additionally, a portion of SG&A expenses was offset by cost-sharing funding. Our SG&A expenditures are summarized as follows (in thousands):

	Three Months Ended June 30,	
	2007	2006
SG&A expenses per Consolidated Statements of Operations	$ 6,118	$ 3,496
SG&A expenditures classified as Costs of revenue	364	1,923
SG&A expenditures offset by cost sharing funding	302	363
Aggregated SG&A expenses	$ 6,784	$ 5,782

SG&A expenses (exclusive of amounts classified as costs of revenue and amounts offset by cost-sharing funding) increased by $2.6 million to $6.1 million in the quarter ended June 30, 2007 from $3.5 million for the same quarter last year, primarily as a result of a lower percentage

Table of Contents

of SG&A expenses being classified as costs of revenue in connection with the lower level of prototype development contract work in AMSC Superconductors on the 36.5MW motor project. In addition, there were higher SG&A expenses related to the recent acquisition of Windtec and PQS. Aggregated SG&A expenses, which include amounts classified as costs of revenue and amounts offset by cost-sharing funding, increased by $1.0 million to $6.8 million for the quarter ended June 30, 2007 from $5.8 million for the same quarter last year. This increase was primarily the result of the increased SG&A related to the Windtec and PQS acquisitions, higher professional fees related to audit and legal services, and higher stock-based compensation expense due to the increased value of our common stock.

We present Aggregated R&D and Aggregated SG&A expenses, which are non-GAAP measures, because we believe this presentation provides useful information on our aggregate R&D and SG&A spending and because R&D and SG&A expenses as reported on the Consolidated Statements of Operations have been and may in the future be subject to significant fluctuations solely as a result of changes in the level of externally funded contract development work, resulting in significant changes in the amount of the costs recorded as costs of revenue rather than as R&D and SG&A expenses, as discussed above.

Amortization of Acquisition Related Intangibles

We recorded $1.2 million in amortization related to our contractual relationships/backlog, customer relationships, core technology and know-how, trade names and trade mark intangible assets during the quarter ended June 30, 2007. There was no comparable amount in the prior year. These intangible assets are a result of our Windtec and PQS acquisitions.

Restructuring and impairments

On March 26, 2007, our Board of Directors approved a restructuring plan (the Plan) to reduce operating costs and to transition our high temperature superconductor products to the manufacturing stage by consolidating AMSC Wires, SuperMachines and Power Electronic Systems business segments into two operating segments: AMSC Superconductors and AMSC Power Systems. We consolidated our manufacturing operations by closing one of our two Westborough, Massachusetts facilities, moving operations from that facility into the Devens, Massachusetts plant, and reducing headcount by 37 employees.

We estimated aggregate restructuring charges associated with the Plan at approximately $0.7 million. Of this total, $0.5 million of the restructuring charges were incurred during the quarter ended March 31, 2007 and $0.2 million were incurred during the quarter ended June 30, 2007, as a small number of the 37 affected employees remained with us through the end of May 2007 in order to complete ongoing projects. Restructuring charges consisted of:

cash payments of $0.6 million for severance obligations payable primarily during the quarter ended June 30, 2007 and

Table of Contents

a $0.1 million accrual for the remaining lease payments on the vacated Westborough facility, with payments being made to our former landlord during the six-month period ending September 30, 2007, and other expenses incurred for the relocation of employees, equipment and inventory to the our Devens facility.

During the quarter ended June 30, 2007, $0.5 million in cash payments related to the restructuring were paid out. The remaining cash payments of approximately $0.2 million are expected to be paid out over the quarter ending September 30, 2007. The restructuring actions under the Plan were substantially completed as of June 30, 2007.

In the fourth quarter of the year ended March 31, 2006, we recorded a $5.0 million impairment charge to write down the value of our 1G asset group (consisting of equipment, patents and licenses), related to our decision to complete the transition of our wire manufacturing operations from 1G to 2G HTS wire, and to cease 1G HTS wire manufacturing. As of March 31, 2007, the net book value of these 1G manufacturing equipment assets were classified as assets held for sale and carried at their estimated salvage value of $2.2 million. A public auction for the sale of these assets was held in June 2007, and we are currently in negotiation for private sales to interested parties for the remaining equipment. Based on the recent results of the auction and our work to sell through private sales, we have determined that an additional impairment charge of $0.6 million was required during the quarter ended June 30, 2007 to write down the value to its net realizable value.

Operating loss

Our operating loss is summarized as follows (in thousands):

	Three Months Ended June 30,	
	2007	**2006**
Operating loss		
AMSC Power Systems	$ (616)	$ (711)
AMSC Superconductors	(6,450)	(5,520)
Unallocated corporate expenses	(1,664)	(1,207)
Total	$ (8,730)	$ (7,438)

The operating loss at AMSC Power Systems decreased to $0.6 million in the quarter ended June 30, 2007 from $0.7 million in the same quarter of the prior year as the result of higher gross margins in the quarter ended June 30, 2007 in connection with the increased level of product sales. The increase in gross margin was offset by higher SG&A and R&D allocations to support the growth and integration required in AMSC Power Systems with the recent acquisitions of Windtec and PQS. Amortization expense related to the Windtec and PQS acquisitions was $1.2 million during the quarter ended June 30, 2007.

Table of Contents

The operating loss at AMSC Superconductors increased to $6.5 million in the quarter ended June 30, 2007 from $5.5 million in the same quarter of 2006. The increase is a result of a $0.9 million inventory write-off for a SuperVAR synchronous condenser, an asset impairment charge of $0.6 million related to the 1G assets held for sale, and $0.2 million of restructuring charges for a reduction in workforce related the March 2007 AMSC Wires and SuperMachines re-alignment into the AMSC Superconductors business unit. This increase was partially offset by a decrease of $0.5 million in the amount of SG&A and R&D allocations to the business unit as a result of the re-alignment of the business in March 2007.

Non-operating expenses/Interest income

Interest income decreased to $0.3 million in the quarter ended June 30, 2007 from $0.7 million in the same quarter of the prior year. This decrease in interest income reflects the lower cash balances available for investment compared to the first quarter of the prior year. We expect to realize an increase in interest income for the fiscal year ending March 31, 2008 compared with the prior year as a result of the additional $94.3 million in net proceeds (after deducting underwriting discounts and commissions, but before deducting offering expenses) we received in the recent stock offering completed on July 25, 2007.

Other income (expense), net, was $(1.0) million in the quarter ended June 30, 2007 compared to an immaterial amount in the same quarter of the prior year and consisted primarily of a loss on the revaluation of the stock warrant issued in April 2005 to TM Capital Corp., a past financial advisor to us, related to a litigation settlement. The litigation settlement amount of $2.7 million, which consisted of a $1.7 million cash payment made in April 2005 and a $1.0 million accrued liability relating to the warrant issued for 200,000 shares of our common stock, was accrued in the fourth quarter of the year ended March 31, 2005. The accrued warrant cost will continue to be classified as a current liability in accordance with Emerging Issues Task Force (EITF) Issue No. 00-19, Accounting for Derivative Financial Instruments Indexed to, and Potentially Settled in, a Company s Own Stock until such time as the warrant is exercised or forfeited, and will be marked to market based primarily on the current price and expected volatility of our common stock as of the end of each reporting period. The warrant was re-valued at $2.4 million as of June 30, 2007, resulting in a loss of $1.0 million for the quarter ended June 30, 2007.

Income Taxes

During the quarter ended June 30, 2007, we recorded income tax expense of $0.3 million primarily related to foreign taxes. Based on our latest operating plan, we expect to continue to incur operating losses through at least the end of the year ending March 31, 2009 as we continue to devote significant financial resources to our commercialization efforts and to our ongoing research and development activities. We anticipate an increase in depreciation associated with the scale-up of our manufacturing line for 344 superconductors as equipment is placed into service, as well as intangible asset amortization associated with the Windtec and PQS acquisitions.

Table of Contents

Please refer to the Risk Factors section below for a discussion of certain factors that may affect our future results of operations and financial condition.

Liquidity and Capital Resources

At June 30, 2007, we had cash, cash equivalents and marketable securities of $30.5 million compared to $35.3 million at March 31, 2007, a decrease of $4.8 million. Our cash, cash equivalents and marketable securities are summarized as follows (in thousands):

	June 30, 2007	March 31, 2007
Cash and cash equivalents	$ 15,142	$ 15,925
Marketable securities	15,343	19,399
Total cash, cash equivalents, and marketable securities	$ 30,485	$ 35,324

The decrease in cash and cash equivalents to $15.1 million at June 30, 2007 from $15.9 million at March 31, 2007 was primarily the result of $8.3 million net cash used in operating activities, $0.7 million of restricted cash for a performance bond, and $1.5 million for the purchase of capital equipment, partially offset by $4.1 million in the maturity of marketable securities and $6.0 million in proceeds from the issuance of common stock. The $8.3 million use of cash in operating activities was primarily related to the net loss of $9.7 million and changes in working capital of $4.7 million, partially offset by depreciation and amortization of $2.3 million, non-cash stock-based compensation expense of $1.2 million, $1.0 million stock warrant revaluation, an asset impairment charge of $0.6 million and the $0.9 million inventory write-down.

We have generated operating losses since our inception in 1987 and expect to continue incurring losses until at least the end of the fiscal year ending March 31, 2009. Operating losses for the fiscal years ended March 31, 2007, March 31, 2006, and 2005 contributed to net cash used by operating activities of $22.8 million, $19.6 million and $9.3 million, respectively, for these periods. For the quarter ended June 30, 2007, net cash used by operating activities was $8.3 million.

On July 25, 2007, we completed a public offering of 4.7 million shares of our common stock at $21.25 per share. Net proceeds from the offering (after deducting underwriting discounts and commissions, but before deducting offering expenses) were $94.3 million.

Although our cash requirements fluctuate based on a variety of factors, including customer adoption of our products and our research and development efforts to commercialize our products, we believe that our available cash will be sufficient to fund our working capital, capital expenditures, and other cash requirements for the next several years.

Pending the uses described above, we intend to invest the net proceeds of this offering in short-term, interest-bearing, investment-grade securities.

Table of Contents

We also have an unused line of credit of 0.7 million (or approximately $0.9 million) which is available until August 31, 2007, after which the amount decreases to 0.6 million (or $0.8 million) and is available until June 30, 2010.

As of June 30, 2007, we have invested approximately $10.1 million in the 344 superconductors production line, and we anticipate spending approximately $6.0 million on this line in the year ended March 31, 2008. These expenditures are being made to enable us to a) achieve a gross production capacity of approximately 720,000 meters annually of 344 superconductors in December 2007 on our 4 cm manufacturing technology, and b) prepare to migrate to the our 10 cm manufacturing technology. We estimate that an additional $28.0 million to $35.0 million of capital expenditures would be needed for a full commercial manufacturing operation with a gross capacity of approximately 9 million meters of wire per year.

We had backlog at June 30, 2007 (excluding amounts included in accounts receivable) of approximately $75.1 million to be received after June 30, 2007 from government and commercial customers, compared to $79.5 million at March 31, 2007. Backlog represents the value of contracts and purchase orders received, less the revenue recognized to date on those contracts and purchase orders. The current backlog, including $10.1 million on U.S. government contracts, is subject to certain standard cancellation provisions. The current backlog includes approximately $0.9 million of the letter contract with DHS, but does not include the remaining $24.0 million of the full contract that is currently being negotiated. It also does not include any funds from DOE awards that were announced in June 2007. Additionally, several of our government contracts are being funded incrementally, and as such, are subject to the future authorization and appropriation of government funding on an annual basis. We have a history of successful performance under incrementally-funded contracts with the government

Of the backlog amount of $75.1 million as of June 30, 2007, approximately 74% is billable to and potentially collectable from our customers within the next 12 months.

The possibility exists that we may pursue additional acquisition and joint venture opportunities in the future that may affect liquidity and capital resource requirements.

To date, inflation and foreign exchange have not had a material impact on our financial results.

Off-Balance Sheet Arrangements

We do not have any off-balance sheet arrangements, as defined under SEC rules, such as relationships with unconsolidated entities or financial partnerships, which are often referred to as structured finance or special purpose entities, established for the purpose of facilitating transactions that are not required to be reflected on our balance sheet.

Table of Contents

New Accounting Pronouncements

In February 2007, the FASB Issued SFAS No. 159, The Fair Value Option for Financial Assets and Financial Liabilities-including an amendment of FASB Statement No. 115. This standard permits entities to choose to measure many financial instruments and certain other items at fair value and provides the opportunity to mitigate volatility in reported earnings caused by measuring related assets and liabilities differently without having to apply complex hedge accounting provisions. This standard is effective for fiscal years beginning after November 15, 2007. We are currently evaluating the provisions of SFAS No. 159.

In September 2006, the FASB issued SFAS No. 157, Fair Value Measurements . SFAS No. 157 defines fair value, establishes a framework for measuring fair value in generally accepted accounting principles and expands disclosures about fair value measurements. SFAS No. 157 applies under other accounting pronouncements that require or permit fair value measurements, the FASB having previously concluded in those accounting pronouncements that fair value is the relevant measurement attribute. Accordingly, SFAS No. 157 does not require any new fair value measurements. SFAS No. 157 is effective for fiscal years beginning after November 15, 2007, and interim periods within those fiscal years, with earlier adoption permitted. The provisions of SFAS No. 157 should be applied prospectively as of the beginning of the fiscal year in which it is initially applied, with limited exceptions. We are currently evaluating the provisions of SFAS No. 157.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our exposure to market risk through financial instruments, such as investments in marketable securities, is limited to interest rate risk and is not material. Our investments in marketable securities consist primarily of corporate debt instruments and are designed, in order of priority, to preserve principal, provide liquidity, and maximize income. Interest rates are variable and fluctuate with current market conditions. We do not believe that a 10% change in interest rates would have a material impact on our financial position or results of operation.

The functional currency of all our foreign entities is the U.S. dollar, except for Windtec for which the local currency (Euro) is the functional currency. We currently do not hedge currency risk. Cumulative translation adjustments are excluded from net loss and reported as a separate component of stockholders equity. Foreign currency transaction gains and losses are included in the net loss and have not been material to date. Future operating results could be impacted by material foreign currency fluctuations. In the future, should foreign currency fluctuations become material, management will review options to limit the financial impact to our operations.

Item 4. Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of June 30, 2007. The term disclosure controls and procedures, as defined in Rules 13a-15(e) and 15d-15(e)

Table of Contents

under the Securities Exchange Act of 1934 (the Exchange Act), means controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company s management, including its principal executive and principal financial officers, as appropriate to allow timely decisions regarding required disclosure. Management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving their objectives and management necessarily applies its judgment in evaluating the cost-benefit relationship of possible controls and procedures. Based on the evaluation of our disclosure controls and procedures as of June 30, 2007, our chief executive officer and chief financial officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in Internal Control Over Financial Reporting

No change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) occurred during the quarter ended June 30, 2007 that has materially affected, or is reasonably likely to materially affect, internal control over financial reporting.

Table of Contents

PART II

OTHER INFORMATION

Item 1. Legal Proceedings

Not Applicable

Item 1A. Risk Factors

Various statements included herein, as well as other statements made from time to time by our representatives, which relate to future matters (including but not limited to statements concerning our future operating results or future commercial success) constitute forward looking statements and are made under the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. There are a number of important factors which could cause our actual results of operations and financial condition in the future to vary from that indicated in such forward looking statements. Factors that may cause such differences include, without limitation, the risks, uncertainties and other information set forth below.

While the following risk factors have been updated to reflect developments subsequent to the filing of our Annual Report on Form 10-K for the fiscal year ended March 31, 2007, there have been no material changes to the risk factors include in that report, other than the addition of disclosure under the risk factor on page 39 relating to government contracts.

We have a history of operating losses, and we expect to incur losses in the future.

We have been focused on research and development activities through the fiscal year ended March 31, 2007. We have incurred net losses in each year since our inception. Our net loss was $9.7 million for the three months ended June 30, 2007 and $34.7 million for the fiscal year ended March 31, 2007, $30.9 million for the fiscal year ended March 31, 2006 and $19.7 million for the fiscal year ended March 31, 2005. Our accumulated deficit as of June 30, 2007 was $394.7 million. We expect to continue to incur operating losses until at least the end of the fiscal year ending March 31, 2009, and we cannot be certain that we will ever achieve profitability.

We had cash, cash equivalents and marketable securities totaling $30.5 million at June 30, 2007. We believe our available cash, cash equivalents and marketable securities, as supplemented by our July 2007 stock offering, will be sufficient to fund our working capital, capital expenditures and other cash requirements for the next several years. However, we may need additional funds if our performance deviates significantly from our current business plan, if there are significant changes in competitive or other market factors, or if unforeseen circumstances arise. Such funds may not be available, or may not be available under terms acceptable to us.

Table of Contents

There are a number of technological challenges that must be successfully addressed before our superconductor products can gain widespread commercial acceptance, and our inability to address such technological challenges could adversely affect our ability to acquire customers for our products.

Many of our superconductor products are in the early stages of commercialization, while others are still under development. There are a number of technological challenges that we must successfully address to complete our development and commercialization efforts for superconductor products. We also believe that several years of further development in the cable, fault current limiter and motor industries will be necessary before a substantial number of additional commercial applications for our HTS wire in these industries can be developed and proven. We will also need to improve the performance and reduce the cost of our HTS wire to expand the number of commercial applications for it. We may be unable to meet such technological challenges or to sufficiently improve the performance and reduce the costs of our HTS wire. Delays in development, as a result of technological challenges or other factors, may result in the introduction or commercial acceptance of our superconductor products later than anticipated.

The commercial uses of superconductor products are limited today, and a widespread commercial market for our products may not develop.

To date, there has been no widespread commercial use of HTS products. Even if the technological hurdles currently limiting commercial uses of HTS products are overcome, it is uncertain whether a robust commercial market for those new and unproven products will ever develop. To date, many projects to install HTS cables and products in power grids have been funded or subsidized by the governmental authorities. If this funding is curtailed, grid operators may not continue to utilize HTS cables and products in their projects. It is possible that the market demands we currently anticipate for our HTS products will not develop and that they will never achieve widespread commercial acceptance.

We have limited experience manufacturing our Power Systems products in commercial quantities, and failure to manufacture our Power Systems products in commercial quantities at acceptable cost and quality levels would impair our ability to meet customer delivery requirements.

To be financially successful, we will have to manufacture our Power Systems products in commercial quantities at acceptable costs while also preserving the necessary performance and quality levels. We cannot be certain that we will be successful in developing product designs and manufacturing processes that permit us to manufacture our Power Systems products in commercial quantities at acceptable costs while preserving the necessary performance and quality. In addition, we may incur significant unforeseen expenses in our product design and manufacturing efforts.

Table of Contents

We have not manufactured our 344 superconductors in commercial quantities, and a failure to manufacture our 344 superconductors in commercial quantities at acceptable cost and quality levels would substantially limit our future revenue and profit potential.

We are developing commercial-scale manufacturing processes for our 344 superconductors, which, while very different from our 1G HTS wire manufacturing processes, are also extremely complex and challenging. We expect to have installed and qualified by December 31, 2007 the capacity to manufacture 720,000 meters of our 344 superconductors annually. However, in order to be able to offer our wire at pricing that we believe will be commercially competitive, we estimate that we will need to develop the capacity to manufacture nine million meters of our 344 superconductors annually. We believe it will cost between approximately $28 million and $35 million to purchase and install additional equipment to achieve this commercial scale manufacturing capability. We may not be able to manufacture satisfactory commercial quantities of 344 superconductors of consistent quality with an acceptable yield and cost. Failure to successfully scale up manufacturing of our 344 superconductors would result in a significant limitation of the broad market acceptance of our HTS products and of our future revenue and profit potential.

We have limited experience in marketing and selling our superconductor products and system-level solutions, and our failure to effectively market and sell our products and solutions could adversely affect our revenue and cash flow.

To date, we have limited experience marketing and selling our superconductor products and system-level solutions, and there are few people who have significant experience marketing or selling superconductor products and system-level solutions. Once our products and solutions are ready for widespread commercial use, we will have to develop a marketing and sales organization that will effectively demonstrate the advantages of our products over both more traditional products and competing superconductor products or other technologies. We may not be successful in our efforts to market this new technology, and we may not be able to establish an effective sales and distribution organization.

We may decide to enter into arrangements with third parties for the marketing or distribution of our products, including arrangements in which our products, such as HTS wire, are included as a component of a larger product, such as a power cable system or a motor. By entering into marketing and sales alliances, the financial benefits to us of commercializing our products are dependent on the efforts of others.

Our success in addressing the wind energy system market is dependent on the system manufacturers that license our system designs.

Because an important element of our strategy for addressing the wind energy system market involves the license of our system designs to manufacturers of wind energy systems, the financial benefits to us of our products for the wind energy market are dependent on the success of these manufacturers in selling wind energy systems that incorporate our designs. We may not be able to enter into marketing or distribution arrangements with third parties on financially acceptable terms, and third parties may not be successful in selling our products or applications incorporating our products.

Table of Contents

Growth of the wind energy market depends largely on the availability and size of government subsidies and economic incentives.

At present, the cost of wind energy exceeds the cost of conventional power generation in many locations around the world. Various governments have used different policy initiatives to encourage or accelerate the development and adoption of wind energy and other renewable energy sources. Renewable energy policies are in place in the European Union, most notably Germany and Spain, certain countries in Asia, including China, Japan and South Korea, and many of the states in Australia and the United States. Examples of government sponsored financial incentives include capital cost rebates, feed-in tariffs, tax credits, net metering and other incentives to end-users, distributors, system integrators and manufacturers of wind energy products to promote the use of wind energy and to reduce dependency on other forms of energy. Governments may decide to reduce or eliminate these economic incentives for political, financial or other reasons. Reductions in, or eliminations of, government subsidies and economic incentives before the wind energy industry reaches a sufficient scale to be cost-effective in a non-subsidized marketplace could reduce demand for our products and adversely affect our business prospects and results of operations.

Many of our revenue opportunities are dependent upon subcontractors and other business collaborators.

Many of the revenue opportunities for our business involve projects, such as the installation of superconductor cables in power grids and electrical system hardware in wind energy systems, in which we collaborate with other companies, including suppliers of cryogenic systems, manufacturers of electric power cables and manufacturers of wind energy systems. In addition, a key element of our business strategy is the formation of business alliances with motor manufacturers and/or marine propulsion system integrators. As a result, most of our current and planned revenue-generating projects involve business collaborators on whose performance our revenue is dependent. If these business partners fail to deliver their products or perform their obligations on a timely basis or fail to generate sufficient demand for the systems they manufacture, our revenue from the project may be delayed or decreased and we may not be successful in selling our products.

We may not realize all of the sales expected from our backlog of orders and contracts.

At June 30, 2007, we had approximately $75 million of backlog of orders and contracts. There can be no assurances that the revenue we expect to generate from our backlog will be realized in the periods we expect to realize such revenue, or at all. In addition, the backlog of orders and contracts, if realized, may not result in profitable revenue. Backlog represents the value of contracts and purchase orders received, less the revenue recognized to date on those contracts and purchase orders. Our customers have the right under some circumstances and with some penalties or consequences to terminate, reduce or defer firm orders that we have in backlog. In addition, our government contracts are subject to the risks described below. If our customers terminate, reduce or defer firm orders, we may be protected from certain costs and losses, but our sales will nevertheless be adversely affected and we may not generate the revenue we expect. Although we strive to maintain ongoing relationships with our customers, there is an ongoing risk that orders may be cancelled or rescheduled due to fluctuations in our customers business needs or purchasing budgets.

Table of Contents

Our contracts with the U.S. government are subject to audit, modification or termination by the U.S. government, and the continued funding of such contracts remains subject to annual congressional appropriation which, if not approved, could adversely affect our results of operations and financial condition.

As a company that contracts with the U.S. government, we are subject to financial audits and other reviews by the U.S. government of our costs and performance, accounting and general business practices relating to these contracts. Based on the results of these audits, the U.S. government may adjust our contract-related costs and fees. We cannot be certain that adjustments arising from government audits and reviews would not have a material adverse effect on our results of operations. Some of our contracts with the U.S. government are on a firm fixed price basis and, as such, are subject to more financial risk in the event of unanticipated cost overruns. For example, we recently announced that we had higher than planned costs in connection with a fixed price contract with the Navy.

All of our U.S. government contracts can be terminated by the U.S. government for its convenience. Termination-for-convenience provisions provide only for our recovery of costs incurred or committed, and for settlement of expenses and profit on work completed prior to termination. In addition to the right of the U.S. government to terminate its contracts with us, U.S. government contracts are conditioned upon the continuing approval by Congress of the necessary spending to honor such contracts. Congress often appropriates funds for a program on a fiscal-year basis even though contract performance may take more than one year. Consequently, at the beginning of many major governmental programs, contracts often may not be fully funded, and additional monies are then committed to the contract only if, as and when appropriations are made by Congress for future fiscal years. We cannot be certain that our U.S. government contracts will not be terminated or suspended in the future. The U.S. government s termination of, or failure to fully fund, one or more of our contracts would have a negative impact on our operating results and financial condition. Further, in the event that any of our government contracts are terminated for cause, it could affect our ability to obtain future government contracts which could, in turn, seriously harm our ability to develop our technologies and products.

We have recently learned that the United States House of Representatives Committee on Energy and Commerce (the Committee) and its Subcommittee on Oversight and Investigations has sent a letter to the United States Department of Homeland Security (DHS) indicating that it is reviewing the origins of the sole source contract that DHS awarded to American Superconductor and Consolidated Edison for a project to develop electricity grids in New York City that can withstand major disruptions. As we previously announced, we signed a letter contract on this project on May 18, 2007 with DHS worth $1.7 million, of which DHS will fund $1.1 million. Final contract terms between DHS and us are being negotiated. Total project costs are estimated to be $39.3 million with DHS providing up to $25.0 million of the total project cost.

Table of Contents

We have also learned that the Committee sent a letter to the Department of the Navy seeking information and documents regarding completed contracts between the U.S. Navy and us.

The Committee did not state the reason for its review of these matters. On August 2, 2007, we received a letter requesting that we provide certain information to the Committee. Negotiations between us and the DHS regarding the final contract are continuing. While we continue to expect to successfully complete this contract, there can be no assurance that we will do so.

Our products face intense competition both from superconductor products developed by others and from traditional, non-superconductor products and alternative technologies, which could limit our ability to acquire or retain customers.

The market for superconductor products is intensely competitive. We face competition both from competitors in the superconductor field and from vendors of traditional products and new technologies. There are many companies in the United States, Europe, Japan and China engaged in the development of HTS wire, including EHTS (a division of Bruker Biospin), Evico, Fujikura, Furukawa Electric, Innova Superconductor Technology, Nexans, MetOx, Showa, Sumitomo Electric Industries, SuperPower (a subsidiary of Royal Philips Electronics) and Zenergy. The superconductor industry is characterized by rapidly changing and advancing technology. Our future success will depend in large part upon our ability to keep pace with advancing HTS technology and developing industry standards.

Our power electronic products, such as D-VAR and PQ-SVC products, compete with a variety of other power reliability products such as dynamic voltage restorers, or DVRs, static VAR compensators, or SVCs, static compensators, or STATCOMS, flywheels, battery-based power quality systems and competing power electronic converter systems. The manufacturers of products that compete with our power electronic products and PowerModule products include ABB, Alstom, Mitsubishi Electric, S&C Electric and Siemens.

Our Windtec business faces competition for the supply of wind turbine engineering design services from design engineering firms, such as Garrad Hassan, and from licensors of wind turbine systems, such as Aerodyn, DeWind and REpower. We also face indirect competition in the wind energy market from manufacturers of wind energy systems, such as Gamesa, General Electric, Suzlon and Vestas.

The stand-alone FCL products that we are developing in collaboration with Siemens face competition from several competitors developing alternative solutions, including Beijing Superconductor, Hypertech, Hyundai, Innopower, KEPRI, Nexans, Rolls-Royce, SC Power, Sumitomo Electric, SuperPower and Toshiba. The HTS motor and generator products that we are developing face competition from copper wire-based motors and generators, from permanent magnet motors that are being developed, including by DRS Technologies, and from companies developing HTS rotating machinery, including Converteam, Doosan Heavy Industries & Construction, General Electric, Ishikawajima-Harima Heavy Industries Co., Rockwell and Siemens. Research efforts and technological advances made by others in the superconductor field, in the wind energy market or in other areas with applications to the power quality and reliability markets may render our development efforts obsolete.

Table of Contents

Many of our competitors have substantially greater financial resources, research and development, manufacturing and marketing capabilities than we have. In addition, as the HTS wire, HTS electric motors and generators, and power electronic systems markets develop, other large industrial companies may enter those fields and compete with us. If we are unable to compete successfully, it may harm our business, which in turn may limit our ability to acquire or retain customers.

Third parties have or may acquire patents that cover the materials, processes and technologies we use or may use in the future to manufacture our HTS products, and our success depends on our ability to license such patents or other proprietary rights.

We expect that some or all of the HTS materials, processes and technologies we use in designing and manufacturing our products are or will become covered by patents issued to other parties, including our competitors. If that is the case, we will need to acquire licenses to these patents, successfully contest the validity of these patents or re-engineer our products so that they do not infringe such patents. The owners of these patents may refuse to grant licenses to us, or may be willing to do so only on terms that we find commercially unreasonable. If we are unable to obtain these licenses, we may have to contest the validity or scope of those patents or re-engineer our products to avoid infringement claims by the owners of these patents. It is possible that we will not be successful in contesting the validity or scope of a patent, or that we will not prevail in a patent infringement claim brought against us. Even if we are successful in such a proceeding, we could incur substantial costs and diversion of management resources in prosecuting or defending such a proceeding.

Our patents may not provide meaningful protection for our technology, which could result in us losing some or all of our market position.

We own or have licensing rights under many patents and pending patent applications. However, the patents that we own or license may not provide us with meaningful protection of our technologies and may not prevent our competitors from using similar technologies, for a variety of reasons, such as:

- the patent applications that we or our licensors file may not result in patents being issued;
- any patents issued may be challenged by third parties; and
- others may independently develop similar technologies not protected by our patents or design around the patented aspects of any technologies we develop.

Moreover, we could incur substantial litigation costs in defending the validity of our own patents. We also rely on trade secrets and proprietary know-how to protect our intellectual property. However, our non-disclosure agreements and other safeguards may not provide meaningful protection for our trade secrets and other proprietary information. If the patents that we own or license or our trade secrets and proprietary know-how fail to protect our technologies, our market position may be adversely affected.

Table of Contents

Our success is dependent upon attracting and retaining qualified personnel, and our inability to do so could significantly damage our business and prospects.

Our success will depend in large part upon our ability to attract and retain highly qualified research and development, management, manufacturing, marketing and sales personnel. Hiring those persons may be especially difficult due to the specialized nature of our business.

We may acquire additional complementary businesses or technologies, which may require us to incur substantial costs for which we may never realize the anticipated benefits.

We acquired Windtec on January 5, 2007 and Power Quality Systems on April 27, 2007. We may in the future acquire additional complementary businesses or technologies, although we currently have no commitments or agreements. As a result of the Windtec and Power Quality Systems acquisitions and any additional acquisitions we pursue, management s attention and resources may be diverted from our other businesses. An acquisition may also involve significant purchase price and significant transaction-related expenses.

Achieving the benefits of any acquisition involves additional risks, including:

- difficulty assimilating acquired operations, technologies and personnel;
- inability to retain management and other key personnel of the acquired business;
- changes in management or other key personnel that may harm relationships with the acquired business s customers and employees; and
- diversion of management attention as a result of the integration process.

We cannot ensure that we will realize any of the anticipated benefits of the Windtec and Power Quality Systems acquisitions or any other acquisition, and if we fail to realize these anticipated benefits, our operating performance could suffer.

Our international operations are subject to risks that we do not face in the U.S., which could have an adverse effect on our operating results.

We completed our acquisition of Windtec, an Austrian-based company, on January 5, 2007 and we are expanding our sales and service operations in Austria and the Asia-Pacific region. We expect our revenue and operations outside the United States will continue to expand in the future. Our international operations are subject to a variety of risks that we do not face in the U.S., including:

- difficulties in staffing and managing our foreign offices and the increased travel, infrastructure and legal compliance costs associated with multiple international locations;
- potentially longer payment cycles for sales in foreign countries and difficulties in collecting accounts receivable;
- additional withholding taxes or other taxes on our foreign income, and tariffs or other restrictions on foreign trade or investment, including export duties and quotas, trade and employment restrictions;
- imposition of, or unexpected adverse changes in, foreign laws or regulatory requirements;

increased exposure to foreign currency exchange rate risk;

reduced protection for intellectual property rights in some countries; and

political unrest, war or acts of terrorism.

Table of Contents

Our overall success in international markets depends, in part, upon our ability to succeed in differing legal, regulatory, economic, social and political conditions. We may not be successful in developing and implementing policies and strategies that will be effective in managing these risks in each country where we do business. Our failure to manage these risks successfully could harm our international operations and reduce our international sales, thus adversely affecting our business, operating results and financial condition.

Our common stock may experience extreme market price and volume fluctuations, which may prevent our stockholders from selling our common stock at a profit and could lead to costly litigation against us that could divert our management s attention.

The market price of our common stock has historically experienced significant volatility and may continue to experience such volatility in the future. Factors such as technological achievements by us and our competitors, the establishment of development or strategic relationships with other companies, our introduction of commercial products, and our financial performance may have a significant effect on the market price of our common stock. In addition, the stock market in general, and the stock of high technology companies in particular, have in recent years experienced extreme price and volume fluctuations, which are often unrelated to the performance or condition of particular companies. Such broad market fluctuations could adversely affect the market price of our common stock. Due to these factors, the price of our common stock may decline and investors may be unable to resell their shares of our common stock for a profit. Following periods of volatility in the market price of a particular company s securities, securities class action litigation has often been brought against that company. If we become subject to this kind of litigation in the future, it could result in substantial litigation costs, a damages award against us and the diversion of our management s attention.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On April 27, 2007, we completed the acquisition of PQS pursuant to the Agreement and Plan of Merger, dated March 6, 2007, as amended, pursuant to which a wholly-owned subsidiary of ours was merged with and into PQS. In consideration of our acquisition of PQS, we issued 295,329 shares of our common stock to PQS s former owners on April 27, 2007. The shares of our common stock issued to PQS s former holders were issued in reliance on the exemption from the registration provisions of Section 4(2) of the Securities Act of 1933, as amended, relating to sales by an issuer not involving any public offering.

Item 6. Exhibits

See the Exhibit Index on the page immediately preceding the exhibits for a list of exhibits filed as part of this quarterly report, which Exhibit Index is incorporated herein by this reference.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

AMERICAN SUPERCONDUCTOR CORPORATION

August 9, 2007 Date	*/s/ David A. Henry* David A. Henry Senior Vice President and Chief Financial Officer (Principal Financial and Accounting Officer)

Table of Contents

Exhibit Index

Exhibit No.	Description
10.1	Transition Agreement dated as June 28, 2007 between the Registrant and Thomas M. Rosa (1)
10.2	Executive Incentive Plan for Fiscal 2007
31.1	Chief Executive Officer - Certification pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
31.2	Chief Financial Officer - Certification pursuant to Rule 13a-14(a) or Rule 15d- 14(a) of the Securities Exchange Act of 1934, as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002
32.1	Chief Executive Officer - Certification pursuant to Rule13a-14(b) or Rule 15d- 14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
32.2	Chief Financial Officer - Certification pursuant to Rule 13a-14(b) or Rule 15d- 14(b) of the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002

(1) Incorporated by reference to Exhibits to the Registrant s Current Report on Form 8-K filed with the Securities and Exchange Commission (the Commission) on July 2, 2007 (Commission File No. 000-19672

anticipated exit of an additional facility in South San Francisco, California. We expect to record $0.1 million of additional termination benefits and the majority of the facility-related charges discussed above as they are determined during the fiscal year ending December 31, 2011.

As of June 30, 2011, the 2010 and 2011 restructuring plans had resulted in aggregate cash expenditures of $20.7 million. We expect to pay an additional $8.5 million, net of cash received from our subtenant, for Building 249 and an additional $7.3 million, net of cash received from our subtenants, for Building 170. In addition, we expect to make cash expenditures of $1.0 million relating to termination benefits and up to $22 million relating to facility charges in connection with the anticipated exit of an additional facility in South San Francisco, California. We expect the termination benefits to be paid during the third and fourth quarters of 2011 and the facility costs to be paid through 2017, or the end of our lease term.

The total outstanding restructuring liability is included in Current portion of restructuring and Long-term portion of restructuring on our Condensed Consolidated Balance Sheet and is based upon restructuring charges recognized as of June 30, 2011 in connection with the 2010 and 2011 plans. As of June 30, 2011, the components of these liabilities are summarized in the following table (in thousands):

	Employee Severance And Other Benefits	Facility Charges	Asset Impairment	Legal and Other Fees	Total
Balance as of December 31, 2010	$ 5,523	$ 8,688	$	$ 70	$ 14,281
Restructuring charge recorded in the six months ended June 30, 2011	1,927	1,841	(542)	27	3,253
Cash payments	(5,940)	(1,409)	397	(16)	(6,968)
Adjustments or non-cash credits including stock compensation expense	(526)	(83)	145		(464)
Ending accrual balance as of June 30, 2011	$ 984	$ 9,037	$	$ 81	$ 10,102

NOTE 6. Sale of Shares of Common Stock

In March 2011, we completed a public offering of 17.3 million shares of our common stock pursuant to a shelf registration statement previously filed with the SEC, which the SEC declared effective on May 8, 2009. We received approximately $179.4 million in net proceeds from the offering after deducting the underwriting discount and related offering expenses.

NOTE 7. Debt

Silicon Valley Bank Loan and Security Agreement

In December 2007, we entered into a third loan modification agreement to the loan and security agreement originally entered into in May 2002 with Silicon Valley Bank. The terms associated with the original line of credit under the May 2002 agreement and the subsequent loan modifications were not modified. The December 2007 loan modification agreement provided for an additional equipment line of credit in the amount of up to $30.0 million with a draw down period of approximately 2 years. Each advance must be repaid in 48 equal, monthly installments of principal, plus accrued interest, at an annual rate of 0.75% fixed. In December 2009, we amended the agreement and extended the draw down period on the line of credit for an additional 18 months through June 2011 and increased the principal amount of the line of credit from $30.0 million to $33.6 million. Pursuant to the terms of the amendment, we were required to make minimum draws of $2.5 million every 6 months through June 2011, for total additional draws of $7.5 million. The loan facility required security in the form of a non-interest bearing certificate of deposit account with the bank, in an amount equal to at least 100% of the outstanding obligations under the line of credit. In June 2008, we drew down $13.6 million under this agreement, in December 2009, we drew down $5.0 million, and we drew down an additional $2.5 million in each of June 2010, December 2010 and June 2011 in accordance with the terms of the modified agreement. In accordance with the amended loan terms, the line of credit has expired and we have no further draw down obligations under the line of credit.

The total outstanding obligation under all lines of credit with Silicon Valley Bank as of June 30, 2011 and December 31, 2010 is $14.2 million and $16.1 million, respectively. The total collateral balance as of June 30, 2011 and December 31, 2010 is $14.9 million and $16.9 million, respectively, and is reflected in our Condensed Consolidated Balance Sheet as Cash and cash equivalents and Marketable securities as the deposit account is not restricted as to withdrawal.

Table of Contents

ITEM 2. MANAGEMENT S DISCUSSION AND ANALYSIS OF FINANCIAL CONDITION AND RESULTS OF OPERATIONS

The following discussion and analysis contains forward-looking statements. These statements are based on our current expectations, assumptions, estimates and projections about our business and our industry, and involve known and unknown risks, uncertainties and other factors that may cause our or our industry s results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied in, or contemplated by, the forward-looking statements. Words such as believe, anticipate, expect, intend, plan, focus, goal, objective, will, may, could, would, estimate, predict, potential, continue, encouraging, or the negative of such terms or other similar expressions identify forward-looking statements. Our actual results and the timing of events may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a difference include those discussed in Part II, Item 1A of this Form 10-Q, as well as those discussed elsewhere in this report.

This discussion and analysis should be read in conjunction with our financial statements and accompanying notes included in this report and the financial statements and accompanying notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the Securities and Exchange Commission, or SEC, on February 22, 2011. Operating results are not necessarily indicative of results that may occur in future periods. We undertake no obligation to update any forward-looking statement to reflect events after the date of this report.

Overview

We are a biotechnology company committed to developing small molecule therapies for the treatment of cancer. We are focusing our resources and development efforts exclusively on cabozantinib (XL184), our most advanced compound, in order to maximize the therapeutic and commercial potential of this compound. We believe cabozantinib has the potential to be a high-quality, broadly-active, differentiated pharmaceutical product that can make a meaningful difference in the lives of patients. We have also established a portfolio of other novel compounds that we believe have the potential to address serious unmet medical needs, most of which are being advanced by partners as part of collaborations.

Cabozantinib inhibits MET, VEGFR2 and RET, proteins that are key drivers of tumor growth and/or vascularization. Cabozantinib is being evaluated in a broad development program encompassing multiple cancer indications. The current clinical program for cabozantinib is focused on the treatment of metastatic castration-resistant prostate cancer and ovarian cancer, based on encouraging interim data that has emerged from a randomized discontinuation trial investigating cabozantinib in nine distinct tumor types. Cabozantinib is also being studied in an ongoing global phase 3 registration trial in medullary thyroid cancer, known as the EXAM trial. We expect to release top-line results from the EXAM trial around the end of the third quarter of 2011 and plan to initiate a rolling submission of a new drug application, or NDA, for cabozantinib in medullary thyroid cancer in the fourth quarter 2011 by submitting with the United States Food and Drug Administration, or FDA, key parts of the NDA, including the preclinical and chemistry, manufacturing and controls information. We expect to complete the NDA filing in the first quarter of 2012. Cabozantinib is eligible for a rolling submission as a result of the FDA s granting Fast Track designation for cabozantinib in medullary thyroid cancer. Assuming a positive outcome of the EXAM trial and approval of our NDA by the FDA, we currently anticipate a commercial launch of cabozantinib for the treatment of medullary thyroid cancer in the second half of 2012.

Based on the strength of our expertise in biology, drug discovery and development, we have established collaborations with leading pharmaceutical and biotechnology companies, including Bristol-Myers Squibb Company, or Bristol-Myers Squibb, sanofi-aventis, Genentech, Inc. (a wholly owned member of the Roche Group), GlaxoSmithKline and Daiichi Sankyo Company Limited for the majority of the remaining compounds and programs in our portfolio. Pursuant to these collaborations, we have out-licensed compounds or programs to a partner for further development and commercialization, generally have no further unfunded cost obligations related to such compounds or programs and may be entitled to receive research funding, milestones and royalties or a share of profits from commercialization. With respect to our partnered compounds, we are eligible to receive potential milestone payments under our collaborations totaling approximately $2.9 billion in the aggregate on a non-risk adjusted basis, of which 12.3% are related to clinical development milestones, 46.2% are related to regulatory milestones and 41.5% are related to commercial milestones.

Our strategy is to aggressively advance cabozantinib through development toward commercialization. In doing so, we will pursue a pragmatic development plan focused on those cancer indications where we believe cabozantinib has the greatest near-term therapeutic and commercial potential. We are aggressively managing our expenses to preserve our cash resources and ensure we are appropriately dedicating those resources towards successfully executing our strategy.

As part of our ongoing effort to manage costs and our strategy to focus our resources and development efforts on our most advanced compound, cabozantinib, we implemented two restructuring plans during 2010 and an additional restructuring plan in March 2011 that resulted in an overall reduction in our workforce by 410 employees. Personnel reductions were made across our entire

15

Table of Contents

organization, including discovery, development and general and administrative departments. We expect to make additional reductions through the end of 2012 as we complete our obligations under collaboration agreements and withdraw resources from completed projects. With the exception of activities related to cabozantinib, we are discontinuing efforts with respect to all of our compounds and programs that are not funded by partners pursuant to collaboration agreements and are actively pursuing collaborations or other external opportunities for the continued development of these compounds and programs. Discovery and clinical activities under various collaborations will continue to be funded by partners until we complete our contractual obligations.

Cabozantinib

Cabozantinib is a first-in-class inhibitor of tumor growth, metastasis and angiogenesis that simultaneously targets MET, VEGFR2 and RET, which are key kinases involved in the development and progression of many cancers. It has recently been shown in preclinical models that treatment with selective inhibitors of VEGF signaling can result in tumors that are more invasive and aggressive compared to control treatment. In preclinical studies, upregulation of MET has been shown to occur in concert with development of invasiveness after selective anti-VEGF therapy, and may constitute a mechanism of acquired or evasive resistance to agents that target VEGF signaling without inhibiting MET. Accordingly, treatment with cabozantinib in similar preclinical studies resulted in tumors that were less invasive and aggressive compared to control or selective anti-VEGF treatment. Therefore, we believe that cabozantinib has the potential for improving outcomes in a range of indications, including those where selective anti-VEGF therapy has shown minimal or no activity.

The current clinical program for cabozantinib is focused on the treatment of metastatic castration-resistant prostate cancer and ovarian cancer, based on encouraging interim data that has emerged from a randomized discontinuation trial, or RDT, investigating cabozantinib in nine distinct tumor types. Data from the RDT were released at the American Society of Clinical Oncology, or ASCO, Annual Meeting in June 2010 and demonstrated broad activity for cabozantinib across multiple tumor types, in particular, metastatic castration-resistant prostate, ovarian, non-small cell lung and hepatocellular cancers. Updated interim data presented at the 22nd EORTC-NCI-AACR Symposium on Molecular Targets and Cancer Therapeutics in November 2010, or the 2010 EORTC Symposium, at the ASCO 2011 Genitourinary Cancers Symposium in February 2011, and at the 2011 ASCO Annual Meeting in June 2011 suggest that cabozantinib has a novel and differentiated clinical profile in metastatic castration-resistant prostate cancer and other solid tumors. The data presented indicate that cabozantinib has shown novel activity against bone and soft tissue lesions in patients with metastatic castration-resistant prostate cancer. In addition, we have observed resolution of metastatic bone lesions on bone scan in patients with metastatic breast cancer, renal cell carcinoma, thyroid cancer and melanoma. It will be a priority for us to generate additional data in the various other cohorts of the RDT, including ovarian cancer, melanoma, breast cancer, non-small cell lung cancer and hepatocellular cancer, to support further prioritization of our clinical and commercial options. In addition, we are conducting ongoing exploratory clinical trials for cabozantinib in other tumor types, including renal cell carcinoma. Objective tumor responses have been observed in patients with cabozantinib in 12 of 13 unique tumor types investigated to date, reflecting the broad potential clinical activity and commercial opportunity with this new agent.

We also are focusing our efforts on our ongoing phase 3 clinical trial of cabozantinib as a potential treatment for medullary thyroid cancer. This registration trial was initiated in July 3, 2008 following agreement between the FDA and us on the trial design through the FDA s Special Protocol Assessment process. We expect to release top-line results from the EXAM trial around the end of the third quarter of 2011.

In January 2011, we announced that the FDA granted orphan drug designation to cabozantinib for the treatment of follicular, medullary and anaplastic thyroid carcinoma, and metastatic or locally advanced papillary thyroid cancer. Orphan drug status is granted to treatments for diseases that affect fewer than 200,000 people in the U.S. and provides the benefits of potential market exclusivity for the orphan-designated product for the orphan designated indication for seven years, tax credits of up to 50% of the qualified clinical trial expenses and a waiver of FDA application user fees.

In April 2011, the FDA designated cabozantinib as a Fast Track development program for patients with unresectable, locally advanced or metastatic medullary thyroid carcinoma. The Fast Track process is designed to facilitate the development, and expedite the review of drugs to treat serious diseases and fill an unmet medical need. A drug that receives Fast Track designation is eligible for rolling review, which means that a drug company can submit completed sections of its NDA for review by the FDA. In addition, most drugs that receive Fast Track designation are likely to be considered appropriate to receive a priority review.

We plan to initiate a rolling submission of an NDA for cabozantinib in medullary thyroid cancer in the fourth quarter 2011 by submitting with the FDA key parts of the NDA, including the preclinical and chemistry, manufacturing and controls information. We expect to complete the NDA filing in the first quarter of 2012. Assuming a positive outcome of the EXAM trial and approval of our NDA by the FDA, we currently anticipate a commercial launch of cabozantinib for the treatment of medullary thyroid cancer in the second half of 2012.

In June 2011, we submitted to the FDA the protocol for a planned pivotal trial for cabozantinib in castration-resistant prostate cancer using an endpoint of pain reduction and bone scan response (XL184-306) for consideration of a Special Protocol

16

Table of Contents

Assessment. Our goal is to initiate this trial by the end of 2011. We are also planning two additional pivotal trials in castration-resistant prostate cancer for overall survival and bone metastasis-free survival (XL184-307 and XL184-308), respectively, and expect to initiate both of these trials in 2012.

Recent Development

Termination of Collaboration Agreement with Bristol-Myers Squibb for XL281

On July 8, 2011, we and one of our wholly-owned subsidiaries received written notification from Bristol-Myers Squibb of its decision to terminate the Amended and Restated Collaboration Agreement dated as of April 15, 2011 by and between us and Bristol-Myers Squibb, which amended and restated the Collaboration Agreement dated as of December 11, 2008 between us and Bristol-Myers Squibb, or the 2008 Agreement, on a worldwide basis as to XL281. The termination is being made pursuant to the terms of the Amended and Restated Collaboration Agreement dated as of April 15, 2011 and will be effective as of the end of the day on October 8, 2011. Bristol-Myers Squibb informed us that the termination was based upon Bristol-Myers Squibb s review of XL281 in the context of Bristol-Myers Squibb s overall research and development priorities and pipeline products. Upon the effectiveness of the termination, Bristol-Myers Squibb s license relating to XL281 will terminate and rights to XL281 will revert to us, and we will be entitled to receive, subject to certain terms and conditions, licenses from Bristol-Myers Squibb to research, develop and commercialize XL281. We plan to wind down ongoing activities related to XL281 following the termination and do not currently expect to further research, develop or commercialize XL281 following the wind-down.

Under the 2008 Agreement, we and Bristol-Myers Squibb originally had agreed to co-develop cabozantinib and Bristol-Myers Squibb also received an exclusive worldwide license to develop and commercialize XL281. On June 18, 2010, we received a notice from Bristol-Myers Squibb of its decision to terminate the 2008 Agreement solely as to cabozantinib, on a worldwide basis, pursuant to the terms of the 2008 Agreement. We continued to carry out certain clinical trials of XL281 under the 2008 Agreement, and Bristol-Myers Squibb was responsible for funding all future development of XL281, including our activities. We were eligible for development and regulatory milestones of up to $315.0 million on XL281, sales performance milestones of up to $150.0 million and double-digit royalties on worldwide sales of XL281.

For purposes of recognizing up-front license fees received under the 2008 Agreement, prior to receiving the termination notification from Bristol-Myers Squibb in July 2011, we were recognizing revenue through April 2014. As a result of the termination, the estimated research term will now end as of the end of the day on October 8, 2011. Accordingly, we expect to accelerate the remaining deferred revenue balance and estimate that we will recognize an aggregate of approximately $109.9 million and $10.4 million in revenue in the third and fourth fiscal quarters of 2011, respectively, relating to the up-front license fees under the 2008 Agreement.

Certain Factors Important to Understanding Our Financial Condition and Results of Operations

Successful development of drugs is inherently difficult and uncertain. Our business requires significant investments in research and development over many years, often for products that fail during the research and development process. Our long-term prospects depend upon our ability, particularly with respect to cabozantinib, and the ability of our partners to successfully commercialize new therapeutics in highly competitive areas such as cancer treatment. Our financial performance is driven by many factors, including those described below.

Clinical Development of Cabozantinib and Other Product Candidates

In December 2008, we entered into a worldwide collaboration with Bristol-Myers Squibb for cabozantinib and XL281. Upon effectiveness of the collaboration agreement in December 2008, Bristol-Myers Squibb made a nonrefundable upfront cash payment of $195.0 million for the development and commercialization rights to both programs. The agreement required Bristol-Myers Squibb to make additional license payments to us of $45.0 million, which were received during 2009.

On June 18, 2010, we regained full rights to develop and commercialize cabozantinib under our collaboration agreement with Bristol-Myers Squibb following receipt of notice from Bristol-Myers Squibb of its decision to terminate the 2008 collaboration, solely as to cabozantinib, on a worldwide basis. Bristol-Myers Squibb informed us that the termination was based upon its review of cabozantinib in the context of Bristol-Myers Squibb s overall research and development priorities and pipeline products. On June 28, 2010, in connection with the termination, we received a $17.0 million transition payment from Bristol-Myers Squibb in satisfaction of its obligations under the collaboration agreement to continue to fund its share of development costs for cabozantinib for a period of three months following the notice of termination. As a result of the termination, Bristol-Myers Squibb s license relating to cabozantinib terminated and its rights to cabozantinib reverted to us, and we received, subject to certain terms and conditions, licenses from Bristol-Myers Squibb to research, develop and commercialize cabozantinib.

We are focusing our resources and development efforts on the development of cabozantinib. However, the product candidate may fail to show adequate safety or efficacy in clinical testing. Furthermore, predicting the timing of the initiation or completion of

Table of Contents

clinical trials is difficult, and our trials may be delayed due to many factors, including factors outside of our control. The future development path of cabozantinib depends upon the results of each stage of clinical development. We expect to incur increased expenses for the development of cabozantinib as it advances in clinical development.

With the exception of activities related to cabozantinib, we are discontinuing efforts with respect to all of our compounds and programs that are not funded by partners pursuant to collaboration agreements and are actively pursuing collaborations or other external opportunities for the continued development of these compounds and programs. Discovery and clinical activities under various collaborations are expected to continue at funded levels until we complete our contractual obligations.

Limited Sources of Revenues

We have no pharmaceutical products that have received marketing approval, and we have generated no revenues to date from the sale of such products. We do not expect to generate revenues from the sale of pharmaceutical products in the near term and expect that all of our near-term revenues, such as research and development funding, license fees and milestone payments and royalty revenues, will be generated from collaboration agreements with our current and potential future partners. Milestones under these agreements may be tied to factors that are outside of our control, such as significant clinical or regulatory events with respect to compounds that have been licensed to our partners.

Liquidity

As of June 30, 2011, we had $353.6 million in cash and cash equivalents, marketable securities and long-term investments, which included restricted cash and investments of $4.2 million and approximately $95.0 million of cash and cash equivalents and marketable securities that we are required to maintain on deposit with Silicon Valley Bank pursuant to covenants in our loan and security agreement with Silicon Valley Bank. We anticipate that our current cash and cash equivalents, marketable securities, long-term investments and funding that we expect to receive from existing collaborators will enable us to maintain our operations for a period of at least 12 months following the filing date of this report. However, our future capital requirements will be substantial and depend on many factors, including the following:

- the progress and scope of the development activity with respect to cabozantinib;
- whether we repay amounts outstanding under our loan and security agreement with GlaxoSmithKline in cash or shares of our common stock;
- whether we elect to pay cash or to issue shares of our common stock in respect of any conversion of our principal, prepayments or payments of interest in connection with the secured convertible notes we issued to entities affiliated with Deerfield Management Company, L.P., or Deerfield, under a note purchase agreement;
- whether we elect to prepay the amounts advanced under our loan from Silicon Valley Bank;
- the level of payments received under existing collaboration agreements, licensing agreements and other arrangements;
- the degree to which we conduct funded development activity on behalf of partners to whom we have out-licensed compounds; and
- whether we enter into new collaboration agreements, licensing agreements or other arrangements (including, in particular, with respect to cabozantinib) that provide additional capital.

Our minimum liquidity needs are also determined by financial covenants in our loan and security agreement with GlaxoSmithKline, our loan and security agreement with Silicon Valley Bank and our note purchase agreement with Deerfield, as well as other factors, which are described under Liquidity and Capital Resources Cash Requirements .

Our ability to raise additional funds may be severely impaired if any of our product candidates fails to show adequate safety or efficacy in clinical testing.

Deerfield Facility

On June 2, 2010, we entered into a note purchase agreement with Deerfield pursuant to which, on July 1, 2010, we sold to Deerfield an aggregate of $124.0 million initial principal amount of our secured convertible notes due June 2015 for an aggregate purchase price of $80.0 million, less closing fees and expenses of approximately $2.0 million. The outstanding principal amount of the notes bears interest in the annual amount of $6.0 million, payable quarterly in arrears. We will be required to make mandatory prepayments on the notes on an annual basis in 2013, 2014 and 2015 equal to 15% of certain payments from our collaborative arrangements received during the prior fiscal year, subject to a maximum annual prepayment amount of $27.5 million and, for payments due in January 2013 and 2014, a minimum prepayment amount of $10.0 million. We may also prepay all or a portion (not less than $5.0 million) of the principal amount of the notes at an optional prepayment price based on a discounted principal amount (during the first three years of the term, subject to a prepayment premium) determined as of the date of prepayment, plus accrued and unpaid interest, plus in the case of a prepayment of the full principal amount of the notes (other than prepayments upon the occurrence

Table of Contents

of specified transactions relating to a change of control or a substantial sale of assets), all accrued interest that would have accrued between the date of such prepayment and the next anniversary of the note purchase agreement. In lieu of making any optional or mandatory prepayment in cash, at any time after July 1, 2011, subject to certain limitations (including a cap on the number of shares issuable under the note purchase agreement), we have the right to convert all or a portion of the principal amount of the notes into, or satisfy all or any portion of the optional prepayment amounts or mandatory prepayment amounts (other than the first $10.0 million of mandatory prepayments required in 2013 and 2014) with shares of our common stock. Additionally, in lieu of making any payment of accrued and unpaid interest in respect of the notes in cash, at any time after July 1, 2011, subject to certain limitations, we may elect to satisfy any such payment with shares of our common stock. The number of shares of our common stock issuable upon conversion or in settlement of principal and interest obligations will be based upon the discounted trading price of our common stock over a specified trading period. Upon certain changes of control of our company, a sale or transfer of assets in one transaction or a series of related transactions for a purchase price of more than $400 million or a sale or transfer of more than 50% of our assets, Deerfield may require us to prepay the notes at the optional prepayment price, plus accrued and unpaid interest and any other accrued and reimbursable expenses, or the Put Price. Upon an event of default, Deerfield may declare all or a portion of the Put Price to be immediately due and payable.

We also entered into a security agreement in favor of Deerfield which provides that our obligations under the notes will be secured by substantially all of our assets except intellectual property. The note purchase agreement and the security agreement include customary representations and warranties and covenants made by us, including restrictions on the incurrence of additional indebtedness.

sanofi-aventis

In May 2009, we entered into a global license agreement with sanofi-aventis for XL147 and XL765 and a broad collaboration for the discovery of inhibitors of phosphoinositide-3 kinase, or PI3K, for the treatment of cancer. The license agreement and collaboration agreement became effective on July 7, 2009. In connection with the effectiveness of the license and collaboration, on July 20, 2009, we received upfront payments of $140.0 million ($120.0 million for the license and $20.0 million for the collaboration), less applicable withholding taxes of $7.0 million, for a net receipt of $133.0 million. We expect to receive a refund payment from the French government in 2011 with respect to the withholding taxes previously withheld.

Under the license agreement, sanofi-aventis received a worldwide exclusive license to XL147 and XL765, which are in phase 1, phase 1b/2 and phase 2 clinical trials, and has sole responsibility for all subsequent clinical, regulatory, commercial and manufacturing activities. sanofi-aventis is responsible for funding all development activities with respect to XL147 and XL765, including our activities. Following the effectiveness of the license agreement, we had been conducting the majority of the clinical trials for XL147 and XL765 at the expense of sanofi-aventis. As provided for under the license agreement, however, the parties agreed to transition all future development activities for these compounds to sanofi-aventis. The transition was substantially completed by the end of June 2011. As a result of the transition of development activities to sanofi-aventis, we expect to no longer receive reimbursements from sanofi-aventis with respect to XL147 and XL765 and we have reduced our headcount commensurately such that no further material operating expenses will be incurred in connection with these programs going forward.

Under the collaboration agreement, the parties agreed to combine efforts in establishing several pre-clinical PI3K programs and jointly share responsibility for research and preclinical activities related to isoform-selective inhibitors of PI3K-a and -ß. sanofi-aventis will continue to provide us with guaranteed annual research and development funding during the research term and is responsible for funding all development activities for each product following approval of the investigational new drug application filed with the applicable regulatory authorities for such product. We are entitled to receive guaranteed research funding of $21.0 million over three years to cover certain of our costs under the collaboration agreement. sanofi-aventis will have sole responsibility for all subsequent clinical, regulatory, commercial and manufacturing activities of any products arising from the collaboration; however, we may be requested to conduct certain clinical trials at sanofi-aventis expense. The research term under the collaboration is three years, although sanofi-aventis has the right to extend the term for an additional one-year period upon prior written notice.

For both the license and the collaboration combined, we will be eligible to receive development, regulatory and commercial milestones of over $1.0 billion in the aggregate, as well as royalties on sales of any products commercialized under the license or collaboration.

sanofi-aventis may, upon certain prior notice to us, terminate the license as to products containing XL147 or XL765. In the event of such termination election, sanofi-aventis license relating to such product would terminate and revert to us, and we would receive, subject to certain terms, conditions and potential payment obligations, licenses from sanofi-aventis to research, develop and commercialize such products.

The collaboration will automatically terminate under certain circumstances upon the expiration of the research term, in which case all licenses granted by the parties to each other would terminate and revert to the respective party, subject to sanofi-aventis right to receive, under certain circumstances, the first opportunity to obtain a license from us to any isoform-selective PI3K inhibitor. In

19

Table of Contents

addition, sanofi-aventis may, upon certain prior written notice to us, terminate the collaboration in whole or as to certain products following expiration of the research term, in which case we would receive, subject to certain terms, conditions and potential payment obligations by us, licenses from sanofi-aventis to research, develop and commercialize such products.

Restructuring Plans

During 2010, we implemented two restructuring plans that resulted in an overall reduction in our workforce by 386 employees. In March 2011, we implemented an additional restructuring plan that resulted in the termination of 24 employees, for an aggregate reduction in headcount resulting from the 2010 and 2011 restructuring plans of 410 employees. Of these reductions in headcount, 11 employees are continuing to provide service through various dates in 2011. The restructuring plans are a consequence of our decision to focus our resources and development efforts on the late-stage development and commercialization of cabozantinib. Further personnel reductions are expected to be made through the end of 2012 as we complete our obligations under collaboration agreements and withdraw resources from completed projects.

In connection with the 2010 and 2011 restructuring plans, we have recorded aggregate restructuring charges of $36.0 million, of which $19.6 million related to termination benefits and $16.3 million related to facility charges and the impairment of various assets. In connection with these restructuring plans, $4.8 million was recorded during the first quarter of 2011, of which $3.5 million was associated with lease-exit costs in connection with the exit and potential sublease of a single floor of a building we lease at 170 Harbor Way, South San Francisco, California, or Building 170. In July 2011, we entered into two sublease agreements for Building 170. As a result of these activities, we updated our estimated charge for all of our facilities to better reflect the actual sublease terms. As a result of this revision, we recorded a reduction to our restructuring liability of $1.7 million during the three months ended June 30, 2011. The balance of our restructuring charges taken during the first half of 2011 primarily related to termination benefits for employees as well as the impairment of excess equipment and other assets, offset by any auction proceeds that we have received from the sale of such assets.

With respect to our restructuring plans, we expect to incur an additional restructuring charge of $6.5 million relating to the sublease of Building 170 and a building we lease at 249 East Grand Avenue, South San Francisco, California that we exited and subleased in 2010, or Building 249, plus additional restructuring charges of up to $17 million in connection with the anticipated exit of an additional facility in South San Francisco, California. We expect to record $0.1 million of additional termination benefits and the majority of the facility-related charges discussed above as they are determined during the fiscal year ending December 31, 2011.

As of June 30, 2011, the 2010 and 2011 restructuring plans had resulted in aggregate cash expenditures of $20.7 million. We expect to pay an additional $8.5 million, net of cash received from our subtenant, for Building 249 and an additional $7.3 million, net of cash received from our subtenants, for Building 170. In addition, we expect to make cash expenditures of $1.0 million relating to termination benefits and up to $22 million relating to facility charges in connection with the anticipated exit of one additional facility in South San Francisco, California. We expect the termination benefits to be paid during the third and fourth quarters of 2011 and the facility costs to be paid through 2017, or the end of our lease term.

The restructuring charges that we expect to incur in connection with the restructuring plans are subject to a number of assumptions, and actual results may materially differ. We may also incur other material charges not currently contemplated due to events that may occur as a result of, or associated with, the restructuring plan.

GlaxoSmithKline Loan Repayment Obligations

In October 2002, we entered into a collaboration with GlaxoSmithKline to discover and develop novel therapeutics in the areas of vascular biology, inflammatory disease and oncology. As part of the collaboration, we entered into a loan and security agreement with GlaxoSmithKline, pursuant to which we borrowed $85.0 million for use in our efforts under the collaboration. The loan bears interest at a rate of 4.0% per annum and is secured by certain intellectual property, technology and equipment created or utilized pursuant to the collaboration. On October 27, 2010, we paid approximately $37.0 million in cash to GlaxoSmithKline as the second of three installments of principal and accrued interest due under the loan agreement. After giving effect to all repayments made, as of June 30, 2011, the aggregate principal and interest outstanding under the loan was $36.5 million. The final installment of principal and accrued interest under the loan is due October 27, 2011. Repayment of all or any of the amounts advanced to us under the loan agreement may, at our election, be made in the form of our common stock at fair market value, subject to certain conditions, or cash. In the event the market price for our common stock is depressed, we may not be able to repay the loan in full using shares of our common stock due to restrictions in the agreement on the number of shares we may issue. In addition, the issuance of shares of our common stock to repay the loan may result in significant dilution to our stockholders. As a result, we may need to obtain additional funding to satisfy our repayment obligations. There can be no assurance that we will have sufficient funds to repay amounts outstanding under the loan when due or that we will satisfy the conditions to our ability to repay the loan in shares of our common stock.

20

Table of Contents

Critical Accounting Estimates

Our consolidated financial statements and related notes are prepared in accordance with U.S. generally accepted accounting principles which require us to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, revenues and expenses and related disclosure of contingent assets and liabilities. We have based our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Our senior management has discussed the development, selection and disclosure of these estimates with the Audit Committee of our Board of Directors. Actual results may differ from these estimates under different assumptions or conditions.

An accounting policy is considered to be critical if it requires an accounting estimate to be made based on assumptions about matters that are highly uncertain at the time the estimate is made, and if different estimates that reasonably could have been used, or changes in the accounting estimates that are reasonably likely to occur periodically, could materially impact the financial statements. We believe the following critical accounting policies reflect the more significant estimates and assumptions used in the preparation of our consolidated financial statements.

Revenue Recognition

Our revenues are derived from three primary sources: license fees, milestone payments and collaborative agreement reimbursements.

Revenues from license fees and milestone payments primarily consist of up-front license fees and milestone payments received under various collaboration agreements. We initially recognize upfront fees received from third party collaborators as unearned revenues and then recognize these amounts on a ratable basis over the expected term of the research collaboration. Therefore, any changes in the expected term of the research collaboration will impact revenue recognition for the given period. For example, in the fourth quarter of 2010, in association with the new ROR agreement with Bristol-Myers Squibb, the estimated research term under our 2007 cancer collaboration with Bristol-Myers Squibb was extended from December 2011 until April 2014, resulting in an extension in the period over which we recognized milestone revenues and a decrease in the milestone revenues recognized each quarter. Often, the total research term is not contractually defined and an estimate of the term of our total obligation must be made. For example, under the 2008 cancer collaboration with Bristol-Myers Squibb, we originally estimated our term to be through August 2013, which is the estimated term of our performance obligations for XL281. We estimated that this would be the period over which we would be obligated to perform services and therefore the appropriate term with which to ratably recognize any license fees. During the fourth quarter of 2010, this estimate was extended to April 2014 as a result of the decision with Bristol-Myers Squibb to complete additional phase 1 trial programs for XL281. As a result of the termination of the 2008 cancer collaboration with Bristol-Myers Squibb, which will be effective as of the end of the day on October 8, 2011, the estimated research term will now end as of the end of the day on October 8, 2011. Accordingly, we expect to accelerate the remaining deferred revenue balance and estimate that we will recognize an aggregate of approximately $109.9 million and $10.4 million in revenue in the third and fourth fiscal quarters of 2011, respectively, relating to the up-front license fees under the 2008 cancer collaboration. License fees are classified as license revenues in our consolidated statement of operations.

Although milestone payments are generally non-refundable once the milestone is achieved, we recognize milestone revenues on a straight-line basis over the expected research term of the arrangement. This typically results in a portion of a milestone being recognized on the date the milestone is achieved, with the balance being recognized over the remaining research term of the agreement. In certain situations, we may receive milestone payments after the end of our period of continued involvement. In such circumstances, we would recognize 100% of the milestone revenues when the milestone is achieved. Milestones are classified as contract revenues in our consolidated statement of operations.

Collaborative agreement reimbursement revenues consist of research and development support received from collaborators and are recorded as earned based on the performance requirements by both parties under the respective contracts. Under the 2008 cancer collaboration with Bristol-Myers Squibb and prior to its termination by Bristol-Myers Squibb as to cabozantinib, certain research and development expenses were partially reimbursable to us. On an annual basis, amounts owed by Bristol-Myers Squibb to us, net of amounts reimbursable to Bristol-Myers Squibb by us for the development of cabozantinib and XL281, are recorded as collaboration reimbursement revenues. Conversely, research and development expenses may include the net settlement of amounts we owe Bristol-Myers Squibb for research and development expenses that Bristol-Myers Squibb incurred in connection with the development of cabozantinib, less amounts reimbursable to us by Bristol-Myers Squibb on the development of both cabozantinib and XL281. In annual periods when net research and development funding payments were payable to Bristol-Myers Squibb, these payments were presented as collaboration cost-sharing expenses. Reimbursements under co-development agreements were classified as collaboration reimbursement revenues, while reimbursements under other arrangements were classified as contract revenues in our consolidated statement of operations. With respect to Bristol-Myers Squibb, revenues from the 2008 cancer collaboration will continue to be reflected as collaboration reimbursement revenues until the expiration of this agreement on October 8, 2011. Following this date, we will no longer expect to report collaboration cost-sharing expenses or collaboration reimbursement revenues with respect to any of our current collaborations.

21

Table of Contents

Some of our research and licensing arrangements have multiple deliverables in order to meet our customer s needs. For example, the arrangements may include a combination of intellectual property rights and research and development services. Multiple element revenue agreements are evaluated to determine whether the delivered item has value to the customer on a stand-alone basis and whether objective and reliable evidence of the fair value of the undelivered item exists. Deliverables in an arrangement that do not meet the separation criteria are treated as one unit of accounting for purposes of revenue recognition. Generally, the revenue recognition guidance applicable to the final deliverable is followed for the combined unit of accounting. For certain arrangements, the period of time over which certain deliverables will be provided is not contractually defined. Accordingly, management is required to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. For example, in 2008, under our collaboration with GlaxoSmithKline, we accelerated $18.5 million in previously deferred revenue as a result of the development term concluding on the earliest scheduled end date of October 27, 2008, instead of the previously estimated end date of October 27, 2010.

Clinical Trial Accruals

All of our clinical trials have been performed by third-party contract research organizations, or CROs, and other vendors. We accrue costs for clinical trial activities performed by CROs based upon the estimated amount of work completed on each study. For clinical trial expenses, the significant factors used in estimating accruals include the number of patients enrolled, the number of active clinical sites, and the duration for which the patients will be enrolled in the study. We monitor patient enrollment levels and related activities to the extent possible through internal reviews, correspondence with CROs and review of contractual terms. We base our estimates on the best information available at the time. However, additional information may become available to us which will allow us to make a more accurate estimate in future periods. In this event, we may be required to record adjustments to research and development expenses in future periods when the actual level of activity becomes more certain. Such increases or decreases in cost are generally considered to be changes in estimates and will be reflected in research and development expenses in the period first known.

Stock Option Valuation

Our estimate of compensation expense requires us to determine the appropriate fair value model and a number of complex and subjective assumptions including our stock price volatility, employee exercise patterns, future forfeitures and related tax effects. The most significant assumptions are our estimates of the expected volatility and the expected term of the award. We have limited historical information available to support the underlying estimates of certain assumptions required to value stock options. The value of a stock option is derived from its potential for appreciation. The more volatile the stock, the more valuable the option becomes because of the greater possibility of significant changes in stock price. Because there is a market for options on our common stock, we have considered implied volatilities as well as our historical realized volatilities when developing an estimate of expected volatility. The expected option term also has a significant effect on the value of the option. The longer the term, the more time the option holder has to allow the stock price to increase without a cash investment and thus, the more valuable the option. Further, lengthier option terms provide more opportunity to exploit market highs. However, empirical data shows that employees, for a variety of reasons, typically do not wait until the end of the contractual term of a nontransferable option to exercise. Accordingly, companies are required to estimate the expected term of the option for input to an option-pricing model. As required under the accounting rules, we review our valuation assumptions at each grant date and, as a result, from time to time we will likely change the valuation assumptions we use to value stock based awards granted in future periods. The assumptions used in calculating the fair value of share-based payment awards represent management s best estimates, but these estimates involve inherent uncertainties and the application of management judgment. As a result, if factors change and we use different assumptions, our stock-based compensation expense could be materially different in the future. In addition, we are required to estimate the expected forfeiture rate and recognize expense only for those shares expected to vest. If our actual forfeiture rate is materially different from our estimate, the stock-based compensation expense could be significantly different from what we have recorded in the current period. As of June 30, 2011, $8.8 million of total unrecognized compensation expense related to stock options was expected to be recognized over a weighted-average period of 1.80 years in addition to $6.9 million of total unrecognized compensation expense relating to restricted stock units, which was expected to be recognized over 2.69 years. See Note 3 of the Notes to Consolidated Financial Statements for a further discussion on stock-based compensation.

Restructuring Charges

We record costs and liabilities associated with exit and disposal activities at fair value in the period in which the cost or liability is incurred. Restructuring charges consist of charges related to employee severance and benefits, lease termination costs, equipment write-downs and other restructuring related charges. Charges related to employee severance and benefits are determined based on the estimated severance and fringe benefit charge for identified employees. Our facility charges are based upon our ability to vacate certain of our facilities and the timing and nature of potential future sublease rates. Based on our future equipment needs, we have disposed of certain assets no longer in use and recorded a charge to impair the book value to an amount relative to our expected future use of the remaining assets.

If the actual amounts differ from our estimates, the amount of restructuring charges could be materially impacted. See Note 5 of the Notes to Consolidated Financial Statements for a further discussion on our restructuring plans.

Table of Contents

Fiscal Year Convention

We have adopted a 52- or 53-week fiscal year that ends on the Friday closest to December 31st of each year. Fiscal year 2010, a 52-week year, ended on December 31, 2010, and fiscal year 2011, a 52-week year, will end on December 30, 2011. For convenience, references in this report as of and for the fiscal quarters ended July 2, 2010 and July 1, 2011 and as of the fiscal year ending December 30, 2011 are indicated as ended June 30, 2010 and 2011 and as ending December 31, 2011, respectively.

Results of Operations

Revenues

Total revenues by category, as compared to the prior year period, were as follows (dollar amounts are presented in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Contract revenue:				
Research and development funding	$ 3.7	$ 10.9	$ 13.6	$ 22.1
Milestones	4.6	1.4	7.2	10.0
License revenue and amortization of upfront payments	22.5	24.6	45.3	49.1
Collaboration reimbursements	1.4	10.7	2.0	8.6
Total revenues	$ 32.2	$ 47.6	$ 68.1	$ 89.8
Dollar decrease	$ 15.4		$ 21.7	
Percentage decrease	32.4%		24.2%	

Total revenues by customer, as compared to the prior year period, were as follows (dollar amounts are presented in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Bristol-Myers Squibb	$ 17.5	$ 27.2	$ 34.4	$ 41.3
sanofi-aventis	12.5	19.7	31.0	39.4
Genentech	2.0		2.0	7.0
Boehringer Ingelheim	0.2	0.7	0.7	2.1
Total revenues	$ 32.2	$ 47.6	$ 68.1	$ 89.8
Dollar decrease	$ 15.4		$ 21.7	
Percentage decrease	32.4%		24.2%	

The decrease in revenues for the three and six months ended June 30, 2011, as compared to the comparable periods for the prior year, was primarily due to the decrease in reimbursement revenue as a result of the termination of our 2008 cancer collaboration agreement with Bristol Myers-Squibb with respect to cabozantinib in 2010. In addition, there was a decrease of $7.2 million and $8.4 million for the three and six months ended June 30, 2011, respectively, related to our May 2009 collaboration agreement with sanofi-aventis for XL147 and XL765 due to the transfer of substantially all development activities relating to these compounds to sanofi-aventis in 2011. Furthermore, there was a decrease in Genentech revenue relating to the one-time milestone payments of $2.0 million in 2011 for the Notch agreement and $7.0 million in 2010 for the MEK agreement, as well as a decrease in license revenue related to our amended 2007 and 2008 collaboration agreements with Bristol-Myers Squibb (in the case of the 2008 collaboration agreement, solely in relationship to XL281). As a result of the extension of the duration of our performance obligations under the XL281 agreement, revenue recognition in the current period, related to the upfront payments previously received, was reduced. These decreases were partially offset by our 2011 collaboration with Bristol-Myers Squibb for TGR5 and ROR Gamma.

Total collaboration reimbursement revenue consisted of research and development expenses and reimbursements related to our 2008 cancer collaboration agreement with Bristol Myers-Squibb for cabozantinib and XL281. To the extent that net annual research and development funding payments were expected to be received from Bristol-Myers Squibb, these payments would have been presented as collaboration reimbursement revenues. In years when net research and development funding payments were expected to be payable to Bristol-Myers Squibb, these payments would have been presented as collaboration cost-sharing expense. For the three

Table of Contents

and six months ended June 30 2010, we recorded collaboration reimbursement revenues from Bristol-Myers Squibb of $10.7 million and $8.6 million, respectively. For the year ending December 31, 2011 we expect to record only collaboration reimbursement revenues with respect to the work we are conducting for XL281. Following the complete termination of the 2008 cancer collaboration with Bristol-Myers Squibb, which will be effective as of the end of the day on October 8, 2011, we do not expect any further collaboration reimbursement revenues or collaboration cost-sharing expenses to be recorded with respect to this agreement for either cabozantinib or XL281.

Research and Development Expenses

Total research and development expenses, as compared to the prior year period, were as follows (dollar amounts are presented in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Research and development expenses	$ 42.9	$ 54.2	$ 88.6	$ 119.0
Dollar decrease	$ 11.3		$ 30.4	
Percentage decrease	20.9%		25.5%	

The decrease for the three and six months ended June 30, 2011, as compared to the comparable periods in 2010, resulted primarily from the following:

Personnel Personnel expense, which includes salaries, bonuses, related fringe benefits, recruiting and relocation costs, decreased by $4.9 million, or 38%, and $12.8 million, or 42%, respectively, primarily due to the reduction in headcount resulting from our 2010 and 2011 restructuring plans.

General Corporate Costs There was a decrease of $2.1 million, or 22%, and $4.6 million, or 23%, respectively, in the allocation of general corporate costs (such as facility costs, property taxes and insurance) to research and development, primarily as a result of a decrease in personnel and the exit of certain facilities in San Diego and South San Francisco, as a result of our 2010 and 2011 restructuring plans, and the resulting decrease in costs to be allocated.

Laboratory Supplies Laboratory supplies decreased by $1.4 million, or 80%, and $4.5 million, or 81%, respectively, primarily due to the decrease in headcount and other cost cutting measures as a result of our 2010 and 2011 restructuring plans.

Stock-Based Compensation Stock-based compensation expense decreased by $1.6 million, or 52%, and $3.5 million, or 52%, respectively, as a result of our reduction in headcount from our 2010 and 2011 restructuring plans.

We do not track total research and development expenses separately for each of our research and development programs. We group our research and development expenses into three categories: drug discovery, development and other. Our drug discovery group utilizes a variety of high-throughput technologies to enable the rapid discovery, optimization and extensive characterization of lead compounds such that we are able to select development candidates with the best potential for further evaluation and advancement into clinical development. Drug discovery expenses relate primarily to personnel expense, lab supplies and general corporate costs. Our development group leads the development and implementation of our clinical and regulatory strategies and prioritizes disease indications in which our compounds may be studied in clinical trials. Development expenses relate primarily to clinical trial, personnel and general corporate costs. The other category primarily includes stock-based compensation expense.

In addition to reviewing the three categories of research and development expenses described above, we principally consider qualitative factors in making decisions regarding our research and development programs. Such factors include enrollment in clinical trials for our drug candidates, the results of and data from clinical trials, the potential indications for our drug candidates, the therapeutic and commercial potential for our drug candidates and competitive dynamics. We also make our research and development decisions in the context of our overall business strategy, which historically included the pursuit of commercial collaborations with major pharmaceutical and biotechnology companies for the

development of our drug candidates. As noted under Overview, we are focusing our resources and development efforts exclusively on cabozantinib in order to maximize the therapeutic and commercial potential of this compound. Our strategy is to aggressively advance cabozantinib through development toward commercialization, and as a result, we expect nearly all of our future research and development expenses to relate to the clinical development of cabozantinib.

Table of Contents

The expenditures summarized in the following table reflect total research and development expenses by category, including allocations for general and administrative expense (dollar amounts are presented in millions):

	Three Months Ended June 30,		Six Months Ended June 30,		Inception to date
	2011	2010	2011	2010	(1)
Drug discovery	$ 4.5	$ 13.2	$ 10.3	$ 33.8	$ 448.9
Development	36.3	37.4	74.3	76.8	655.3
Other	2.1	3.6	4.0	8.4	98.1
Total	$ 42.9	$ 54.2	$ 88.6	$ 119.0	$ 1,202.3

(1) Inception is as of January 1, 2006, the date on which we began tracking research and development expenses by category.

While we do not track total research and development expenses separately for each program, beginning in fiscal 2006, we began tracking third party expenditures directly relating to each program as a way of monitoring external costs. Our third party research and development expenditures relate principally to our clinical trial and related development activities, such as preclinical and clinical studies and contract manufacturing, and represent only a portion of the costs related to each program. Third party expenditures for programs initiated prior to the beginning of fiscal 2006 have not been tracked from project inception, and therefore such expenditures from the actual inception for most of our programs are not available. We do not accumulate on a program-specific basis internal research and development expenses, such as salaries and personnel expenses, facilities overhead expenses and external costs not directly attributable to a specific project. Nevertheless, we believe that third party expenditures by program provide a reasonable estimate of the percentage of our total research and development expenses that are attributable to each such program. For the six months ended June 30, 2011, the programs representing the greatest portion of our external third party research and development expenditures were cabozantinib (85%), XL765 (6%), XL147 (5%), and XL281 (4%). The expenses for these programs were primarily included in the development category of our research and development expenses and exclude the impact of any amounts reimbursed by our partners.

We do not have reliable estimates regarding the timing of our clinical trials. We estimate that typical phase 1 clinical trials last approximately one year, phase 2 clinical trials last approximately one to two years and phase 3 clinical trials last approximately two to four years. However, the length of time may vary substantially according to factors relating to the particular clinical trial, such as the type and intended use of the drug candidate, the clinical trial design and the ability to enroll suitable patients. In general, we will incur increased research and development expenses for compounds that advance in clinical development, whereas expenses will end for compounds that do not warrant further clinical development.

We do not have reliable estimates of total costs for a particular drug candidate to reach the market. Our potential therapeutic products are subject to a lengthy and uncertain regulatory process that may involve unanticipated additional clinical trials and may not result in receipt of the necessary regulatory approvals. Failure to receive the necessary regulatory approvals would prevent us from commercializing the product candidates affected. In addition, clinical trials of our potential products may fail to demonstrate safety and efficacy, which could prevent or significantly delay regulatory approval.

General and Administrative Expenses

Total general and administrative expenses, as compared to the prior year period, were as follows (dollar amounts are presented in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
General and administrative expenses	$ 8.8	$ 9.6	$ 17.9	$ 18.4
Dollar decrease	$ 0.8		$ 0.5	

Percentage decrease	8.2%	2.5%

The decrease in general and administrative expenses for the three and six months ended June 30, 2011, as compared to the comparable period in 2010, was primarily due to a decrease in facility and personnel costs relating to our 2010 and 2011 restructuring plans. This decrease was offset by a decrease in allocation of general corporate costs to research and development also as a result of the reduction in headcount from our 2010 and 2011 restructuring plans, in addition to an increase in marketing and promotional expenses relating to cabozantinib.

Table of Contents

Restructuring Charge

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Restructuring charge	$ (1.5)	$ 9.4	$ 3.3	$ 25.5
Dollar change	$ 10.9		$ 22.2	
Percentage change	116%		87%	

As part of our ongoing efforts to manage costs and our strategy to focus our resources and development efforts on cabozantinib, we implemented two restructuring plans during 2010 that resulted in an overall reduction of our workforce by 386 employees. In March 2011, we implemented an additional restructuring plan that resulted in the termination of 24 employees, for an aggregate reduction in headcount resulting from the 2010 and 2011 restructuring plans of 410 employees. The restructuring charge taken in 2010 primarily related to termination benefits for the initial reduction in 243 positions in March 2010, while the restructuring charge taken in 2011 related primarily to facility charges in association with the exit and potential sublease of Building 170. In July 2011, we entered into two sublease agreements for Building 170. As a result of these activities, we updated our estimated charge for all of our facilities to better reflect the actual sublease terms. As a result of this revision, we recorded a reduction to our restructuring liability of $1.7 million during the period ended June 30, 2011, offset by additional employee related termination benefits. As a result of our 2010 and 2011 restructuring plans, we expect to incur additional restructuring charges, primarily related to facility costs, through the end of 2017.

Total Other Income (Expense), Net

Total other income (expense), net as compared to the prior year period, was as follows (dollar amounts are presented in millions):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
Total other income (expense), net	$ (3.0)	$ 3.0	$ (6.7)	$ 7.2
Dollar change	$ (6.0)		$ (13.9)	
Percentage change	Not meaningful		Not meaningful	

Total other income (expense), net consists primarily of interest income earned on our marketable securities and gains on sales of businesses, offset by interest expense incurred on our notes payable, bank obligations, capital lease obligations, convertible notes and loans and our credit facility. The change in total other income for the three and six months ended June 30, 2011, as compared to the comparable periods in 2010, was primarily due to the recording of gains relating to the sale of our plant trait business and the sale of our cell factory business in 2010. In addition, we had increased interest expense in 2011 as a result of our entry into a note purchase agreement with Deerfield in June 2010 and a $1.0 million gain on the sale of XL647 materials in 2011.

Liquidity and Capital Resources

Sources and Uses of Cash

The following table summarizes our cash flow activities for the six months ended June 30, 2011 and 2010, respectively (dollar amounts presented in thousands):

	Six Months Ended June 30,	
	2011	2010
Consolidated net loss	$ (48,464)	$ (65,862)
Adjustments to reconcile net loss to net cash provided by operating activities	16,472	13,491
Changes in operating assets and liabilities	(54,800)	(26,104)
Net cash used in operating activities	(86,792)	(78,475)

Net cash used in investing activities	(121,397)	(10,771)
Net cash provided by financing activities	186,029	159,653
Net (decrease) increase in cash and cash equivalents	(22,160)	70,407
Cash and cash equivalents, at beginning of period	97,440	86,796
Cash and cash equivalents, at end of period	$ 75,280	$ 157,203

To date, we have financed our operations primarily through the sale of equity, payments and loans from collaborators and banks, debt-financing arrangements and equipment financing facilities. We have also financed certain of our research and development activities under our agreements with various collaborators. As of June 30, 2011, we had $353.6 million in cash and cash equivalents, marketable securities and long-term investments, which included restricted cash and investments of $4.2 million and approximately $95.0 million of cash and cash equivalents and marketable securities that we are required to maintain on deposit with Silicon Valley Bank pursuant to covenants in our loan and security agreement with Silicon Valley Bank.

Table of Contents

Operating Activities

Our operating activities used cash of $86.8 million for the six months ended June 30, 2011, compared to cash used of $78.5 million for the comparable period in 2010. Cash used by operating activities for the 2011 period related primarily to our net loss of $48.5 million, in addition to a $50.5 million reduction in deferred revenue and a decrease in our restructuring liability of $4.2 million as we made severance payments relating to our 2010 and 2011 restructuring activities. These increases in cash used were partially offset by non-cash charges totaling $16.5 million relating to stock-based compensation, depreciation and amortization, accretion of implied interest under our 2010 note purchase agreement with Deerfield, impairment of assets due to our 2010 and 2011 restructuring plans, and other non-cash changes.

Cash used by operating activities for the 2010 period related primarily to our net loss attributable to Exelixis, Inc. of $65.9 million, in addition to a $35.3 million reduction in deferred revenue and a gain on the sale of our plant trait and cell factory businesses of $7.8 million. These increases in cash used were partially offset by non-cash charges totaling $19.6 million relating to stock-based compensation, depreciation and amortization, and asset impairment as a result of our March 2010 restructuring and a related restructuring charge of $11.1 million relating to Building 249.

Investing Activities

Our investing activities used cash of $121.4 million for the six months ended June 30, 2011, compared to cash used of $10.8 million for the comparable period in 2010. Cash used by investing activities for the 2011 period was primarily driven by the purchase of $189.4 million of marketable securities. This use of cash was partially offset by proceeds from the maturity of marketable securities of $66.4 million and a decrease in restricted cash of $2.2 million.

Cash used by investing activities for the 2010 period was primarily driven by the purchase of $103.6 million of marketable securities and certificates of deposit, partially offset by proceeds from the maturity of marketable securities of $72.0 million in addition to the sale of investments prior to maturity of $12.8 million and an additional gain of $8.6 million associated with our 2007 sale of our plant trait business and the sale of our cell factory business in 2010. The proceeds provided by the sale and maturity of our investments were used to fund our operations.

Financing Activities

Our financing activities provided cash of $186.0 million for the six months ended June 30, 2011, compared to cash provided of $159.7 million for the comparable period in 2010. Cash provided by our financing activities for the 2011 period was due to proceeds from the issuance of 17.3 million shares of common stock for net proceeds of $179.4 million, proceeds from the exercise of stock options of $7.6 million and $2.6 million from our Silicon Valley Bank loan agreement. These increases were partially offset by cash used for principal payments on notes payable and bank obligations of $4.6 million. Cash provided by our financing activities for the 2010 period was primarily due to our loan agreements with Silicon Valley Bank and Deerfield for proceeds of $162.5 million as well as proceeds from employee option exercises of $2.1 million offset by principal payments on notes payable and bank obligations of $6.0 million.

We finance property and equipment purchases through equipment financing facilities, such as bank notes payable. Proceeds from collaboration loans and common stock issuances are used for general working capital purposes, such as research and development activities and other general corporate purposes. Over the next several years, we are required to make certain payments on notes and our loan from GlaxoSmithKline.

Table of Contents

Cash Requirements

We have incurred net losses since inception, including a net loss of $21.0 million and $48.5 million for three and six months ended June 30, 2011, respectively. While we expect to be in a net income position for 2011, as a result of the acceleration of deferred revenue under our terminated collaboration with Bristol Myers-Squibb for XL281, we anticipate negative operating cash flow for the foreseeable future. As of June 30, 2011, we had $353.6 million in cash and cash equivalents, marketable securities and long-term investments, which included restricted cash and investments of $4.2 million and approximately $95.0 million of cash and cash equivalents and marketable securities that we are required to maintain on deposit with Silicon Valley Bank pursuant to covenants in our loan and security agreement with Silicon Valley Bank. We anticipate that our current cash and cash equivalents, marketable securities, long-term investments and funding that we expect to receive from existing collaborators will enable us to maintain our operations for a period of at least 12 months following the filing date of this report. However, our future capital requirements will be substantial and will depend on many factors that may require us to use available capital resources significantly earlier than we currently anticipate. These factors include:

the cabozantinib development program We are focusing our resources and development efforts on cabozantinib, our most advanced compound, which is being studied in a variety of tumor types, with the goal of rapidly commercializing the compound. The current clinical program for cabozantinib is focused on the treatment of metastatic castration-resistant prostate cancer and ovarian cancer, based on encouraging interim data that has emerged from the RDT. Data from the RDT were released at the ASCO Annual Meeting in June 2010 and demonstrated broad activity for cabozantinib across multiple tumor types, in particular, metastatic castration-resistant prostate, ovarian, non-small cell lung and hepatocellular cancers. Updated interim data presented at the 2010 EORTC Symposium, at the ASCO 2011 Genitourinary Cancers Symposium in February 2011, and at the 2011 ASCO Annual Meeting in June 2011, suggest that cabozantinib has a novel and differentiated clinical profile in metastatic castration-resistant prostate cancer and other solid tumors. The data presented indicate that cabozantinib has shown novel activity against bone and soft tissue lesions in metastatic castration-resistant prostate cancer. In addition, we have observed resolution of metastatic bone lesions on bone scan in patients with metastatic breast cancer, renal cell carcinoma, thyroid cancer and melanoma. It will be a priority for us to generate additional data in the various other cohorts of the RDT, including ovarian cancer, melanoma, breast cancer, non-small cell lung cancer and hepatocellular cancer, to support further prioritization of our clinical and commercial options. Objective tumor responses have been observed in patients with cabozantinib in 12 of 13 unique tumor types investigated to date, reflecting the broad potential clinical activity and commercial opportunity with this new agent. We also are focusing our efforts on EXAM, our ongoing phase 3 clinical trial of cabozantinib as a potential treatment for medullary thyroid cancer. In addition, we are conducting ongoing exploratory clinical trials for cabozantinib in other tumor types, including renal cell carcinoma. Our development plan for cabozantinib is dependent on the extent of our available financial resources. There can be no assurance that we will have sufficient financial resources independently or through other arrangements to fund a broad development plan for cabozantinib. If adequate funds are not available, we may be required to delay, discontinue or elect not to pursue one or more trials for cabozantinib;

repayment of our loan from GlaxoSmithKline In October 2002, we entered into a collaboration agreement with GlaxoSmithKline. As part of the collaboration, we entered into a loan and security agreement with GlaxoSmithKline, pursuant to which we borrowed $85.0 million for use in our efforts under the collaboration. The loan bears interest at a rate of 4.0% per annum and is secured by certain intellectual property, technology and equipment created or utilized pursuant to the collaboration. On October 27, 2010, we paid approximately $37.0 million in cash to GlaxoSmithKline as the second of three installments of principal and accrued interest due under the loan agreement. As of June 30, 2011, the aggregate principal and interest outstanding under the loan was $36.5 million. The final installment of principal and accrued interest under the loan is due on October 27, 2011. Repayment of all or any of the amounts advanced to us under the loan agreement may, at our election, be made in the form of our common stock at fair market value, subject to certain conditions, or cash. In the event the market price for our common stock is depressed, we may not be able to repay the loan in full using shares of our common stock due to restrictions in the agreement on the number of shares we may issue. In addition, the issuance of shares of our common stock to repay the loan may result in significant dilution to our stockholders. As a result, we may need to obtain additional funding to satisfy our repayment obligations. However, there can be no assurance that we will have sufficient funds to repay amounts outstanding under the loan when due or that we will satisfy the conditions to our ability to repay the loan in shares of our common stock;

repayment of the notes under our note purchase agreement with Deerfield On June 2, 2010, we entered into a note purchase agreement with Deerfield, pursuant to which, on July 1, 2010, we sold to Deerfield an aggregate of $124.0 million initial principal amount of our secured convertible notes, due June 2015, for an aggregate purchase price of $80.0 million, less closing fees and expenses. The outstanding principal amount of the notes bears interest in the annual amount of $6.0 million, payable quarterly in

arrears. We will be required to make mandatory prepayments on the notes on an annual basis in 2013, 2014 and 2015 equal to 15% of certain payments from our collaborative arrangements received during the prior fiscal year, subject to a maximum annual prepayment amount of $27.5 million and, for payments due in January 2013 and 2014, a minimum prepayment amount of $10.0 million. We may also prepay all or a portion (not less than $5.0 million) of the principal amount of the notes at an optional prepayment price based on a discounted principal

Table of Contents

amount (during the first three years of the term, subject to a prepayment premium) determined as of the date of prepayment, plus accrued and unpaid interest, plus in the case of a prepayment of the full principal amount of the notes (other than prepayments upon the occurrence of specified transactions relating to a change of control or a substantial sale of assets), all accrued interest that would have accrued between the date of such prepayment and the next anniversary of the note purchase agreement. In lieu of making any optional or mandatory prepayment in cash, at any time after July 1, 2011, subject to certain limitations, we have the right to convert all or a portion of the principal amount of the notes into, or satisfy all or any portion of the optional prepayment amounts or mandatory prepayment amounts (other than the first $10.0 million of mandatory prepayments required in 2013 and 2014) with shares of our common stock. Additionally, in lieu of making any payment of accrued and unpaid interest in respect of the notes in cash, at any time after July 1, 2011, subject to certain limitations, we may elect to satisfy any such payment with shares of our common stock. The number of shares of our common stock issuable upon conversion or in settlement of principal and interest obligations will be based upon the discounted trading price of our common stock over a specified trading period. In the event the market price for our common stock is depressed, we may not be able to convert the principal amount of the notes or satisfy our payment obligations in full using shares of our common stock due to restrictions in the agreement on the number of shares we may issue. In addition, the issuance of shares of our common stock to convert the notes or satisfy our payment obligations may result in significant dilution to our stockholders. As a result, we may need to obtain additional funding to satisfy our repayment obligations. There can be no assurance that we will have sufficient funds to repay the notes or satisfy our payment obligations under the note purchase agreement when due or that we will comply with the conditions to our ability to convert the principal amount of the notes into or satisfy our payment obligations with shares of our common stock;

repayment of our loan from Silicon Valley Bank On June 2, 2010, we amended our loan and security agreement with Silicon Valley Bank to provide for a new seven-year term loan in an amount of $80.0 million. The principal amount outstanding under the term loan accrues interest at 1.0% per annum, which interest is due and payable monthly. We are required to repay the term loan in one balloon principal payment, representing 100% of the principal balance and accrued and unpaid interest, on May 31, 2017. We have the option to prepay all, but not less than all, of the amounts advanced under the term loan, provided that we pay all unpaid accrued interest thereon that is due through the date of such prepayment and the interest on the entire principal balance of the term loan that would otherwise have been paid after such prepayment date until the maturity date of the term loan. In accordance with the terms of the loan and security agreement, we are also required to maintain on deposit an amount equal to at least 100% of the outstanding principal balance of the term loan at all times as support for our obligations under the loan and security agreement. As a result, although the proceeds of the new term loan improve our ability to comply with minimum working capital and cash covenants imposed by our debt instruments with GlaxoSmithKline and Deerfield and thus provide us with more flexibility to use our other cash resources, the proceeds of the term loan cannot directly be used to satisfied our other obligations without causing a default under our loan and security agreement with Silicon Valley Bank;

the level of payments received under existing collaboration agreements, licensing agreements and other arrangements;

the degree to which we conduct funded development activity on behalf of partners to whom we have out-licensed compounds;

whether we enter into new collaboration agreements, licensing agreements or other arrangements (including, in particular, with respect to cabozantinib) that provide additional capital;

our ability to control costs;

our ability to remain in compliance with, or amend or cause to be waived, financial covenants contained in agreements with third parties;

the amount of our cash and cash equivalents and marketable securities that serve as collateral for bank lines of credit;

future clinical trial results;

our need to expand our product and clinical development efforts;

our ability to share the costs of our clinical development efforts with third parties;

the cost and timing of regulatory approvals;

the cost of clinical and research supplies of our product candidates;

the effect of competing technological and market developments;

the filing, maintenance, prosecution, defense and enforcement of patent claims and other intellectual property rights; and

the cost of any acquisitions of or investments in businesses, products and technologies.

One or more of these factors or changes to our current operating plan may require us to use available capital resources significantly earlier than we anticipate. If our capital resources are insufficient to meet future capital requirements, we will have to raise additional funds. We may seek to raise funds through the sale of equity or debt securities or through external borrowings. In

Table of Contents

addition, we may enter into additional strategic partnerships or collaborative arrangements for the development and commercialization of our compounds. However, we may be unable to raise sufficient additional capital when we need it, on favorable terms or at all. The sale of equity or convertible debt securities in the future may be dilutive to our stockholders, and debt-financing arrangements may require us to pledge certain assets and enter into covenants that would restrict certain business activities or our ability to incur further indebtedness, and may contain other terms that are not favorable to our stockholders or us. If we are unable to obtain adequate funds on reasonable terms, we may be required to curtail operations significantly or obtain funds by entering into financing, supply or collaboration agreements on unattractive terms or we may be required to relinquish rights to technology or product candidates or to grant licenses on terms that are unfavorable to us.

We may need to obtain additional funding in order to stay in compliance with financial covenants contained in agreements with third parties. As described below, the terms of our debt owed to GlaxoSmithKline, Deerfield and Silicon Valley Bank each contain covenants requiring us to maintain specified cash balances or levels of working capital:

GlaxoSmithKline Our loan and security agreement with GlaxoSmithKline contains financial covenants pursuant to which our working capital (the amount by which our current assets exceed our current liabilities as defined by the agreement, which excludes restricted cash and deferred revenue) must not be less than $25.0 million and our cash and investments (total cash, cash equivalents and investments as defined by the agreement, which excludes restricted cash) must not be less than $50.0 million. As of June 30, 2011, our working capital was $189.8 million and our cash and investments were $349.4 million. If we default on the financial covenants under the loan and security agreement, GlaxoSmithKline may, among other remedies, declare immediately due and payable all obligations under the loan and security agreement. Outstanding borrowings and accrued interest under the loan and security agreement totaled $36.5 million at June 30, 2011. The final installment of principal and accrued interest under the loan is due on October 27, 2011.

Deerfield Our note purchase agreement with Deerfield contains an event of default that would be triggered if our cash and cash equivalents fall below $10.0 million as of December 30, 2011, subject to a cure period. Upon such an event of default, Deerfield may declare all or a portion of the Put Price to be immediately due and payable. Cash and cash equivalents for purposes of our note purchase agreement includes our total cash, cash equivalents and short-term and long-term marketable securities. As of June 30, 2011, our cash and cash equivalents were $353.6 million.

Silicon Valley Bank Our loan and security agreement with Silicon Valley Bank requires that we maintain $80.0 million at all times on deposit in a non-interest bearing demand deposit account(s) as support for our obligations under the loan and security agreement. If the balance on our deposit account(s) falls below $80.0 million for more than 10 days, Silicon Valley Bank may declare all or part of the obligations under the loan and security agreement to be immediately due and payable and stop advancing money or extending credit to us. Our loan and security agreement with Silicon Valley Bank also contains similar deposit covenants with respect to funds drawn under our equipment lines of credit.

If we cannot raise additional capital in order to remain in compliance with our financial covenants or if we are unable to renegotiate such covenants and the lender exercises its remedies under the agreement, we would not be able to operate under our current operating plan.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Our market risks at June 30, 2011 have not changed significantly from those discussed in Item 7A of our Annual Report on Form 10-K for the year ended December 31, 2010, filed with the Securities and Exchange Commission on February 22, 2011. Our exposure to market risk for changes in interest rates relates primarily to our investment portfolio and our long-term debt. We have estimated the effects on our interest rate sensitive assets and liabilities based on a one percentage point hypothetical adverse change in interest rates as of June 30, 2011 and December 31, 2010. As of June 30, 2011 and December 31, 2010, a decrease in the interest rates of one percentage point would have had a net adverse change in the fair value of interest rate sensitive assets and liabilities of $8.3 million and $9.7 million, respectively.

In addition, we have exposure to fluctuations in certain foreign currencies in countries in which we conduct clinical trials. Most of our foreign expenses incurred are associated with establishing and conducting clinical trials for cabozantinib and various other compounds in our pipeline at sites outside of the United States. Our agreements with the foreign sites that conduct such clinical trials generally provide that payments for the services provided will be calculated in the currency of that country, and converted into U.S. dollars using various exchange rates based upon when services are rendered or the timing of invoices. When the U.S. dollar weakens against foreign currencies, the U.S. dollar value of the

foreign-currency denominated expense increases, and when the U.S. dollar strengthens against these currencies, the U.S. dollar value of the foreign-currency denominated expense decreases. As of June 30, 2011 and December 31, 2010, approximately $3.2 million and $3.1 million, respectively, of our clinical accrual balance related to foreign currencies. As of June 30, 2011 and December 31, 2010, an adverse change of one percentage point in the in foreign currency exchange rates would have resulted in a net loss of $32 thousand and $31 thousand, respectively.

Table of Contents

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of disclosure controls and procedures. Based on the evaluation of our disclosure controls and procedures (as defined in Rules 13a-15(e) or 15d-15(e) of the Securities Exchange Act of 1934, as amended or the Exchange Act) required by Rules 13a-15(b) or 15d-15(b) of the Exchange Act, our Chief Executive Officer and Chief Financial Officer have concluded that as of the end of the period covered by this report, our disclosure controls and procedures were effective.

Changes in internal controls. There were no changes in our internal control over financial reporting that occurred during our most recent fiscal quarter that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

ITEM 1A. RISK FACTORS

In addition to the factors discussed elsewhere in this report and our other reports filed with the Securities and Exchange Commission, the following are important factors that could cause actual results or events to differ materially from those contained in any forward-looking statements made by us or on our behalf. The risks and uncertainties described below are not the only ones facing the company. Additional risks and uncertainties not presently known to us or that we currently deem immaterial also may impair our business operations. If any of the following risks or such other risks actually occurs, our business could be harmed.

We have marked with an asterisk (*) those risk factors below that reflect substantive changes from the risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010 filed with the Securities and Exchange Commission on February 22, 2011.

Risks Related to Our Need for Additional Financing and Our Financial Results

If additional capital is not available to us, we would be forced to delay, reduce or eliminate our product development programs or commercialization efforts and we may breach our financial covenants.*

We will need to raise additional capital to:

- fund our operations and clinical trials;
- continue our research and development efforts; and
- commercialize our product candidates, if any such candidates receive regulatory approval for commercial sale.

As of June 30, 2011, we had $353.6 million in cash and cash equivalents, marketable securities and long-term investments, which included restricted cash and investments of $4.2 million and approximately $95.0 million of cash and cash equivalents and marketable securities that we are required to maintain on deposit with Silicon Valley Bank pursuant to covenants in our loan and security agreement with Silicon Valley Bank. We anticipate that our current cash and cash equivalents, marketable securities, long-term investments and funding that we expect to receive from existing collaborators will enable us to maintain our operations for a period of at least 12 months following the filing date of this report. However, our future capital requirements will be substantial and will depend on many factors that may require us to use available capital resources significantly earlier than we currently anticipate. These factors include:

- the cabozantinib development program We are focusing our resources and development efforts on cabozantinib, our most advanced compound, which is being studied in a variety of tumor types, with the goal of rapidly commercializing the compound. The current clinical program for cabozantinib is focused on the treatment of metastatic castration-resistant prostate cancer and ovarian cancer, based on encouraging interim data that has emerged from the RDT. Data from the RDT were released at the ASCO Annual Meeting in June 2010 and demonstrated broad activity for cabozantinib across multiple tumor types, in particular, metastatic castration-resistant prostate, ovarian, non-small cell lung and hepatocellular cancers. Updated interim data presented at the 2010 EORTC Symposium, at the ASCO 2011 Genitourinary Cancers Symposium in February 2011, and at the 2011 ASCO Annual Meeting in June 2011, suggest that cabozantinib has a novel and differentiated clinical profile in metastatic castration-resistant prostate cancer and other solid tumors. The data presented indicate that cabozantinib has shown novel activity against bone and soft tissue lesions in metastatic castration-resistant prostate cancer. In addition, we have observed resolution of metastatic bone lesions on bone scan in patients with metastatic breast cancer, renal cell carcinoma, thyroid cancer and melanoma. It will be a priority for us to generate additional data in the various other cohorts of the RDT, including ovarian cancer, melanoma, breast cancer, non-small cell lung cancer and hepatocellular cancer, to support further prioritization of our clinical and commercial options. Objective tumor responses have been observed in patients with cabozantinib in 12 of 13 unique tumor types investigated to date, reflecting the broad

potential clinical activity and commercial opportunity with this new agent. We also are focusing our efforts on EXAM, our ongoing phase 3 clinical trial of cabozantinib as a potential treatment for medullary thyroid cancer. In addition, we are conducting ongoing exploratory clinical trials for cabozantinib in other tumor types, including renal cell carcinoma. Our development plan for cabozantinib is dependent on the extent of our available financial resources. There can be no assurance that we will have sufficient financial resources independently or through other arrangements to fund a broad development plan for cabozantinib. If adequate funds are not available, we may be required to delay, discontinue or elect not to pursue one or more trials for cabozantinib;

repayment of our loan from GlaxoSmithKline In October 2002, we entered into a collaboration agreement with GlaxoSmithKline. As part of the collaboration, we entered into a loan and security agreement with GlaxoSmithKline pursuant to which we borrowed $85.0 million for use in our efforts under the collaboration. The loan bears interest at a rate of 4.0% per annum and is secured by certain intellectual property, technology and equipment created or utilized

Table of Contents

pursuant to the collaboration. On October 27, 2010, we paid approximately $37.0 million in cash to GlaxoSmithKline as the second of three installments of principal and accrued interest due under the loan agreement. As of June 30, 2011, the aggregate principal and interest outstanding under the loan was $36.5 million. The final installment of principal and accrued interest under the loan is due on October 27, 2011. Repayment of all or any of the amounts advanced to us under the loan agreement may, at our election, be made in the form of our common stock at fair market value, subject to certain conditions, or cash. In the event the market price for our common stock is depressed, we may not be able to repay the loan in full using shares of our common stock due to restrictions in the agreement on the number of shares we may issue. In addition, the issuance of shares of our common stock to repay the loan may result in significant dilution to our stockholders. As a result, we may need to obtain additional funding to satisfy our repayment obligations. However, there can be no assurance that we will have sufficient funds to repay amounts outstanding under the loan when due or that we will satisfy the conditions to our ability to repay the loan in shares of our common stock;

repayment of the notes under our note purchase agreement with Deerfield On June 2, 2010, we entered into a note purchase agreement with entities affiliated with Deerfield Management Company, L.P., or Deerfield, pursuant to which, on July 1, 2010, we sold to Deerfield an aggregate of $124.0 million initial principal amount of our secured convertible notes, due June 2015, for an aggregate purchase price of $80.0 million, less closing fees and expenses. The outstanding principal amount of the notes bears interest in the annual amount of $6.0 million, payable quarterly in arrears. We will be required to make mandatory prepayments on the notes on an annual basis in 2013, 2014 and 2015 equal to 15% of our collaborative arrangements received during the prior fiscal year, subject to a maximum annual prepayment amount of $27.5 million and, for payments due in January 2013 and 2014, a minimum prepayment amount of $10.0 million. We may also prepay all or a portion (not less than $5.0 million) of the principal amount of the notes at an optional prepayment price based on a discounted principal amount (during the first three years of the term, subject to a prepayment premium) determined as of the date of prepayment, plus accrued and unpaid interest, plus in the case of a prepayment of the full principal amount of the notes (other than prepayments upon the occurrence of specified transactions relating to a change of control or a substantial sale of assets), all accrued interest that would have accrued between the date of such prepayment and the next anniversary of the note purchase agreement. In lieu of making any optional or mandatory prepayment in cash, at any time after July 1, 2011, subject to certain limitations, we have the right to convert all or a portion of the principal amount of the notes into, or satisfy all or any portion of the optional prepayment amounts or mandatory prepayment amounts (other than the first $10.0 million of mandatory prepayments required in 2013 and 2014) with shares of our common stock. Additionally, in lieu of making any payment of accrued and unpaid interest in respect of the notes in cash, at any time after July 1, 2011, subject to certain limitations, we may elect to satisfy any such payment with shares of our common stock. The number of shares of our common stock issuable upon conversion or in settlement of principal and interest obligations will be based upon the discounted trading price of our common stock over a specified trading period. In the event the market price for our common stock is depressed, we may not be able to convert the principal amount of the notes or satisfy our payment obligations in full using shares of our common stock due to restrictions in the agreement on the number of shares we may issue. In addition, the issuance of shares of our common stock to convert the notes or satisfy our payment obligations may result in significant dilution to our stockholders. As a result, we may need to obtain additional funding to satisfy our repayment obligations. There can be no assurance that we will have sufficient funds to repay the notes or satisfy our payment obligations under the note purchase agreement when due or that we will comply with the conditions to our ability to convert the principal amount of the notes into or satisfy our payment obligations with shares of our common stock;

repayment of our loan from Silicon Valley Bank On June 2, 2010, we amended our loan and security agreement with Silicon Valley Bank to provide for a new seven-year term loan in an amount of $80.0 million. The principal amount outstanding under the term loan accrues interest at 1.0% per annum, which interest is due and payable monthly. We are required to repay the term loan in one balloon principal payment, representing 100% of the principal balance and accrued and unpaid interest, on May 31, 2017. We have the option to prepay all, but not less than all, of the amounts advanced under the term loan, provided that we pay all unpaid accrued interest thereon that is due through the date of such prepayment and the interest on the entire principal balance of the term loan that would otherwise have been paid after such prepayment date until the maturity date of the term loan. In accordance with the terms of the loan and security agreement, we are also required to maintain on deposit an amount equal to at least 100% of the outstanding principal balance of the term loan at all times as support for our obligations under the loan and security agreement. As a result, although the proceeds of the new term loan improve our ability to comply with minimum working capital and cash covenants imposed by our debt instruments with GlaxoSmithKline and Deerfield and thus provide us with more flexibility to use our other cash resources, the proceeds of the term loan cannot directly be used to satisfied our other obligations without causing a default under our loan and security agreement with Silicon Valley Bank;

the level of payments received under existing collaboration agreements, licensing agreements and other arrangements;

the degree to which we conduct funded development activity on behalf of partners to whom we have out-licensed compounds;

Table of Contents

whether we enter into new collaboration agreements, licensing agreements or other arrangements (including, in particular, with respect to cabozantinib) that provide additional capital;

our ability to control costs;

our ability to remain in compliance with, or amend or cause to be waived, financial covenants contained in agreements with third parties;

the amount of our cash and cash equivalents and marketable securities that serve as collateral for bank lines of credit;

future clinical trial results;

our need to expand our product and clinical development efforts;

our ability to share the costs of our clinical development efforts with third parties;

the cost and timing of regulatory approvals;

the cost of clinical and research supplies of our product candidates;

the effect of competing technological and market developments;

the filing, maintenance, prosecution, defense and enforcement of patent claims and other intellectual property rights; and

the cost of any acquisitions of or investments in businesses, products and technologies.

One or more of these factors or changes to our current operating plan may require us to use available capital resources significantly earlier than we anticipate. If our capital resources are insufficient to meet future capital requirements, we will have to raise additional funds. We may seek to raise funds through the sale of equity or debt securities or through external borrowings. In addition, we may enter into additional strategic partnerships or collaborative arrangements for the development and commercialization of our compounds. However, we may be unable to raise sufficient additional capital when we need it, on favorable terms or at all. The sale of equity or convertible debt securities in the future may be dilutive to our stockholders, and debt-financing arrangements may require us to pledge certain assets and enter into covenants that would restrict certain business activities or our ability to incur further indebtedness, and may contain other terms that are not favorable to our stockholders or us. If we are unable to obtain adequate funds on reasonable terms, we may be required to curtail operations significantly or obtain funds by entering into financing, supply or collaboration agreements on unattractive terms or we may be required to relinquish rights to technology or product candidates or to grant licenses on terms that are unfavorable to us.

We may need to obtain additional funding in order to stay in compliance with financial covenants contained in agreements with third parties. As described above under Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations Liquidity and Capital Resources Cash Requirements, the terms of our debt owed to GlaxoSmithKline, Deerfield and Silicon Valley Bank each contain covenants requiring us to maintain specified cash balances or working capital. The failure to comply with these covenants could result in an acceleration of the underlying debt obligations. If we cannot raise additional capital in order to remain in compliance with such covenants or if we are unable to renegotiate such covenants and the lender exercises its remedies under the agreement, we would not be able to operate under our current

operating plan.

We have a history of net losses. We expect to continue to incur net losses, and we may not achieve or maintain profitability.*

We have incurred net losses since inception, including a net loss of $21.0 million and $48.5 million for the three and six months ended June 30, 2011, respectively. As of that date, we had an accumulated deficit of $1,230.5 million. While we expect to be in a net income position for 2011, as a result of the acceleration of deferred revenue under our terminated collaboration with Bristol Myers-Squibb for XL281, we anticipate negative operating cash flow for the foreseeable future. We have not yet completed the development, including obtaining regulatory approval, of cabozantinib or any other product candidates and, consequently, have not generated revenues from the sale of pharmaceutical products. We have derived substantially all of our revenues to date from collaborative research and development agreements. Revenues from research and development collaborations depend upon continuation of the collaborations, research funding, the achievement of milestones and royalties we earn from any future products developed from the collaborative research. If research funding we receive from collaborators decreases, we are unable to successfully achieve milestones or our collaborators fail to develop successful products, we will not earn the revenues contemplated under such collaborative agreements. The amount of our net losses will depend, in part, on the rate of growth, if any, in our license and contract revenues and on the level of our expenses. These losses have had and will continue to have an adverse effect on our stockholders equity and working capital. Our research and development expenditures and general and administrative expenses have exceeded our revenues to date, and we expect to spend significant additional amounts to fund the development of cabozantinib. As a result, we expect to continue to incur substantial operating expenses, and, consequently, we will need to generate significant additional revenues to achieve profitability. Because of the numerous risks and uncertainties associated with developing drugs, we are unable to predict the extent of any future losses or when we will become profitable, if at all.

Table of Contents

We may not realize the expected benefits of our initiatives to control costs.

Managing costs is a key element of our business strategy. Consistent with this element of our strategy, on December 1, 2010 we implemented a restructuring that will result in a reduction of our workforce by approximately 65% over a two-year period. We anticipate that we will incur restructuring charges through the end of 2017 as we implement this restructuring.

We are still assessing our ability to sublease certain of our facilities in light of the workforce reduction as well as the potential for sublease income. Estimates for sublease income would require significant assumptions regarding the time required to contract with subtenants, the amount of idle space we would be able to sublease and potential future sublease rates. If we are able to vacate certain of our facilities, we would need to continue to update our estimate of the lease exist costs in our financial statements until we were able to negotiate an exit to the lease or negotiate a sublease for the remaining term of the lease.

If we experience excessive unanticipated inefficiencies or incremental costs in connection with restructuring activities, such as unanticipated inefficiencies caused by reducing headcount, we may be unable to meaningfully realize cost savings and we may incur expenses in excess of what we anticipate. Either of these outcomes could prevent us from meeting our strategic objectives and could adversely impact our results of operations and financial condition.

We are exposed to risks related to foreign currency exchange rates.

Most of our foreign expenses incurred are associated with establishing and conducting clinical trials for cabozantinib. The amount of expenses incurred will be impacted by fluctuations in the currencies of those countries in which we conduct clinical trials. Our agreements with the foreign sites that conduct such clinical trials generally provide that payments for the services provided will be calculated in the currency of that country, and converted into U.S. dollars using various exchange rates based upon when services are rendered or the timing of invoices. When the U.S. dollar weakens against foreign currencies, the U.S. dollar value of the foreign-currency denominated expense increases, and when the U.S. dollar strengthens against these currencies, the U.S. dollar value of the foreign-currency denominated expense decreases. Consequently, changes in exchange rates may affect our results of operations.

Global credit and financial market conditions could negatively impact the value of our current portfolio of cash equivalents or short-term investments and our ability to meet our financing objectives.

Our cash and cash equivalents are maintained in highly liquid investments with remaining maturities of 90 days or less at the time of purchase. Our short-term and long-term investments consist primarily of readily marketable debt securities with remaining maturities of more than 90 days at the time of purchase. While as of the date of this filing we are not aware of any downgrades, material losses, or other significant deterioration in the fair value of our cash equivalents, short-term investments or long-term investments since June 30, 2011, no assurance can be given that a deterioration in conditions of the global credit and financial markets would not negatively impact our current portfolio of cash equivalents or investments or our ability to meet our financing objectives.

Risks Related to Development of Cabozantinib

We are dependent on the successful development and commercialization of cabozantinib.

The success of our business is dependent upon the successful development and commercialization of cabozantinib. As part of our strategy, we intend to dedicate all of our proprietary resources to advance cabozantinib as aggressively as feasible. Our ability to realize the value of our investment is contingent on, among other things, successful clinical development, regulatory approval and market acceptance of cabozantinib. If we encounter difficulties in the development of cabozantinib due to any of the factors discussed in this Risk Factors section or otherwise, or we do not receive regulatory approval and are unable to commercialize cabozantinib, we will not have the resources necessary to continue our business in its current form.

Clinical testing of cabozantinib and other product candidates is a lengthy, costly, complex and uncertain process and may fail to demonstrate safety and efficacy.

Clinical trials are inherently risky and may reveal that our product candidates are ineffective or have unacceptable toxicity or other side effects that may significantly decrease the likelihood of regulatory approval. The results of preliminary studies do not necessarily predict clinical or commercial success, and later-stage clinical trials may fail to confirm the results observed in earlier-stage trials or preliminary studies. Although we have established timelines for manufacturing and clinical development of cabozantinib based on existing knowledge of our compounds in development and industry metrics, we may not be able to meet those timelines.

We may experience numerous unforeseen events during, or as a result of, clinical testing that could delay or prevent commercialization of cabozantinib, including:

- cabozantinib may not prove to be efficacious or may cause, or potentially cause, harmful side effects;

Table of Contents

- negative or inconclusive clinical trial results may require us to conduct further testing or to abandon projects that we had expected to be promising;
- our competitors may subsequently discover other compounds or therapies that we believe show significantly improved safety or efficacy compared to cabozantinib;
- patient registration or enrollment in our clinical testing may be lower than we anticipate, resulting in the delay or cancellation of clinical testing; and
- regulators or institutional review boards withhold authorization of, or delay, suspend or terminate clinical research for various reasons, including noncompliance with regulatory requirements or their determination that participating patients are being exposed to unacceptable health risks.

If we were to have significant delays in or termination of our clinical testing of cabozantinib as a result of any of the events described above or otherwise, our expenses could increase or our ability to generate revenues from cabozantinib could be impaired, either of which could adversely impact our financial results.

We have limited experience in conducting clinical trials and may not be able to rapidly or effectively continue the further development of cabozantinib or meet current or future requirements of the United States Food and Drug Administration, or FDA, including those identified based on our discussions with the FDA. Our planned clinical trials may not begin on time, or at all, may not be completed on schedule, or at all, may not be sufficient for registration of cabozantinib or may not result in an approvable product.

Completion of clinical trials may take several years or more, but the length of time generally varies substantially according to the type, complexity, novelty and intended use of cabozantinib as a product candidate. The duration and the cost of clinical trials may vary significantly over the life of a project as a result of factors relating to the clinical trial, including, among others:

- the number of patients that ultimately participate in the clinical trial;
- the duration of patient follow-up that is appropriate in view of the results;
- the number of clinical sites included in the trials; and
- the length of time required to enroll suitable patient subjects.

Any delay could limit our ability to generate revenues, cause us to incur additional expense and cause the market price of our common stock to decline significantly. Our partners may experience similar risks with respect to the compounds we have outlicensed to them. If any of the events described above were to occur with such programs or compounds, the likelihood of receipt of milestones and royalties under such collaboration agreements could decrease.

If third parties upon which we rely do not perform as contractually required or expected, we may not be able to obtain regulatory approval for or commercialize cabozantinib.

We do not have the ability to independently conduct clinical trials for cabozantinib, and we rely on third parties we do not control such as contract research organizations, medical institutions, clinical investigators and contract laboratories to conduct our clinical trials. If these third parties do not successfully carry out their contractual duties or regulatory obligations or meet expected deadlines, if the third parties need to be replaced or if the quality or accuracy of the data they obtain is compromised due to the failure to adhere to our clinical protocols or regulatory requirements or for other reasons, our preclinical development activities or clinical trials may be extended, delayed, suspended or terminated, and we may not be able to obtain regulatory approval for or successfully commercialize cabozantinib.

We lack the capability to manufacture compounds for clinical trials and rely on third parties to manufacture cabozantinib, and we may be unable to obtain required material in a timely manner, at an acceptable cost or at a quality level required to receive regulatory approval.

We do not have the manufacturing capabilities or experience necessary to enable us to produce materials for our clinical trials. We rely on collaborators and third-party contractors to produce cabozantinib for clinical testing. These suppliers must comply with applicable regulatory requirements, including the FDA s current good manufacturing processes, or GMP. Our current and anticipated future dependence upon these third-party manufacturers may adversely affect our future profit margins and our ability to develop and commercialize cabozantinib on a timely and competitive basis. These manufacturers may not be able to produce material on a timely basis or manufacture material at the quality or in the quantity required to meet our development timelines and applicable regulatory requirements. We may not be able to maintain or renew our existing third-party manufacturing arrangements, or enter into new arrangements, on acceptable terms, or at all. Our third-party manufacturers could terminate or decline to renew our manufacturing arrangements based on their own business priorities, at a time that is costly or inconvenient for us. If we are unable to contract for the production of materials in sufficient quantity and of sufficient quality on acceptable terms, our clinical trials may be delayed. Delays in preclinical or clinical testing could delay the initiation of clinical trials.

Table of Contents

Our third-party manufacturers may not be able to comply with the GMP regulations, other applicable FDA regulatory requirements or similar regulations applicable outside of the United States. Additionally, if we are required to enter into new supply arrangements, we may not be able to obtain approval from the FDA of any alternate supplier in a timely manner, or at all, which could delay or prevent the clinical development and commercialization of cabozantinib. Failure of our third-party manufacturers or us to obtain approval from the FDA or to comply with applicable regulations could result in sanctions being imposed on us, including fines, civil penalties, delays in or failure to grant marketing approval of cabozantinib, injunctions, delays, suspension or withdrawal of approvals, license revocation, seizures or recalls of products and compounds, operating restrictions and criminal prosecutions, any of which could have a significant adverse affect on our business.

Materials necessary to manufacture cabozantinib may not be available on commercially reasonable terms, or at all, which may delay its development and commercialization.

Some of the materials necessary for the manufacture of cabozantinib may, from time to time, be available either in limited quantities, or from a limited number of manufacturers, or both. Our contract manufacturers need to obtain these materials for our clinical trials and, potentially, for commercial distribution when and if we obtain marketing approval for cabozantinib. Suppliers may not sell us these materials at the time we need them or on commercially reasonable terms. If we are unable to obtain the materials needed to conduct our clinical trials, product testing and potential regulatory approval could be delayed, adversely affecting our ability to develop cabozantinib. Similarly, if we are unable to obtain critical manufacturing materials after regulatory approval has been obtained, the commercial launch of cabozantinib could be delayed or there could be a shortage in supply, which could materially affect our ability to generate revenues from sales of cabozantinib. If suppliers increase the price of manufacturing materials, the price for cabozantinib may increase, which may make it less competitive in the marketplace. If it becomes necessary to change suppliers for any of these materials or if any of our suppliers experience a shutdown or disruption at the facilities used to produce these materials, due to technical, regulatory or other reasons, it could harm our ability to manufacture cabozantinib.

Risks Related to Our Relationships with Third Parties

We are dependent upon our collaborations with major companies, which subjects us to a number of risks.

We have established collaborations with leading pharmaceutical and biotechnology companies, including Bristol-Myers Squibb, sanofi-aventis, Genentech, GlaxoSmithKline and Daiichi Sankyo, for the development and ultimate commercialization of a significant number of compounds generated from our research and development efforts. We continue to pursue collaborations for selected unpartnered preclinical and clinical programs and compounds. Our dependence on our relationships with existing collaborators for the development and commercialization of our compounds subjects us to, and our dependence on future collaborators for development and commercialization of additional compounds will subject us to, a number of risks, including:

- we are not able to control the amount and timing of resources that our collaborators will devote to the development or commercialization of drug candidates or to their marketing and distribution;
- we may not be able to control the amount and timing of resources that our potential future collaborators may devote to the development or commercialization of drug candidates or to their marketing and distribution;
- collaborators may delay clinical trials, provide insufficient funding for a clinical trial program, stop a clinical trial or abandon a drug candidate, repeat or conduct new clinical trials or require a new formulation of a drug candidate for clinical testing;
- disputes may arise between us and our collaborators that result in the delay or termination of the research, development or commercialization of our drug candidates or that result in costly litigation or arbitration that diverts management s attention and resources;
- collaborators may experience financial difficulties;

collaborators may not be successful in their efforts to obtain regulatory approvals in a timely manner, or at all;

collaborators may not properly maintain or defend our intellectual property rights or may use our proprietary information in such a way as to invite litigation that could jeopardize or invalidate our proprietary information or expose us to potential litigation;

business combinations or significant changes in a collaborator s business strategy may adversely affect a collaborator s willingness or ability to complete its obligations under any arrangement;

a collaborator could independently move forward with a competing drug candidate developed either independently or in collaboration with others, including our competitors;

we may be precluded from entering into additional collaboration arrangements with other parties in an area or field of exclusivity;

Table of Contents

future collaborators may require us to relinquish some important rights, such as marketing and distribution rights; and

collaborations may be terminated (as occurred with respect to cabozantinib and XL281, that were previously subject to our 2008 collaboration with Bristol-Myers Squibb) or allowed to expire, which would delay the development and may increase the cost of developing our drug candidates.

If any of these risks materialize, our product development efforts could be delayed and otherwise adversely affected, which could adversely impact our business, operating results and financial condition.

If we are unable to continue current collaborations and achieve milestones or royalties, our revenues would suffer.*

We have derived substantially all of our revenues to date from collaborative research and development agreements. Revenues from research and development collaborations depend upon continuation of the collaborations, the achievement of milestones and royalties we earn from any future products developed from the collaborative research. If we are unable to successfully achieve milestones or royalties, or our collaborators fail to develop successful products, we will not earn the revenues contemplated under such collaborative agreements.

If any of these agreements is terminated early (as occurred with respect to cabozantinib and XL281, which were previously subject to our 2008 collaboration with Bristol-Myers Squibb), whether unilaterally or by mutual agreement, our revenues could suffer. Most of our collaboration agreements contain early termination provisions. In addition, from time to time we review and assess certain aspects of our collaborations, partnerships and agreements and may amend or terminate, either by mutual agreement or pursuant to any applicable early termination provisions, such collaborations, partnerships or agreements if we deem them to be no longer in our economic or strategic interests. We may not be able to enter into new collaboration agreements on similar or superior financial terms to offset the loss of revenues from the termination or expiration of any of our existing or recently terminated arrangements.

We may be unable to establish collaborations for selected preclinical and clinical compounds.

Our strategy includes the pursuit of new collaborations with leading pharmaceutical and biotechnology companies for the development and ultimate commercialization of selected preclinical and clinical programs and compounds, particularly those drug candidates for which we believe that the capabilities and resources of a partner can accelerate development and help to fully realize their therapeutic and commercial potential. We face significant competition in seeking appropriate collaborators, and these collaborations are complex and time consuming to negotiate and document. We may not be able to negotiate additional collaborations on acceptable terms, or at all. We are unable to predict when, if ever, we will enter into any additional collaborations because of the numerous risks and uncertainties associated with establishing additional collaborations. If we are unable to negotiate additional collaborations, we may not be able to realize value from a particular drug candidate, particularly those drug candidates as to which we believe a broad development program is appropriate or for which we have determined not to continue to utilize our own resources to develop. As a result, our revenues, capital resources and product development efforts could be adversely affected.

Risks Related to Regulatory Approval of Cabozantinib

Cabozantinib is subject to a lengthy and uncertain regulatory process that may not result in the necessary regulatory approvals, which could adversely affect our ability to commercialize this product candidate.

Cabozantinib, as well as the activities associated with the research, development and commercialization of the product candidate, are subject to extensive regulation by the FDA and other regulatory agencies in the United States and by comparable authorities in other countries. Failure to obtain regulatory approval for cabozantinib would prevent us from commercializing this product candidate. We have not received regulatory approval to market cabozantinib in any jurisdiction and have only limited experience in preparing and filing the applications necessary to gain regulatory approvals. The process of obtaining regulatory approvals is expensive, and often takes many years, if approval is obtained at all, and can vary substantially based upon the type, complexity and novelty of the product candidates involved. Before a new drug application, or NDA, can be submitted to the FDA, the product candidate must undergo extensive clinical trials, which can take many years and requires substantial expenditures. Any clinical trial may fail to produce results satisfactory to the FDA. For example, the FDA could determine that the design of a clinical trial is inadequate to produce reliable results. The regulatory process also requires preclinical testing, and data obtained from preclinical and clinical activities are susceptible to varying interpretations. The FDA has substantial discretion in the approval process and may refuse to approve any NDA or decide that our data is insufficient for approval and require additional preclinical, clinical or other studies. For example, varying interpretations of the data obtained from preclinical and clinical testing could delay, limit or prevent regulatory approval of cabozantinib.

In addition, delays or rejections may be encountered based upon changes in regulatory policy for product approval during the period of product development and regulatory agency review. Changes in regulatory approval policy, regulations or statutes or the process for regulatory review during the development or approval periods of cabozantinib may cause delays in the approval or rejection of an application.

Table of Contents

Even if the FDA or a comparable authority in another country approves cabozantinib, the approval may impose significant restrictions on the indicated uses, conditions for use, labeling, distribution, advertising, promotion, marketing and/or production of cabozantinib and may impose ongoing requirements for post- approval studies, including additional research and development and clinical trials. These agencies also may impose various civil or criminal sanctions for failure to comply with regulatory requirements, including withdrawal of product approval.

Risks Related to Commercialization of Cabozantinib

The commercial success of cabozantinib will depend upon the degree of market acceptance of the product candidate among physicians, patients, health care payors, private health insurers and the medical community.

Our ability to commercialize cabozantinib will be highly dependent upon the extent to which the product candidate gains market acceptance among physicians; patients; health care payors, such as Medicare and Medicaid; private health insurers, including managed care organizations and group purchasing organizations, and the medical community. If cabozantinib does not achieve an adequate level of acceptance, we may not generate adequate product revenues, if at all, and we may not become profitable. The degree of market acceptance of cabozantinib, if approved for commercial sale, will depend upon a number of factors, including:

- the effectiveness, or perceived effectiveness, of cabozantinib in comparison to competing products;
- the existence of any significant side effects of cabozantinib, as well as their severity in comparison to any competing products;
- potential advantages over alternative treatments;
- the ability to offer cabozantinib for sale at competitive prices;
- relative convenience and ease of administration;
- the strength of marketing and distribution support; and
- sufficient third-party coverage or reimbursement.

If we are unable to establish sales and marketing capabilities or enter into agreements with third parties to market and sell cabozantinib, we may be unable to generate product revenues.

We have no experience as a company in the sales, marketing and distribution of pharmaceutical products and do not have a sales and marketing organization. Developing a sales and marketing force would be expensive and time-consuming, could delay any product launch, and we may never be able to develop this capacity. To the extent that we enter into arrangements with third parties to provide sales, marketing and distribution services, our product revenues are likely to be lower than if we market and sell cabozantinib ourselves. If we are unable to establish adequate sales, marketing and distribution capabilities, independently or with others, we may not be able to generate product revenues.

If we are unable to obtain adequate coverage and reimbursement from third-party payors for cabozantinib, our revenues and prospects for profitability will suffer.

Our ability to commercialize cabozantinib will be highly dependent on the extent to which coverage and reimbursement for the product candidate will be available from third-party payors, including governmental payors, such as Medicare and Medicaid, and private health insurers, including managed care organizations and group purchasing organizations. Many patients will not be capable of paying themselves for cabozantinib and will rely on third-party payors to pay for, or subsidize, their medical needs. If third-party payors do not provide coverage or reimbursement for cabozantinib, our revenues and prospects for profitability will suffer. In addition, even if third-party payors provide some

coverage or reimbursement for cabozantinib, the availability of such coverage or reimbursement for prescription drugs under private health insurance and managed care plans often varies based on the type of contract or plan purchased.

Another factor that may affect the pricing of drugs is proposed congressional action regarding drug reimportation into the United States. For example, the Medicare Prescription Drug, Improvement and Modernization Act of 2003 gives discretion to the Secretary of Health and Human Services to allow drug reimportation into the United States under some circumstances from foreign countries, including countries where the drugs are sold at a lower price than in the United States. Proponents of drug reimportation may attempt to pass legislation, which would allow direct reimportation under certain circumstances. If legislation or regulations were passed allowing the reimportation of drugs, it could decrease the price we receive for cabozantinib, thereby negatively affecting our revenues and prospects for profitability.

Table of Contents

In addition, in some foreign countries, particularly the countries in the European Union, the pricing of prescription pharmaceuticals is subject to governmental control. In these countries, price negotiations with governmental authorities can take six to twelve months or longer after the receipt of regulatory marketing approval for a product. To obtain reimbursement and/or pricing approval in some countries, we may be required to conduct a clinical trial that compares the cost effectiveness of cabozantinib to other available therapies. The conduct of such a clinical trial could be expensive and result in delays in the commercialization of cabozantinib. Third-party payors are challenging the prices charged for medical products and services, and many third-party payors limit reimbursement for newly approved health care products. In particular, third-party payors may limit the indications for which they will reimburse patients who use cabozantinib. Cost-control initiatives could decrease the price we might establish for cabozantinib, which would result in lower product revenues to us.

Current healthcare laws and regulations and future legislative or regulatory reforms to the healthcare system may affect our ability to sell cabozantinib profitably.

The U.S. and some foreign jurisdictions are considering or have enacted a number of legislative and regulatory proposals to change the healthcare system in ways that could affect our ability to sell our products profitably. Among policy makers and payors in the U.S. and elsewhere, there is significant interest in promoting changes in healthcare systems with the stated goals of containing healthcare costs, improving quality and/or expanding access. In the U.S., the pharmaceutical industry has been a particular focus of these efforts and has been significantly affected by major legislative initiatives.

In March 2010, the Patient Protection and Affordable Care Act, as amended by the Health Care and Education Affordability Reconciliation Act, or collectively, PPACA, became law in the U.S. PPACA substantially changes the way healthcare is financed by both governmental and private insurers and significantly affects the pharmaceutical industry. Among the provisions of PPACA of greatest importance to the pharmaceutical industry are the following:

an annual, nondeductible fee on any entity that manufactures or imports certain branded prescription drugs and biologic agents, apportioned among these entities according to their market share in certain government healthcare programs, beginning in 2011;

an increase in the rebates a manufacturer must pay under the Medicaid Drug Rebate Program, retroactive to January 1, 2010, to 23.1% and 13% of the average manufacturer price for branded and generic drugs, respectively;

a new Medicare Part D coverage gap discount program, in which manufacturers must agree to offer 50% point-of-sale discounts off negotiated prices of applicable brand drugs to eligible beneficiaries during their coverage gap period, as a condition for the manufacturer s outpatient drugs to be covered under Medicare Part D, beginning in 2011;

extension of manufacturers Medicaid rebate liability to covered drugs dispensed to individuals who are enrolled in Medicaid managed care organizations, effective March 23, 2010;

expansion of eligibility criteria for Medicaid programs by, among other things, allowing states to offer Medicaid coverage to additional individuals beginning in April 2010 and by adding new mandatory eligibility categories for certain individuals with income at or below 133% of the Federal Poverty Level beginning in 2014, thereby potentially increasing manufacturers Medicaid rebate liability;

expansion of the entities eligible for discounts under the Public Health Service pharmaceutical pricing program, effective in January 2010;

new requirements to report certain financial arrangements with physicians, including reporting any transfer of value made or distributed to prescribers and other healthcare providers, effective March 30, 2013, and reporting any investment interests held by

physicians and their immediate family members during the preceding calendar year;

a new requirement to annually report drug samples that manufacturers and distributors provide to physicians, effective April 1, 2012;

a licensure framework for follow-on biologic products; and

a new Patient-Centered Outcomes Research Institute to oversee, identify priorities in, and conduct comparative clinical effectiveness research, along with funding for such research.

We anticipate that the PPACA, as well as other healthcare reform measures that may be adopted in the future, may result in more rigorous coverage criteria and an additional downward pressure on the price that we receive for any approved product, and could seriously harm our business. Any reduction in reimbursement from Medicare or other government programs may result in a similar reduction in payments from private payors.

We also cannot be certain that cabozantinib will successfully be placed on the list of drugs covered by particular health plan formularies, nor can we predict the negotiated price for cabozantinib, which will be determined by market factors. Many states have also created preferred drug lists and include drugs on those lists only when the manufacturers agree to pay a supplemental rebate. If cabozantinib is not included on these preferred drug lists, physicians may not be inclined to prescribe it to their Medicaid patients, thereby diminishing the potential market for cabozantinib.

Table of Contents

As a result of the PPACA and the trend towards cost-effectiveness criteria and managed healthcare in the United States, third-party payors are increasingly attempting to contain healthcare costs by limiting both coverage and the level of reimbursement of new drugs. They may also refuse to provide any coverage of uses of approved products for medical indications other than those for which the FDA has granted market approvals. As a result, significant uncertainty exists as to whether and how much third-party payors will reimburse for newly-approved drugs, which in turn will put pressure on the pricing of drugs. Further, we do not have experience in ensuring approval by applicable third-party payors outside of the United States for coverage and reimbursement of cabozantinib. We also anticipate pricing pressures in connection with the sale of our products due to the trend toward managed healthcare, the increasing influence of health maintenance organizations and additional legislative proposals.

Our competitors may develop products and technologies that make cabozantinib obsolete.*

The biotechnology industry is highly fragmented and is characterized by rapid technological change. In particular, the area of kinase-targeted therapies is a rapidly evolving and competitive field. We face, and will continue to face, intense competition from biotechnology and pharmaceutical companies, as well as academic research institutions, clinical reference laboratories and government agencies that are pursuing research activities similar to ours. Some of our competitors have entered into collaborations with leading companies within our target markets, including some of our existing collaborators. In addition, significant delays in the development of cabozantinib could allow our competitors to bring products to market before us, which would impair our ability to commercialize cabozantinib. Our future success will depend upon our ability to maintain a competitive position with respect to technological advances. Any products that are developed through our technologies will compete in highly competitive markets. Further, our competitors may be more effective at using their technologies to develop commercial products. Many of the organizations competing with us have greater capital resources, larger research and development staff and facilities, more experience in obtaining regulatory approvals and more extensive product manufacturing and marketing capabilities. As a result, our competitors may be able to more easily develop technologies and products that would render our technologies and products, and those of our collaborators, obsolete and noncompetitive. There may also be drug candidates of which we are not aware at an earlier stage of development that may compete with cabozantinib. In addition, if cabozantinib is successfully developed, it may compete with existing therapies that have long histories of use, such as chemotherapy and radiation treatments in cancer indications. Examples of potential competition for cabozantinib include: AstraZeneca s development-stage RET, VEGFR and EGFR inhibitor, vandetanib; Algeta s development-stage alpha-pharmaceutical, Alpharadin (Radium-223); other VEGF pathway inhibitors, including Genentech s bevacizumab; and other MET inhibitors, including Pfizer s crizotinib, ArQule s ARQ197, GlaxoSmithKline s foretinib (XL880) and Genentech s Met MAb.

We may not be able to manufacture cabozantinib in commercial quantities, which would prevent us from commercializing the product candidate.

To date, cabozantinib has been manufactured in small quantities for preclinical and clinical trials. If cabozantinib is approved by the FDA or other regulatory agencies for commercial sale, we will need to manufacture it in larger quantities. We may not be able to successfully increase the manufacturing capacity, whether in collaboration with third-party manufacturers or on our own, for cabozantinib in a timely or economic manner, or at all. Significant scale-up of manufacturing may require additional validation studies, which the FDA must review and approve. If we are unable to successfully increase the manufacturing capacity for cabozantinib, the regulatory approval or commercial launch of the product candidate may be delayed or there may be a shortage in supply. Cabozantinib requires precise, high-quality manufacturing. The failure to achieve and maintain these high manufacturing standards, including the incidence of manufacturing errors, could result in patient injury or death, product recalls or withdrawals, delays or failures in product testing or delivery, cost overruns or other problems that could seriously hurt our business.

Risks Related to Our Intellectual Property

If we are unable to adequately protect our intellectual property, third parties may be able to use our technology, which could adversely affect our ability to compete in the market.

Our success will depend in part upon our ability to obtain patents and maintain adequate protection of the intellectual property related to our technologies and products. The patent positions of biotechnology companies, including our patent position, are generally uncertain and involve complex legal and factual questions. We will be able to protect our intellectual property rights from unauthorized use by third parties only to the extent that our technologies are covered by valid and enforceable patents or are effectively maintained as trade secrets. We will continue to apply for patents covering our technologies and products as and when we deem appropriate. However, these applications may be challenged or may fail to result in issued patents. In addition, because patent applications can take many years to issue, there may be pending applications, unknown to us, which may later result in issued patents that cover the production, manufacture, commercialization or use of our product candidates. Our existing patents and any future patents we obtain may not be sufficiently broad to prevent others from practicing our technologies or from developing competing products. Furthermore, others may independently develop similar or alternative technologies or design around our patents. In addition, our patents may be challenged or invalidated or may fail to provide us with any competitive advantages, if, for example, others were the first to invent or to file patent applications for these inventions.

41

Table of Contents

The laws of some foreign countries do not protect intellectual property rights to the same extent as the laws of the United States, and many companies have encountered significant problems in protecting and defending such rights in foreign jurisdictions. Many countries, including certain countries in Europe, have compulsory licensing laws under which a patent owner may be compelled to grant licenses to third parties (for example, the patent owner has failed to work the invention in that country or the third party has patented improvements). In addition, many countries limit the enforceability of patents against government agencies or government contractors. In these countries, the patent owner may have limited remedies, which could materially diminish the value of the patent. Compulsory licensing of life-saving drugs is also becoming increasingly popular in developing countries either through direct legislation or international initiatives. Such compulsory licenses could be extended to include some of our product candidates, which could limit our potential revenue opportunities. Moreover, the legal systems of certain countries, particularly certain developing countries, do not favor the aggressive enforcement of patent and other intellectual property protection, which makes it difficult to stop infringement. We rely on trade secret protection for our confidential and proprietary information. We have taken security measures to protect our proprietary information and trade secrets, but these measures may not provide adequate protection. While we seek to protect our proprietary information by entering into confidentiality agreements with employees, collaborators and consultants, we cannot assure you that our proprietary information will not be disclosed, or that we can meaningfully protect our trade secrets. In addition, our competitors may independently develop substantially equivalent proprietary information or may otherwise gain access to our trade secrets.

Litigation or third-party claims of intellectual property infringement could require us to spend substantial time and money and adversely affect our ability to develop and commercialize products.

Our commercial success depends in part upon our ability to avoid infringing patents and proprietary rights of third parties and not to breach any licenses that we have entered into with regard to our technologies. Other parties have filed, and in the future are likely to file, patent applications covering genes and gene fragments, techniques and methodologies relating to model systems and products and technologies that we have developed or intend to develop. If patents covering technologies required by our operations are issued to others, we may have to obtain licenses from third parties, which may not be available on commercially reasonable terms, or at all, and may require us to pay substantial royalties, grant a cross-license to some of our patents to another patent holder or redesign the formulation of a product candidate so that we do not infringe third-party patents, which may be impossible to obtain or could require substantial time and expense.

Third parties may accuse us of employing their proprietary technology without authorization. In addition, third parties may obtain patents that relate to our technologies and claim that use of such technologies infringes on their patents. Regardless of their merit, such claims could require us to incur substantial costs, including the diversion of management and technical personnel, in defending ourselves against any such claims or enforcing our patents. In the event that a successful claim of infringement is brought against us, we may be required to pay damages and obtain one or more licenses from third parties. We may not be able to obtain these licenses at a reasonable cost, or at all. Defense of any lawsuit or failure to obtain any of these licenses could adversely affect our ability to develop and commercialize products.

We may be subject to damages resulting from claims that we, our employees or independent contractors have wrongfully used or disclosed alleged trade secrets of their former employers.

Many of our employees and independent contractors were previously employed at universities, other biotechnology or pharmaceutical companies, including our competitors or potential competitors. We may be subject to claims that these employees, independent contractors or we have inadvertently or otherwise used or disclosed trade secrets or other proprietary information of their former employers. Litigation may be necessary to defend against these claims. Even if we are successful in defending against these claims, litigation could result in substantial costs and divert management s attention. If we fail in defending such claims, in addition to paying money claims, we may lose valuable intellectual property rights or personnel. A loss of key research personnel and/or their work product could hamper or prevent our ability to commercialize certain product candidates, which could severely harm our business.

Risks Related to Employees and Location

The loss of key personnel or the inability to retain and, where necessary, attract additional personnel could impair our ability to expand our operations.

We are highly dependent upon the principal members of our management and scientific staff, the loss of whose services might adversely impact the achievement of our objectives and the continuation of existing collaborations. Also, we may not have sufficient personnel to execute our business plan. Retaining and, where necessary, recruiting qualified clinical and scientific personnel will be critical to support activities related to advancing our clinical and preclinical development programs, and supporting our collaborative arrangements and our internal proprietary research and development efforts. The restructuring plans that we implemented in 2010 and

42

Table of Contents

additional and planned personnel reductions through 2012 could have an adverse impact on our ability to retain and recruit qualified personnel. Competition is intense for experienced clinical personnel, and we may be unable to retain or recruit clinical personnel with the expertise or experience necessary to allow us to pursue collaborations, develop our products and core technologies or expand our operations to the extent otherwise possible. Further, all of our employees are employed at will and, therefore, may leave our employment at any time.

Our collaborations with outside scientists may be subject to restriction and change.

We work with scientific and clinical advisors and collaborators at academic and other institutions that assist us in our research and development efforts. These advisors and collaborators are not our employees and may have other commitments that limit their availability to us. Although these advisors and collaborators generally agree not to do competing work, if a conflict of interest between their work for us and their work for another entity arises, we may lose their services. In such a circumstance, we may lose work performed by them, and our development efforts with respect to the matters on which they were working may be significantly delayed or otherwise adversely affected. In addition, although our advisors and collaborators sign agreements not to disclose our confidential information, it is possible that valuable proprietary knowledge may become publicly known through them.

Our headquarters are located near known earthquake fault zones, and the occurrence of an earthquake or other disaster could damage our facilities and equipment, which could harm our operations.

Our headquarters are located in South San Francisco, California, and therefore our facilities are vulnerable to damage from earthquakes. We do not carry earthquake insurance. We are also vulnerable to damage from other types of disasters, including fire, floods, power loss, communications failures, terrorism and similar events since any insurance we may maintain may not be adequate to cover our losses. If any disaster were to occur, our ability to operate our business at our facilities could be seriously, or potentially completely, impaired. In addition, the unique nature of our research activities could cause significant delays in our programs and make it difficult for us to recover from a disaster. Accordingly, an earthquake or other disaster could materially and adversely harm our ability to conduct business.

Security breaches may disrupt our operations and harm our operating results.

Our network security and data recovery measures may not be adequate to protect against computer viruses, break-ins, and similar disruptions from unauthorized tampering with our computer systems. The misappropriation, theft, sabotage or any other type of security breach with respect to any of our proprietary and confidential information that is electronically stored, including research or clinical data, could have a material adverse impact on our business, operating results and financial condition. Additionally, any break-in or trespass of our facilities that results in the misappropriation, theft, sabotage or any other type of security breach with respect to our proprietary and confidential information, including research or clinical data, or that results in damage to our research and development equipment and assets could have a material adverse impact on our business, operating results and financial condition.

Risks Related to Environmental and Product Liability

We use hazardous chemicals and radioactive and biological materials in our business. Any claims relating to improper handling, storage or disposal of these materials could be time consuming and costly.

Our research and development processes involve the controlled use of hazardous materials, including chemicals and radioactive and biological materials. Our operations produce hazardous waste products. We cannot eliminate the risk of accidental contamination or discharge and any resultant injury from these materials. Federal, state and local laws and regulations govern the use, manufacture, storage, handling and disposal of hazardous materials. We may face liability for any injury or contamination that results from our use or the use by third parties of these materials, and such liability may exceed our insurance coverage and our total assets. Compliance with environmental laws and regulations may be expensive, and current or future environmental regulations may impair our research, development and production efforts.

In addition, our collaborators may use hazardous materials in connection with our collaborative efforts. In the event of a lawsuit or investigation, we could be held responsible for any injury caused to persons or property by exposure to, or release of, these hazardous materials used by these parties. Further, we may be required to indemnify our collaborators against all damages and other liabilities arising out of our development activities or products produced in connection with these collaborations.

We face potential product liability exposure far in excess of our limited insurance coverage.

We may be held liable if any product we or our collaborators develop causes injury or is found otherwise unsuitable during product testing, manufacturing, marketing or sale. Regardless of merit or eventual outcome, product liability claims could result in decreased demand for our

product candidates, injury to our reputation, withdrawal of patients from our clinical trials, substantial monetary awards to trial participants and the inability to commercialize any products that we may develop. These claims might be

Table of Contents

made directly by consumers, health care providers, pharmaceutical companies or others selling or testing our products. We have obtained limited product liability insurance coverage for our clinical trials in the amount of $10.0 million per occurrence and $10.0 million in the aggregate. However, our insurance may not reimburse us or may not be sufficient to reimburse us for expenses or losses we may suffer. Moreover, if insurance coverage becomes more expensive, we may not be able to maintain insurance coverage at a reasonable cost or in sufficient amounts to protect us against losses due to liability. If we obtain marketing approval for cabozantinib, we intend to expand our insurance coverage to include the sale of commercial products, but we may be unable to obtain commercially reasonable product liability insurance for any products approved for marketing. On occasion, juries have awarded large judgments in class action lawsuits for claims based on drugs that had unanticipated side effects. In addition, the pharmaceutical and biotechnology industries, in general, have been subject to significant medical malpractice litigation. A successful product liability claim or series of claims brought against us could harm our reputation and business and would decrease our cash reserves.

Risks Related to Our Common Stock

We expect that our quarterly results of operations will fluctuate, and this fluctuation could cause our stock price to decline, causing investor losses.

Our quarterly operating results have fluctuated in the past and are likely to fluctuate in the future. A number of factors, many of which we cannot control, could subject our operating results to volatility, including:

- the scope of our research and development activities;
- recognition of upfront licensing or other fees or revenues;
- payments of non-refundable upfront or licensing fees, or payment for cost-sharing expenses, to third parties;
- acceptance of our technologies and platforms;
- the success rate of our efforts leading to milestone payments and royalties;
- the introduction of new technologies or products by our competitors;
- the timing and willingness of collaborators to further develop or, if approved, commercialize our product outlicensed to them;
- our ability to enter into new collaborative relationships;
- the termination or non-renewal of existing collaborations;
- the timing and amount of expenses incurred for clinical development and manufacturing cabozantinib;
- adjustments to expenses accrued in prior periods based on management s estimates after the actual level of activity relating to such expenses becomes more certain;

the impairment of acquired goodwill and other assets;

the impact of our restructuring plans; and

general and industry-specific economic conditions that may affect our collaborators research and development expenditures.

A large portion of our expenses, including expenses for facilities, equipment and personnel, are relatively fixed in the short term. If our revenues decline or do not grow as anticipated due to the expiration or termination of existing contracts, our failure to obtain new contracts or our inability to meet milestones or because of other factors, we may not be able to correspondingly reduce our operating expenses. Failure to achieve anticipated levels of revenues could therefore significantly harm our operating results for a particular fiscal period.

Due to the possibility of fluctuations in our revenues and expenses, we believe that quarter-to-quarter comparisons of our operating results are not a good indication of our future performance. As a result, in some future quarters, our operating results may not meet the expectations of securities analysts and investors, which could result in a decline in the price of our common stock.

Our stock price may be extremely volatile.

The trading price of our common stock has been highly volatile, and we believe the trading price of our common stock will remain highly volatile and may fluctuate substantially due to factors such as the following, many of which we cannot control:

adverse results or delays in our or our collaborators clinical trials;

announcement of FDA approval or non-approval, or delays in the FDA review process, of cabozantinib or our collaborators product candidates or those of our competitors or actions taken by regulatory agencies with respect to our, our collaborators or our competitors clinical trials;

Table of Contents

the timing of achievement of our clinical, regulatory, partnering and other milestones, such as the commencement of clinical development, the completion of a clinical trial, the filing for regulatory approval or the establishment of collaborative arrangements for one or more of our outlicensed programs and compounds;

actions taken by regulatory agencies with respect to cabozantinib or our clinical trials for cabozantinib;

the announcement of new products by our competitors;

quarterly variations in our or our competitors results of operations;

developments in our relationships with our collaborators, including the termination or modification of our agreements;

conflicts or litigation with our collaborators;

litigation, including intellectual property infringement and product liability lawsuits, involving us;

failure to achieve operating results projected by securities analysts;

changes in earnings estimates or recommendations by securities analysts;

financing transactions;

developments in the biotechnology or pharmaceutical industry;

sales of large blocks of our common stock or sales of our common stock by our executive officers, directors and significant stockholders;

departures of key personnel or board members;

developments concerning current or future collaborations;

FDA or international regulatory actions;

third-party reimbursement policies;

disposition of any of our subsidiaries, technologies or compounds; and

general market conditions and other factors, including factors unrelated to our operating performance or the operating performance of our competitors.

These factors, as well as general economic, political and market conditions, may materially adversely affect the market price of our common stock. Excessive volatility may continue for an extended period of time following the filing date of this report.

In the past, following periods of volatility in the market price of a company s securities, securities class action litigation has often been instituted. A securities class action suit against us could result in substantial costs and divert management s attention and resources, which could have a material and adverse effect on our business.

Future sales of our common stock may depress our stock price.

If our stockholders sell substantial amounts of our common stock (including shares issued upon the exercise of options and warrants or upon vesting of restricted stock units and shares issued under our employee stock purchase plan) in the public market, the market price of our common stock could fall. These sales also might make it more difficult for us to sell equity or equity-related securities in the future at a time and price that we deem appropriate.

Some of our existing stockholders can exert control over us, and their interests could conflict with the best interests of our other stockholders.

Due to their combined stock holdings, our officers, directors and principal stockholders (stockholders holding more than 5% of our common stock), acting together, may be able to exert significant influence over all matters requiring stockholder approval, including the election of directors and approval of significant corporate transactions. In addition, this concentration of ownership may delay or prevent a change in control of our company, even when a change may be in the best interests of our stockholders. In addition, the interests of these stockholders may not always coincide with our interests as a company or the interests of other stockholders. Accordingly, these stockholders could cause us to enter into transactions or agreements that would not be widely viewed as beneficial.

Anti-takeover provisions in our charter documents and under Delaware law could make an acquisition of us, which may be beneficial to our stockholders, more difficult and may prevent or deter attempts by our stockholders to replace or remove our current management.

Provisions in our corporate charter and bylaws may discourage, delay or prevent an acquisition of our company, a change in control, or attempts by our stockholders to replace or remove members of our current Board of Directors. Because our Board of

Table of Contents

Directors is responsible for appointing the members of our management team, these provisions could in turn affect any attempt by our stockholders to replace current members of our management team. These provisions include:

- a classified Board of Directors;
- a prohibition on actions by our stockholders by written consent;
- the inability of our stockholders to call special meetings of stockholders;
- the ability of our Board of Directors to issue preferred stock without stockholder approval, which could be used to institute a poison pill that would work to dilute the stock ownership of a potential hostile acquirer, effectively preventing acquisitions that have not been approved by our Board of Directors;
- limitations on the removal of directors; and
- advance notice requirements for director nominations and stockholder proposals.

Moreover, because we are incorporated in Delaware, we are governed by the provisions of Section 203 of the Delaware General Corporation Law, which prohibits a person who owns in excess of 15% of our outstanding voting stock from merging or combining with us for a period of three years after the date of the transaction in which the person acquired in excess of 15% of our outstanding voting stock, unless the merger or combination is approved in a prescribed manner.

ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS.

On April 25, 2011, we issued an aggregate of 47,101 shares of common stock pursuant to cashless exercises of warrants issued to an accredited investor transferee that were originally issued to Symphony Evolution Holdings LLC in June 2006 and June 2009 in connection with a clinical development financing arrangement. The warrants issued in June 2006 were exercisable for an aggregate of 68,720 shares of common stock and had an exercise price of $8.90 per share. The number of shares issued upon exercise of the June 2006 warrants was reduced by an aggregate of 49,262 shares to effect the cashless exercise of such warrants in accordance with their terms. The warrants issued in June 2009 were exercisable for an aggregate of 58,785 shares of common stock and had an exercise price of $6.05 per share. The number of shares issued upon exercise of the June 2009 warrants was reduced by an aggregate of 31,142 shares to effect the cashless exercise of such warrants in accordance with their terms.

On May 12, 2011, we issued an aggregate of 68,217 shares of common stock pursuant to cashless exercises of warrants issued to an accredited investor transferee that were originally issued to Symphony Evolution Holdings LLC in June 2006 in connection with a clinical development financing arrangement. The warrants were exercisable for an aggregate of 294,101 shares of common stock and had an exercise price of $8.90 per share. The number of shares issued upon exercise was reduced by an aggregate of 225,884 shares to effect the cashless exercise of such warrants in accordance with their terms.

On May 13, 2011, we issued an aggregate of 40,906 shares of common stock pursuant to cashless exercises of warrants issued to an accredited investor transferee that were originally issued to Symphony Evolution Holdings LLC in June 2006 in connection with a clinical development financing arrangement. The warrants were exercisable for an aggregate of 176,356 shares of common stock and had an exercise price of $8.90 per share. The number of shares issued upon exercise was reduced by an aggregate of 135,450 shares to effect the cashless exercise of such warrants in accordance with their terms.

On May 27, 2011, we issued an aggregate of 3,361 shares of common stock pursuant to cashless exercises of warrants issued to an accredited investor transferee that were originally issued to Symphony Evolution Holdings LLC in June 2006 in connection with a clinical development

financing arrangement. The warrants were exercisable for an aggregate of 15,009 shares of common stock and had an exercise price of $8.90 per share. The number of shares issued upon exercise was reduced by an aggregate of 11,648 shares to effect the cashless exercise of such warrants in accordance with their terms.

On June 30, 2011, we issued an aggregate of 36,848 shares of common stock pursuant to cashless exercises of warrants issued to an accredited investor transferee that were originally issued to Symphony Evolution Holdings LLC in June 2006 in connection with a clinical development financing arrangement. The warrants were exercisable for an aggregate of 176,356 shares of common stock and had an exercise price of $8.90 per share. The number of shares issued upon exercise was reduced by an aggregate of 139,508 shares to effect the cashless exercise of such warrants in accordance with their terms.

All of the shares of common stock identified above were issued pursuant to the exemption from the registration requirements of the Securities Act of 1933, as amended, or the Securities Act, afforded by Section 3(a)(9) of the Securities Act. We received no cash proceeds from such issuances of common stock.

ITEM 6. EXHIBITS

(a) Exhibits

The exhibits listed on the accompanying exhibit index are filed or incorporated by reference (as stated therein) as part of this Quarterly Report on Form 10-Q.

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Date: August 4, 2011

EXELIXIS, INC.

/s/ Frank Karbe
Frank Karbe

Executive Vice President and Chief Financial Officer

(Principal Financial and Accounting Officer)

Table of Contents

EXHIBIT INDEX

Exhibit Number	Exhibit Description	Incorporation by Reference Form	File Number	Exhibit/ Appendix Reference	Filing Date	Filed Herewith
2.2*	Share Sale and Transfer Agreement, dated November 20, 2007, by and between Taconic Farms, Inc. and Exelixis, Inc.	10-K	000-30235	2.3	2/25/2008	
3.1	Amended and Restated Certificate of Incorporation of Exelixis, Inc.	10-K	000-30235	3.1	3/10/2010	
3.2	Certificate of Amendment of Amended and Restated Certificate of Incorporation of Exelixis, Inc.	10-K	000-30235	3.2	3/10/2010	
3.3	Amended and Restated Bylaws of Exelixis, Inc.	8-K	000-30235	3.1	10/4/2007	
4.1	Specimen Common Stock Certificate.	S-1, as amended	333-96335	4.1	2/7/2000	
4.2	Form of Warrant, dated June 13, 2006, to purchase 750,000 shares of Exelixis, Inc. common stock in favor of Symphony Evolution Holdings LLC.	8-K	000-30235	4.1	6/15/2006	
4.3	Form of Warrant, dated June 10, 2009, to purchase 500,000 shares of Exelixis, Inc. common stock in favor of Symphony Evolution Holdings LLC.	10-Q, as amended	000-30235	4.4	7/30/2009	
4.4*	Warrant Purchase Agreement, dated June 9, 2005, between Exelixis, Inc. and Symphony Evolution Holdings LLC.	10-Q	000-30235	10.8	8/9/2005	
4.5*	Form Warrant to Purchase Common Stock of Exelixis, Inc. issued or issuable to Deerfield Private Design Fund, L.P., Deerfield Private Design International, L.P., Deerfield Partners, L.P. and Deerfield International Limited	8-K	000-30235	4.9	6/9/2008	
4.6	Form of Common Stock Agreement and Warrant Certificate	S-3, as amended	333-158792	4.17	4/24/2009	
4.7	Form of Preferred Stock Agreement and Warrant Certificate	S-3, as amended	333-158792	4.18	4/24/2009	
4.8	Form of Debt Securities Warrant Agreement and Warrant Certificate	S-3, as amended	333-158792	4.19	4/24/2009	
4.9	Form of Senior Debt Indenture	S-3, as amended	333-158792	4.13	5/28/2009	
4.10	Form of Subordinated Debt Indenture	S-3, as amended	333-158792	4.14	5/28/2009	

4.11	Form of Note, dated July 1, 2010, in favor of Deerfield Private Design International, L.P.	10-Q	000-30235	10.1 (Exhibit A-1)	8/5/2010	
4.12	Form of Note, dated July 1, 2010, in favor of Deerfield Private Design Fund, L.P.	10-Q	000-30235	10.1 (Exhibit A-2)	8/5/2010	
10.1	Exelixis, Inc. 2000 Non-Employee Directors Plan.					X
10.2	Exelixis, Inc. 2011 Equity Incentive Plan	8-K	000-30235	10.1	5/24/2011	
10.3	Form of Stock Option Agreement under the Exelixis, Inc. 2011 Equity Incentive Plan					X
10.4	Form of Restricted Stock Unit Agreement under the Exelixis, Inc. 2011 Equity Incentive Plan					X

Table of Contents

Exhibit Number	Exhibit Description	Incorporation by Reference				Filed Herewith
		Form	File Number	Exhibit/ Appendix Reference	Filing Date	
10.5**	Amended and Restated Collaboration Agreement, dated April 15, 2011, by and between Exelixis, Inc. Exelixis Patent Company, LLC and Bristol-Myers Squibb Company (amending and restating the Collaboration Agreement, dated December 15, 2006, by and between Exelixis, Inc. and Bristol-Myers Squibb Company).					X
10.6**	Amended and Restated Collaboration Agreement, dated April 15, 2011, by and between Exelixis, Inc. Exelixis Patent Company, LLC and Bristol-Myers Squibb Company (amending and restating the Collaboration Agreement, dated December 11, 2008, by and between Exelixis, Inc. and Bristol-Myers Squibb Company).					X
10.7**	Amended and Restated License Agreement, dated April 15, 2011, by and between Exelixis, Inc. Exelixis Patent Company, LLC and Bristol-Myers Squibb Company (amending and restating the License Agreement, dated October 8, 2006, by and between Exelixis, Inc. and Bristol-Myers Squibb Company).					X
10.8**	Amended and Restated Collaboration Agreement, dated April 15, 2011, by and between Exelixis, Inc. Exelixis Patent Company, LLC and Bristol-Myers Squibb Company (amending and restating the Collaboration Agreement, dated October 8, 2010, by and between Exelixis, Inc. and Bristol-Myers Squibb Company).					X
31.1	Certification required by Rule 13a-14(a) or Rule 15d-14(a).					X
31.2	Certification required by Rule 13a-14(a) or Rule 15d-14(a).					X
32.1	Certification by the Chief Executive Officer and the Chief Financial Officer of Exelixis, Inc., as required by Rule 13a-14(b) or Rule 15d-14(b) and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350).					X
101.INS#	XBRL Instance Document					X
101.SCH#	XBRL Taxonomy Extension Schema Document					X
101.CAL#	XBRL Taxonomy Extension Calculation Linkbase Document					X
101.LAB#	XBRL Taxonomy Extension Labels Linkbase Document					X
101.PRE#	XBRL Taxonomy Extension Presentation Linkbase Document					X

Table of Contents

Management contract or compensatory plan.

* Confidential treatment granted for certain portions of this exhibit.

** Confidential treatment requested for certain portions of this exhibit.

This certification accompanies this Quarterly Report on Form 10-Q, is not deemed filed with the SEC and is not to be incorporated by reference into any filing of Exelixis, Inc. under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of this Quarterly Report on Form 10-Q), irrespective of any general incorporation language contained in such filing.

Pursuant to applicable securities laws and regulations, we are deemed to have complied with the reporting obligation relating to the submission of interactive data files in such exhibits and are not subject to liability under any anti-fraud provisions of the federal securities laws as long as we have made a good faith attempt to comply with the submission requirements and promptly amend the interactive data files after becoming aware that the interactive data files fail to comply with the submission requirements. In accordance with Rule 406T of Regulation S-T, the information in these exhibits is furnished and deemed not filed or a part of a registration statement or prospectus for purposes of Sections 11 or 12 of the Securities Act of 1933, as amended, is deemed not filed for purposes of Section 18 of the Exchange Act of 1934, as amended, and otherwise is not subject to liability under these sections and shall not be incorporated by reference into any registration statement or other document filed under the Securities Act of 1933, as amended, except as expressly set forth by specific reference in such filing.