Pacira Pharmaceuticals, Inc.
Form 10-Q
August 02, 2018
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, 2018

OR

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

For the transition period from to

Commission File Number: 001-35060

PACIRA PHARMACEUTICALS, INC.
(Exact Name of Registrant as Specified in its Charter)

Delaware	51-0619477
(State or Other Jurisdiction of Incorporation or Organization)	(I.R.S. Employer Identification No.)

5 Sylvan Way, Suite 300
Parsippany, New Jersey, 07054
(Address and Zip Code of Principal Executive Offices)

(973) 254-3560
(Registrant's Telephone Number, Including Area Code)

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

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

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

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

If an emerging growth company, indicate by check mark if the registrant has elected not to use the extended transition period for complying with any new or revised financial accounting standards pursuant to Section 13(a) of the Exchange Act. o

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

As of July 26, 2018, 40,960,416 shares of the registrant's common stock, $0.001 par value per share, were outstanding.

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PACIRA PHARMACEUTICALS, INC.
QUARTERLY REPORT ON FORM 10-Q
FOR THE QUARTER ENDED JUNE 30, 2018
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PART I — FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS (Unaudited)
PACIRA PHARMACEUTICALS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands, except share and per share amounts)
(Unaudited)

	June 30, 2018	December 31, 2017
ASSETS		
Current assets:		
Cash and cash equivalents	$116,871	$ 54,126
Short-term investments	254,450	257,221
Accounts receivable, net	35,641	31,658
Inventories, net	42,053	41,411
Prepaid expenses and other current assets	6,039	6,694
Total current assets	455,054	391,110
Long-term investments	1,601	60,047
Fixed assets, net	111,276	107,046
Goodwill	59,912	55,197
Equity investment	14,146	14,146
Other assets	692	825
Total assets	$642,681	$ 628,371
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$14,260	$ 14,658
Accrued expenses and current portion of deferred revenue	38,434	41,159
Convertible senior notes	330	324
Income taxes payable	—	76
Total current liabilities	53,024	56,217
Convertible senior notes	283,258	276,173
Other liabilities	15,886	16,498
Total liabilities	352,168	348,888
Commitments and contingencies (Note 13)		
Stockholders' equity:		
Preferred stock, par value $0.001; 5,000,000 shares authorized; none issued and outstanding at June 30, 2018 and December 31, 2017	—	—
Common stock, par value $0.001; 250,000,000 shares authorized; 40,954,969 shares issued and outstanding at June 30, 2018; 40,668,877 shares issued and outstanding at December 31, 2017	41	41
Additional paid-in capital	686,888	669,032
Accumulated deficit	(395,871)	(389,136)
Accumulated other comprehensive loss	(545)	(454)
Total stockholders' equity	290,513	279,483
Total liabilities and stockholders' equity	$642,681	$ 628,371

See accompanying condensed notes to consolidated financial statements.

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PACIRA PHARMACEUTICALS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Revenues:				
Net product sales	$80,717	$70,139	$155,004	$138,564
Collaborative licensing and milestone revenue	3,000	130	3,000	336
Royalty revenue	390	665	710	1,317
Total revenues	84,107	70,934	158,714	140,217
Operating expenses:				
Cost of goods sold	20,916	23,811	43,801	48,392
Research and development	12,239	18,856	26,617	35,487
Selling, general and administrative	44,249	39,552	88,439	81,672
Product discontinuation	162	4,495	252	4,495
Total operating expenses	77,566	86,714	159,109	170,046
Income (loss) from operations	6,541	(15,780)	(395)	(29,829)
Other (expense) income:				
Interest income	1,533	1,224	2,906	1,738
Interest expense	(5,397)	(5,226)	(10,553)	(7,815)
Loss on early extinguishment of debt	—	(11)	—	(3,732)
Other, net	(78)	80	(4)	89
Total other expense, net	(3,942)	(3,933)	(7,651)	(9,720)
Income (loss) before income taxes	2,599	(19,713)	(8,046)	(39,549)
Income tax expense	(35)	(30)	(70)	(60)
Net income (loss)	$2,564	$(19,743)	$(8,116)	$(39,609)
Net income (loss) per share:				
Basic and diluted net income (loss) per common share	$0.06	$(0.49)	$(0.20)	$(1.01)
Weighted average common shares outstanding:				
Basic	40,796	40,160	40,751	39,079
Diluted	41,694	40,160	40,751	39,079

See accompanying condensed notes to consolidated financial statements.

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PACIRA PHARMACEUTICALS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME (LOSS)

(In thousands)
(Unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net income (loss)	$2,564	$(19,743)	$(8,116)	$(39,609)
Other comprehensive income (loss):				
Net unrealized gain (loss) on investments	356	18	(91)	(34)
Total other comprehensive income (loss)	356	18	(91)	(34)
Comprehensive income (loss)	$2,920	$(19,725)	$(8,207)	$(39,643)

See accompanying condensed notes to consolidated financial statements.

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PACIRA PHARMACEUTICALS, INC.
CONDENSED CONSOLIDATED STATEMENT OF STOCKHOLDERS' EQUITY
FOR THE SIX MONTHS ENDED JUNE 30, 2018

(In thousands)
(Unaudited)

	Common Stock		Additional Paid-In Capital	Accumulated Deficit	Accumulated Other Comprehensive Loss	Total
	Shares	Amount				
Balance at December 31, 2017	40,669	$ 41	$669,032	$(389,136)	$ (454)	$279,483
Cumulative effect adjustment of the adoption of Accounting Standards Update 2014-09 (Note 2)	—	—	—	1,361	—	1,361
Cumulative effect adjustment of the adoption of Accounting Standards Update 2018-07 (Note 2)	—	—	(20)	20	—	—
Exercise of stock options	103	—	1,492	—	—	1,492
Vested restricted stock units	148	—	—	—	—	—
Shares issued under employee stock purchase plan	35	—	952	—	—	952
Stock-based compensation	—	—	15,432	—	—	15,432
Net unrealized loss on investments	—	—	—	—	(91)	(91)
Net loss	—	—	—	(8,116)	—	(8,116)
Balance at June 30, 2018	40,955	$ 41	$686,888	$(395,871)	$ (545)	$290,513

See accompanying condensed notes to consolidated financial statements.

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PACIRA PHARMACEUTICALS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)
(Unaudited)

	Six Months Ended June 30,	
	2018	2017 (Note 2)
Operating activities:		
Net loss	$(8,116)	$(39,609)
Adjustments to reconcile net loss to net cash provided by operating activities:		
Depreciation of fixed assets	5,610	6,813
Amortization of unfavorable lease obligation and debt issuance costs	786	524
Amortization of debt discount	6,283	4,362
Loss on early extinguishment of debt	—	3,732
Loss on disposal of fixed assets	10	2,030
Stock-based compensation	15,432	14,744
Changes in operating assets and liabilities:		
Accounts receivable, net	(3,640)	2,470
Inventories, net	(642)	(2,324)
Prepaid expenses and other assets	102	1,849
Accounts payable	(2,826)	2,149
Accrued expenses and income taxes payable	(2,303)	8,402
Other liabilities	325	(1,480)
Net cash provided by operating activities	11,021	3,662
Investing activities:		
Purchases of fixed assets	(7,818)	(8,771)
Purchases of investments	(182,749)	(274,791)
Sales of investments	244,562	82,782
Payment of contingent consideration	(4,715)	(4,206)
Net cash provided by (used in) investing activities	49,280	(204,986)
Financing activities:		
Proceeds from exercise of stock options	1,492	2,613
Proceeds from shares issued under employee stock purchase plan	952	1,056
Proceeds from 2022 convertible senior notes	—	345,000
Repayment of 2019 convertible senior notes	—	(118,191)
Payment of debt issuance and financing costs	—	(11,000)
Costs for conversions of convertible senior notes	—	(284)
Net cash provided by financing activities	2,444	219,194
Net increase in cash and cash equivalents	62,745	17,870
Cash and cash equivalents, beginning of period	54,126	35,944
Cash and cash equivalents, end of period	$116,871	$53,814
Supplemental cash flow information:		
Cash paid for interest	$4,102	$2,384
Cash paid for income taxes, net of refunds	$146	$133
Non-cash investing and financing activities:		
Issuance of common stock from conversion of 2019 convertible senior notes	$—	$120,960
Retirement of equity component of 2019 convertible senior notes	$—	$(126,326)

Net increase in accrued fixed assets	$2,032	$2,294

See accompanying condensed notes to consolidated financial statements.

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PACIRA PHARMACEUTICALS, INC.
CONDENSED NOTES TO CONSOLIDATED FINANCIAL STATEMENTS
(Unaudited)

NOTE 1—DESCRIPTION OF BUSINESS

Pacira Pharmaceuticals, Inc. and its subsidiaries (collectively, the "Company" or "Pacira") is a specialty pharmaceutical company focused on the development, manufacture and commercialization of pharmaceutical products, based on its proprietary DepoFoam® extended release drug delivery technology, for use primarily in hospitals and ambulatory surgery centers. Pacira is committed to driving innovation in postsurgical pain management by improving patient outcomes through the use of opioid-reducing strategies.

The Company's lead product, EXPAREL® (bupivacaine liposome injectable suspension), which consists of bupivacaine encapsulated in DepoFoam, was approved by the United States Food and Drug Administration, or FDA, on October 28, 2011 and launched commercially in April 2012. The Company also sells its bupivacaine liposome injectable suspension product to a commercial partner to serve animal health indications.

Pacira is subject to risks common to companies in similar industries and stages of development, including, but not limited to, competition from larger companies, reliance on revenue from one product, reliance on a single manufacturing site, new technological innovations, dependence on key personnel, reliance on third-party service providers and sole source suppliers, protection of proprietary technology and compliance with government regulations.

NOTE 2—SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Basis of Presentation and Principles of Consolidation

These interim condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles in the United States of America, or GAAP, and in accordance with the rules and regulations of the Securities and Exchange Commission, or SEC, for interim reporting. Pursuant to these rules and regulations, certain information and footnote disclosures normally included in complete annual financial statements have been condensed or omitted. Therefore, these interim condensed consolidated financial statements should be read in conjunction with the audited annual consolidated financial statements and notes thereto included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017.

The condensed consolidated financial statements at June 30, 2018, and for the three and six month periods ended June 30, 2018 and 2017, are unaudited, but include all adjustments (consisting of only normal recurring adjustments) which, in the opinion of management, are necessary to present fairly the financial information set forth herein in accordance with GAAP. The condensed consolidated balance sheet at December 31, 2017 is derived from the audited consolidated financial statements included in the Company's Annual Report on Form 10-K for the year ended December 31, 2017. The consolidated financial statements as presented reflect certain reclassifications from previously issued financial statements to conform to the current year presentation. The accounts of wholly-owned subsidiaries are included in the condensed consolidated financial statements. Intercompany accounts and transactions have been eliminated in consolidation.

The results of operations for the interim periods are not necessarily indicative of results that may be expected for any other interim periods or for the full year.

Concentration of Major Customers

The Company sells EXPAREL through a drop-ship program under which orders are processed through wholesalers (including AmerisourceBergen Health Corporation, Cardinal Health, Inc. and McKesson Drug Company), but shipments of the product are sent directly to individual accounts, such as hospitals, ambulatory surgery centers and individual doctors. The table below includes the percentage of sales processed by the Company's three largest wholesalers in each period presented:

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	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Largest wholesaler	33%	35%	33%	35%
Second largest wholesaler	29%	29%	30%	29%
Third largest wholesaler	25%	25%	26%	25%
Total	87%	89%	89%	89%

Recently Adopted Accounting Pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, 2014-09, Revenue from Contracts with Customers, and subsequently issued a number of amendments to this update. The new standard, as amended in Accounting Standards Codification, or ASC, 606, provides a single comprehensive model to be used in accounting for revenue arising from contracts with customers and supersedes previous revenue recognition guidance. The standard's stated core principle is that an entity should recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. In addition, the standard requires disclosure of the nature, amount, timing and uncertainty of revenue and cash flows arising from contracts with customers.

The Company adopted this standard on January 1, 2018 using the modified retrospective method and recorded a cumulative effect adjustment of $1.4 million to accumulated deficit upon adoption—with the impact related to the acceleration of $1.0 million of deferred revenue and $0.4 million of royalties. Under the modified retrospective method of adoption, the comparative information in the consolidated financial statements has not been revised and continues to be reported under the previously applicable revenue accounting guidance, ASC 605. The implementation of ASC 606 did not have a material impact on the Company's consolidated statements of operations because the timing of revenue recognition for EXPAREL product sales did not change. The Company is recognizing existing collaborative licensing, milestone and royalty revenue earlier, subject to the variable consideration constraints, than it would have under the previous standard. If ASC 605 had been applied to each of the first and second quarters of 2018, deferred revenue would have been $1.0 million higher on the consolidated balance sheet, with $0.1 million in accrued expenses and current portion of deferred revenue and $0.9 million in other liabilities. Under ASC 605, royalty revenue and accounts receivable for both the three and six months ended June 30, 2018 would have been lower by $0.4 million.

For additional information regarding the Company's revenue, see Note 3, Revenue.

In January 2016, the FASB issued ASU 2016-01, Financial Instruments—Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities. ASU 2016-01 changes accounting for equity investments and presentation and disclosure requirements for financial instruments. ASU 2016-01 does not apply to equity investments in consolidated subsidiaries or those accounted for under the equity method of accounting. Equity investments with readily determinable fair values will be measured at fair value with changes in fair value recognized in net income (loss). Entities have the option to measure equity investments without readily determinable fair values either at fair value or at cost minus impairment, if any, plus or minus changes resulting from observable price changes in orderly transactions for the identical or a similar investment of the same issuer. The standard also simplifies the impairment assessment of equity investments without readily determinable fair values by requiring a qualitative assessment to identify impairment. When a qualitative assessment indicates that impairment exists, an entity is required to measure the investment at fair value. ASU 2016-01 became effective for the Company beginning January 1, 2018. The Company has elected to measure equity investments without readily determinable fair values at cost

adjusted for changes in observable prices. The guidance related to equity investments without readily determinable fair values is being applied prospectively to the Company's investment in TELA Bio, Inc. The adoption of ASU 2016-01 may increase volatility in the Company's net income as changes in observable prices of equity investments without readily determinable fair values will be recorded in net income (loss). The implementation of this standard did not have a material impact on the Company's consolidated financial statements and related disclosures.

In August 2016, the FASB issued ASU 2016-15, Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments, which clarifies existing guidance on how companies present and classify certain cash receipts and cash payments in the statement of cash flows by addressing specific cash flow issues in an effort to reduce diversity in practice, including guidance on debt prepayment or extinguishment costs and contingent consideration payments made after a business combination. ASU 2016-15 became effective for the Company on January 1, 2018 and did not have a material impact on the Company's consolidated statement of cash flows.

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In June 2018, the FASB issued ASU 2018-07, Compensation—Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting, which aligns accounting for share-based payments issued to nonemployees to that of employees under the existing guidance of Topic 718, with certain exceptions. This update supersedes previous guidance for equity-based payments to nonemployees under Subtopic 505-50, Equity—Equity-Based Payments to Non-Employees. The Company chose to early adopt ASU 2018-07 in June 2018 and recorded a cumulative effect adjustment of less than $0.1 million to accumulated deficit upon adoption.

Recent Accounting Pronouncements Not Adopted as of June 30, 2018

In February 2016, the FASB issued ASU 2016-02, Leases (Topic 842) and subsequently issued clarifications and corrections to the update by issuing ASU 2018-10 in July 2018. This update requires lessees to recognize lease assets and lease liabilities on the balance sheet for those leases classified as operating leases under previous authoritative guidance. The lease liability will be equal to the present value of lease payments and the right-of-use asset will be based on the lease liability, subject to adjustment for items such as initial direct costs. For income statement purposes, the new standard retains a dual model similar to ASC 840, requiring leases to be classified as either operating or financing. For lessees, operating leases will result in straight-line expense (similar to current accounting by lessees for operating leases under ASC 840) while financing leases will result in a front-loaded expense pattern (similar to current accounting by lessees for capital leases under ASC 840). This update also introduces new disclosure requirements for leasing arrangements. The standard will become effective for the Company beginning January 1, 2019. Early adoption is permitted, although the Company does not expect to do so. The Company is currently evaluating the impact of ASU 2016-02 on its consolidated financial statements. For operating leases it will result in the recognition of lease liabilities and corresponding right-of-use assets upon adoption, which will have a material impact on the Company's consolidated balance sheet. The Company does not believe the adoption of this ASU will have a significant impact on its consolidated statements of operations, stockholders' equity or cash flows. At adoption, this update will be applied using a modified retrospective approach. Refer to Note 13, Commitments and Contingencies, for further discussion on the Company's leases.

In June 2016, the FASB issued ASU 2016-13, Financial Instruments—Credit Losses (Topic 326), which requires entities to measure all expected credit losses for financial assets held at the reporting date based on historical experience, current conditions and reasonable and supportable forecasts. Entities will now use forward-looking information to better form their credit loss estimates. This update also requires enhanced disclosures to help financial statement users better understand significant estimates and judgments used in estimating credit losses, as well as the credit quality and underwriting standards of an entity's portfolio. This ASU will become effective for the Company beginning January 1, 2020, with early adoption permitted. The Company is currently evaluating the impact of ASU 2016-13 on its consolidated financial statements.

Other pronouncements issued by the FASB or other authoritative accounting standards groups with future effective dates are either not applicable or not significant to the consolidated financial statements of the Company.

NOTE 3—REVENUE

Revenue from Contracts with Customers

The Company's sources of revenue include (i) sales of EXPAREL in the U.S.; (ii) sales of its bupivacaine liposome injectable suspension product for use in animal health indications in the U.S.; (iii) royalties based on sales of its bupivacaine liposome injectable suspension product for use in animal health indications; and (iv) license fees and milestone payments. The majority of the Company's revenue is derived from sales of EXPAREL. The Company does not consider revenue from other product sales, collaborative licensing, milestones and royalties to be material sources

of its consolidated revenue. As such, the following disclosure only relates to revenue associated with net EXPAREL product sales.

Net Product Sales

The Company sells EXPAREL through a drop-ship program under which orders are processed through wholesalers based on orders of the product placed by end-users which include hospitals, ambulatory surgery centers and doctors. EXPAREL is delivered directly to the end-user without the wholesaler ever taking physical possession of the product. Product revenue is recognized when control of the promised goods are transferred to the customers, in an amount that reflects the consideration the Company expects to be entitled to in exchange for transferring those goods. EXPAREL revenue is recorded at the time the product is delivered to the end-user.

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Revenues from sales of products are recorded net of returns allowances, prompt payment discounts, wholesaler service fees, volume rebates and chargebacks. These reserves are based on estimates of the amounts earned or to be claimed on the related sales. These amounts are treated as variable consideration, estimated and recognized as a reduction of the transaction price at the time of the sale, using the most likely amount method for the gross to net adjustments, except for returns, which is based on the expected value method. The Company includes these estimated amounts in the transaction price to the extent it is probable that a significant reversal of cumulative revenue recognized for such transaction will not occur, or when the uncertainty associated with the variable consideration is resolved. The calculation of some of these items requires management to make estimates based on sales data, historical return data, contracts and other related information that may become known in the future. The adequacy of these provisions is reviewed on a quarterly basis.

Accounts Receivable

The majority of accounts receivable arise from product sales and represent amounts due from wholesalers, hospitals, ambulatory surgery centers and doctors. Payment terms generally range from zero to 37 days from the date of the transaction so there is no significant financing component.

Performance Obligations

A performance obligation is a promise in a contract to transfer a distinct good or service to the customer and is the unit of account in ASC 606. A contract's transaction price is allocated to each distinct performance obligation and recognized as revenue when, or as, the performance obligation is satisfied.

At contract inception, the Company assesses the goods promised in its contracts with customers and identifies a performance obligation for each promise to transfer to the customer a good that is distinct. When identifying individual performance obligations, the Company considers all goods promised in the contract regardless of whether explicitly stated in the customer contract or implied by customary business practices. The Company's contracts with customers require it to transfer an individual distinct product, which represents a single performance obligation. The Company's performance obligation with respect to its product sales are satisfied at a point in time, which transfers control upon delivery of EXPAREL to its customers. The Company considers control to have transferred upon delivery because the customer has legal title to the asset, physical possession of the asset has been transferred, the customer has significant risks and rewards of ownership of the asset and the Company has a present right to payment at that time.

Disaggregated Revenue

The following table represents disaggregated net product sales in the periods presented as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Net product sales:				
EXPAREL	$80,430	$69,773	$154,464	$137,474
Other product sales	287	366	540	1,090
Total net product sales	$80,717	$70,139	$155,004	$138,564

NOTE 4—INVENTORIES

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

	June 30, 2018	December 31, 2017
Raw materials	$16,070	$ 16,500
Work-in-process	7,331	8,371
Finished goods	18,652	16,540
Total	$42,053	$ 41,411

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NOTE 5—FIXED ASSETS

Fixed assets, summarized by major category, consist of the following (in thousands):

	June 30, 2018	December 31, 2017
Machinery and laboratory equipment	$41,809	$39,002
Leasehold improvements	34,932	34,933
Computer equipment and software	7,448	7,086
Office furniture and equipment	1,420	1,603
Construction in progress	79,670	73,632
Total	165,279	156,256
Less: accumulated depreciation	(54,003)	(49,210)
Fixed assets, net	$111,276	$107,046

For the three months ended June 30, 2018 and 2017, depreciation expense was $2.8 million and $3.7 million, respectively. For each of the three and six month periods ended June 30, 2018 and 2017, capitalized interest on the construction of manufacturing sites was $0.2 million.

For the six months ended June 30, 2018 and 2017, depreciation expense was $5.6 million and $6.8 million, respectively. For the six months ended June 30, 2018 and 2017, capitalized interest on the construction of manufacturing sites was $0.6 million and $0.4 million, respectively.

At June 30, 2018 and December 31, 2017, total fixed assets, net, includes leasehold improvements and manufacturing process equipment located in England in the amount of $65.2 million and $59.8 million, respectively.

NOTE 6—GOODWILL

In March 2007, the Company acquired from SkyePharma Holding, Inc., or Skyepharma, its California operating subsidiary, referred to herein as the Acquisition. The Company’s goodwill arose in April 2012 from a contingent milestone payment to Skyepharma in connection with the Acquisition. The Acquisition was accounted for under Statement of Financial Accounting Standards 141, Accounting for Business Combinations, which was the effective GAAP standard at the Acquisition date. In connection with the Acquisition, the Company agreed to certain earn-out payments based on a percentage of net sales of DepoBupivacaine products collected, including EXPAREL and certain other yet-to-be-developed products, as well as milestone payments for DepoBupivacaine products, including EXPAREL, as follows:

(i) $10.0 million upon the first commercial sale in the United States (met April 2012);
(ii) $4.0 million upon the first commercial sale in a major E.U. country (United Kingdom, France, Germany, Italy and Spain);
(iii) $8.0 million when annual net sales collected reach $100.0 million (met September 2014);
(iv) $8.0 million when annual net sales collected reach $250.0 million (met June 2016); and
(v) $32.0 million when annual net sales collected reach $500.0 million.

The first milestone was met in April 2012, resulting in a $10.0 million payment to Skyepharma. The Company recorded this payment net of a $2.0 million contingent consideration liability recognized at the time of the Acquisition, resulting in $8.0 million recorded as goodwill. In September 2014, the Company recorded an $8.0 million milestone in connection with achieving $100.0 million of annual EXPAREL net sales collected, and in June 2016, the Company recorded another $8.0 million milestone for achieving $250.0 million of annual EXPAREL net sales

collected. For purposes of meeting future potential milestone payments, with certain exceptions, annual net sales are measured on a rolling quarterly basis. Cumulatively through June 30, 2018, the Company has recorded an additional $35.9 million as goodwill for earn-out payments that are based on a percentage of net sales of DepoBupivacaine products collected, including EXPAREL. Any remaining earn-out payments will also be treated as additional costs of the Acquisition and, therefore, recorded as goodwill if and when each contingency is resolved.

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The change in the carrying value of goodwill is summarized as follows (in thousands):

	Carrying Value
Balance at December 31, 2017	$55,197
Percentage payments on collections of net sales of DepoBupivacaine products	4,715
Balance at June 30, 2018	$59,912

NOTE 7—DEBT

Convertible Senior Notes Due 2022

On March 13, 2017, the Company completed a private placement of $345.0 million in aggregate principal amount of 2.375% convertible senior notes due 2022, or 2022 Notes, and entered into an indenture, or 2022 Indenture, with respect to the 2022 Notes. The 2022 Notes accrue interest at a fixed rate of 2.375% per year, payable semiannually in arrears on April 1 and October 1 of each year. The 2022 Notes mature on April 1, 2022.

The total debt composition of the 2022 Notes is as follows (in thousands):

	June 30, 2018	December 31, 2017
2.375% convertible senior notes due 2022	$345,000	$345,000
Deferred financing costs	(6,675)	(7,482)
Discount on debt	(55,067)	(61,345)
Total debt, net of debt discount and deferred financing costs	$283,258	$276,173

The net proceeds from the issuance of the 2022 Notes were $334.0 million, after deducting commissions and the offering expenses paid by the Company. A portion of the net proceeds from the 2022 Notes were used by the Company to repurchase the majority of its then-outstanding 3.25% convertible senior notes due 2019 in privately-negotiated transactions.

Holders may convert their 2022 Notes prior to October 1, 2021 only if certain circumstances are met, including if during the previous calendar quarter, the last reported sales price of the Company’s common stock was greater than 130% of the conversion price then applicable for at least 20 out of the last 30 consecutive trading days of the quarter. During the quarter ended June 30, 2018, this condition for conversion was not met.

On or after October 1, 2021, until the close of business on the second scheduled trading day immediately preceding April 1, 2022, holders may convert their 2022 Notes at any time.

Upon conversion, holders will receive the principal amount of their 2022 Notes and any excess conversion value, calculated based on the per share volume-weighted average price for each of the 40 consecutive trading days during the observation period (as more fully described in the 2022 Indenture). For both the principal and excess conversion value, holders may receive cash, shares of the Company’s common stock or a combination of cash and shares of the Company’s common stock, at the Company’s option. The initial conversion rate for the 2022 Notes is 14.9491 shares of common stock per $1,000 principal amount, which is equivalent to an initial conversion price of $66.89 per share of the Company’s common stock. The conversion rate will be subject to adjustment in some events but will not be adjusted for any accrued and unpaid interest. The initial conversion price of the 2022 Notes represents a premium of approximately 37.5% to the closing sale price of $48.65 per share of the Company’s common stock on the NASDAQ Global Select Market on March 7, 2017, the date that the Company priced the private offering of the 2022 Notes.

As of June 30, 2018, the 2022 Notes had a market price of $934 per $1,000 principal amount. In the event of conversion, holders would forgo all future interest payments, any unpaid accrued interest and the possibility of stock price appreciation. Upon the receipt of conversion requests, the settlement of the 2022 Notes will be paid pursuant to the terms of the 2022 Indenture. In the event that all of the 2022 Notes are converted, the Company would be required to repay the $345.0 million in principal value and any conversion premium in any combination of cash and shares of its common stock (at the Company's option).

Prior to April 1, 2020, the Company may not redeem the 2022 Notes. On or after April 1, 2020, the Company may redeem for cash, shares of the Company's common stock or a combination of cash and shares of the Company's common stock, at the

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Company's option, all or part of the 2022 Notes if the last reported sale price (as defined in the 2022 Indenture) of the Company's common stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive) during any 30 consecutive trading-day period ending within five trading days prior to the date on which the Company provides notice of redemption. The redemption price will equal the sum of (i) 100% of the principal amount of the 2022 Notes being redeemed, plus (ii) accrued and unpaid interest, including additional interest, if any, to, but excluding, the redemption date. In addition, calling the 2022 Notes for redemption will constitute a "make whole fundamental change" (as defined in the 2022 Indenture) and will, in certain circumstances, increase the conversion rate applicable to the conversion of such notes if it is converted in connection with the redemption. No sinking fund is provided for the 2022 Notes.

While the 2022 Notes are currently classified on the Company's consolidated balance sheet at June 30, 2018 as long-term debt, the future convertibility and resulting balance sheet classification of this liability will be monitored at each quarterly reporting date and will be analyzed dependent upon market prices of the Company's common stock during the prescribed measurement periods. In the event that the holders of the 2022 Notes have the right to convert the 2022 Notes at any time during the prescribed measurement period, the 2022 Notes would then be considered a current obligation and classified as such.

Under ASC 470-20, Debt with Conversion and Other Options, an entity must separately account for the liability and equity components of convertible debt instruments (such as the 2022 Notes) that may be settled entirely or partially in cash upon conversion in a manner that reflects the issuer's economic interest cost. The liability component of the instrument is valued in a manner that reflects the market interest rate for a similar nonconvertible instrument at the date of issuance. The initial carrying value of the liability component of $274.1 million was calculated using a 7.45% assumed borrowing rate. The equity component of $70.9 million, representing the conversion option, was determined by deducting the fair value of the liability component from the par value of the 2022 Notes and was recorded in additional paid-in capital on the consolidated balance sheet at the issuance date. That equity component is treated as a discount on the liability component of the 2022 Notes, which is amortized over the five-year term of the 2022 Notes using the effective interest rate method. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

The Company allocated the total transaction costs of $11.0 million related to the issuance of the 2022 Notes to the liability and equity components of the 2022 Notes based on their relative values. Transaction costs attributable to the liability component are amortized to interest expense over the five-year term of the 2022 Notes, and transaction costs attributable to the equity component are netted with the equity component in stockholders' equity.

Convertible Senior Notes Due 2019

On January 23, 2013, the Company completed a private placement of $120.0 million in aggregate principal amount of 3.25% convertible senior notes due 2019, or 2019 Notes. The 2019 Notes accrue interest at a fixed rate of 3.25% per year, payable semiannually in arrears on February 1 and August 1 of each year. The 2019 Notes mature on February 1, 2019.

The total debt composition of the 2019 Notes is as follows (in thousands):

	June 30, 2018	December 31, 2017
3.25% convertible senior notes due 2019	$338	$ 338
Deferred financing costs	(1)	(2)
Discount on debt	(7)	(12)
Total debt, net of debt discount and deferred financing costs	$330	$ 324

In March 2017, the Company used part of the net proceeds from the issuance of the 2022 Notes discussed above to repurchase $117.7 million aggregate principal of the 2019 Notes in privately-negotiated transactions for an aggregate of approximately $118.2 million in cash and the issuance of an aggregate of approximately 2.5 million shares of common stock. The partial repurchase of the 2019 Notes resulted in a $3.7 million loss on early debt extinguishment. In May 2017, the Company repurchased $0.5 million aggregate principal of the 2019 Notes in a privately-negotiated transaction for an aggregate of approximately $0.5 million in cash and the issuance of an aggregate of approximately ten thousand shares of common stock.

The 2019 Notes are convertible at any time. As of June 30, 2018, the 2019 Notes had a market price of $1,320 per $1,000 principal amount, compared to an estimated conversion value of $1,291 per $1,000 principal amount. In the event that the remaining 2019 Notes are converted, the Company would be required to repay approximately $0.3 million of principal value in cash and settle approximately $0.1 million of the conversion premium in cash, common stock or a combination of cash and shares of its common stock, at the Company’s option as of June 30, 2018.

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Interest Expense

The following table sets forth the total interest expense recognized in the periods presented (dollar amounts in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Contractual interest expense	$2,051	$2,053	$4,102	$3,242
Amortization of debt issuance costs	406	389	808	590
Amortization of debt discount	3,170	2,951	6,283	4,362
Capitalized interest and other (Note 5)	(230)	(167)	(640)	(379)
Total	$5,397	$5,226	$10,553	$7,815
Effective interest rate on convertible senior notes	7.81%	7.81%	7.81%	7.70%

NOTE 8—FINANCIAL INSTRUMENTS

Fair Value Measurements

Fair value is defined as the price that would be received to sell an asset or be paid to transfer a liability in the principal or most advantageous market in an orderly transaction. To increase consistency and comparability in fair value measurements, the FASB established a three-level hierarchy which requires an entity to maximize the use of observable inputs and minimize the use of unobservable inputs when measuring fair value. The three levels of fair value measurements are:

- Level 1—Quoted prices (unadjusted) in active markets that are accessible at the measurement date for assets or liabilities. The fair value hierarchy gives the highest priority to Level 1 inputs.

- Level 2—Observable prices that are based on inputs not quoted on active markets, but corroborated by market data.

- Level 3—Unobservable inputs that are used when little or no market data is available. The fair value hierarchy gives the lowest priority to Level 3 inputs.

The carrying value of financial instruments including cash and cash equivalents, accounts receivable and accounts payable approximate their respective fair values due to the short-term nature of these items. The fair value of the Company's convertible senior notes at June 30, 2018 are calculated utilizing market quotations from an over-the-counter trading market for these instruments (Level 2). The carrying amount and fair value of the Company's convertible senior notes are as follows (in thousands):

Financial Liabilities Carried at Historical Cost	Carrying Value	Fair Value Measurements Using		
June 30, 2018		Level 1	Level 2	Level 3
2.375% convertible senior notes due 2022 [1]	$283,258	$—	$322,351	$—
3.25% convertible senior notes due 2019 [2]	$330	$—	$446	$—

(1) The closing price of the Company's common stock was $32.05 per share at June 30, 2018 compared to a conversion price of $66.89 per share. Currently, the conversion price is above the stock price. The maximum conversion premium that can be due on the 2022 Notes is approximately 5.2 million shares of the Company's common stock, which assumes no increases in the conversion rate for certain corporate events.

(2) The closing price of the Company's common stock was $32.05 per share at June 30, 2018 compared to a conversion price of $24.82 per share which, if converted, would result in a conversion premium of less than ten thousand shares of the Company's common stock or $0.1 million of cash. The maximum conversion premium that can be due on the 2019 Notes is approximately ten thousand shares of the Company's common stock, which assumes no increases in the conversion rate for certain corporate events.

Short-term investments consist of asset-backed securities collateralized by credit card receivables, investment grade commercial paper and corporate bonds with maturities greater than three months, but less than one year. Long-term investments consist of asset-backed securities collateralized by credit card receivables and corporate bonds with maturities greater than one year. Net unrealized gains and losses from the Company's short-term and long-term investments are reported in other comprehensive income (loss). At June 30, 2018, all of the Company's short-term and long-term investments are classified as available for sale investments and are determined to be Level 2 instruments, which are measured at fair value using standard

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industry models with observable inputs. The fair value of the commercial paper is measured based on a standard industry model that uses the three-month U.S. Treasury bill rate as an observable input. The fair value of the asset-backed securities and corporate bonds is principally measured or corroborated by trade data for identical issues in which related trading activity is not sufficiently frequent to be considered a Level 1 input or that of comparable securities. At June 30, 2018, all short-term and long-term investments were rated A or better by Standard & Poor's.

The following summarizes the Company's investments at June 30, 2018 and December 31, 2017 (in thousands):

June 30, 2018 Debt Securities	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Level 2)
Short-term:				
Asset-backed securities	$47,341	$ —	$ (152)	$47,189
Commercial paper	72,447	8	(3)	72,452
Corporate bonds	135,206	—	(397)	134,809
Subtotal	254,994	8	(552)	254,450
Long-term:				
Corporate bonds	1,602	—	(1)	1,601
Subtotal	1,602	—	(1)	1,601
Total	$256,596	$ 8	$ (553)	$256,051

December 31, 2017 Debt Securities	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value (Level 2)
Short-term:				
Asset-backed securities	$28,338	$ —	$ (37)	$28,301
Commercial paper	48,999	—	(23)	48,976
Corporate bonds	180,119	—	(175)	179,944
Subtotal	257,456	—	(235)	257,221
Long-term:				
Asset-backed securities	23,836	—	(79)	23,757
Corporate bonds	36,430	—	(140)	36,290
Subtotal	60,266	—	(219)	60,047
Total	$317,722	$ —	$ (454)	$317,268

Certain assets and liabilities are measured at fair value on a nonrecurring basis, including assets and liabilities acquired in a business combination, and long-lived assets, which would be recognized at fair value if deemed to be impaired or if reclassified as assets held for sale. The fair value in these instances would be determined using Level 3 inputs.

TELA Bio, Inc.

In October 2017, the Company made a cash investment of $15.0 million in Series B Preferred Stock of TELA Bio Inc., or TELA Bio, a privately-held surgical reconstruction company that markets its proprietary OviTex™ portfolio of products for ventral hernia repair and abdominal wall reconstruction. In conjunction with the investment in TELA Bio, the Company acquired an option to purchase an additional $10.0 million of Series B Preferred Stock under the same terms and conditions as existed on the initial purchase date. The purchase option expires on September 15, 2018. If the Company does not exercise its purchase option, the Company may be required to invest up to $10.0 million in Series B Preferred Stock under certain conditions. This contingent purchase obligation expires on October 31, 2018. The investment in TELA Bio, the purchase option and the contingent purchase obligation were recorded at fair value based on integrated valuation pricing models. These models included both unobservable and observable market inputs including option purchase price, volatility and projected liquidity date. The equity investment in the Series B Preferred Stock was recorded at $14.1 million and the purchase option was recorded in prepaid expenses and other current assets at $0.9 million. The fair value of the contingent purchase obligation was determined to be de minimis.

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Credit Risk

Financial instruments that potentially subject the Company to concentrations of credit risk consist primarily of cash and cash equivalents, short-term investments, long-term investments and accounts receivable. The Company maintains its cash and cash equivalents with high-credit quality financial institutions. Such amounts may exceed federally-insured limits.

As of June 30, 2018, three wholesalers each accounted for over 10% of the Company's accounts receivable, at 31%, 28% and 24%, respectively. At December 31, 2017, three wholesalers each accounted for over 10% of the Company's accounts receivable, at 35%, 30% and 27%, respectively. For additional information regarding the Company's wholesalers, see Note 2, Summary of Significant Accounting Policies. Revenues are primarily derived from major wholesalers and pharmaceutical companies that generally have significant cash resources. The Company performs ongoing credit evaluations of its customers as warranted and generally does not require collateral. Allowances for doubtful accounts receivable are maintained based on historical payment patterns, aging of accounts receivable and the Company's actual write-off history. As of June 30, 2018 and December 31, 2017, no allowances for doubtful accounts were deemed necessary by the Company on its accounts receivable.

NOTE 9—STOCK PLANS

Stock-Based Compensation

The Company recognized stock-based compensation expense in the periods presented as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Cost of goods sold	$1,046	$1,395	$2,252	$2,770
Research and development	951	647	1,648	1,304
Selling, general and administrative	5,050	5,303	11,532	10,670
Total	$7,047	$7,345	$15,432	$14,744
Stock-based compensation from:				
Stock options (employee awards)	$4,827	$5,741	$11,182	$11,658
Stock options (consultant awards)	202	29	241	83
Restricted stock units (employee awards)	1,819	1,389	3,609	2,611
Employee stock purchase plan	199	186	400	392
Total	$7,047	$7,345	$15,432	$14,744

Equity Awards

The following tables contain information about the Company's stock option and restricted stock unit, or RSU, activity for the six months ended June 30, 2018:

Stock Options	Number of Options	Weighted Average Exercise Price
Outstanding at December 31, 2017	4,951,493	$ 43.51
Granted	1,683,007	38.33
Exercised	(103,263)	14.45

Forfeited	(242,188)	44.43
Expired	(253,483)	64.19
Outstanding at June 30, 2018	6,035,566	41.65

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Restricted Stock Units	Number of Units	Weighted Average Grant Date Fair Value
Unvested at December 31, 2017	499,546	$ 47.32
Granted	327,779	38.33
Vested	(147,844)	49.70
Forfeited	(42,722)	45.86
Unvested at June 30, 2018	636,759	42.23

The weighted average fair value of stock options granted during the six months ended June 30, 2018 was $18.85 per share. The fair values of stock options granted were estimated using the Black-Scholes option valuation model with the following weighted average assumptions:

	Six Months Ended June 30, 2018
Expected dividend yield	None
Risk-free interest rate	2.78%
Expected volatility	53.2%
Expected term of options	5.21 years

Employee Stock Purchase Plan

The Company's 2014 Employee Stock Purchase Plan, or ESPP, features two six-month offering periods per year, running from January 1 to June 30 and July 1 to December 31. Under the ESPP, employees may elect to contribute after-tax earnings to purchase shares at 85% of the closing fair market value of the Company's common stock on either the offering date or the purchase date, whichever is less. During the six months ended June 30, 2018, 34,985 shares were purchased and issued under the ESPP.

NOTE 10—STOCKHOLDERS' EQUITY

Accumulated Other Comprehensive Income (Loss)

The following table illustrates the changes in the balances of the Company's accumulated other comprehensive income (loss) for the periods presented (in thousands):

	Six Months Ended June 30,	
Net unrealized gains (losses) from available for sale investments:	2018	2017
Balance at beginning of period	$(454)	$(30)
Other comprehensive loss before reclassifications	(91)	(34)
Amounts reclassified from accumulated other comprehensive income (loss)	—	—
Balance at end of period	$(545)	$(64)

NOTE 11—NET INCOME (LOSS) PER SHARE

Basic net income (loss) per share is calculated by dividing the net income (loss) attributable to common shares by the weighted average number of common shares outstanding during the period. Diluted net income (loss) per common share is calculated by dividing the net income (loss) attributable to common shares by the weighted average number of common shares outstanding plus dilutive potential common shares outstanding during the period. Potential common

shares include the shares of common stock issuable upon the exercise of outstanding stock options, the vesting of RSUs and the purchase of shares from the ESPP (using the treasury stock method) as well as the conversion of the excess conversion value on the 2022 Notes. As discussed in Note 7, Debt, the Company has the option to pay cash for the aggregate principal amount due upon the conversion of its 2022 Notes. Since it is the Company's intent to settle the principal amount of its 2022 Notes in cash, the potentially dilutive effect of such notes on net income (loss) per share is computed under the treasury stock method. The Company must settle the principal of its 2019 Notes in cash and also intends to settle any conversion premium in cash.

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Potential common shares are excluded from the diluted net income (loss) per share computation to the extent they would be antidilutive. Because the Company reported a net loss for the three months ended June 30, 2017 and the six months ended June 30, 2018 and 2017, no potentially dilutive securities have been included in the computation of diluted net loss per share for those periods.

The following table sets forth the computation of basic and diluted net income (loss) per share for the three and six months ended June 30, 2018 and 2017 (in thousands, except per share amounts):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Numerator:				
Net income (loss)	$2,564	$(19,743)	$(8,116)	$(39,609)
Denominator:				
Weighted average common shares outstanding	40,796	40,160	40,751	39,079
Computation of diluted securities:				
Dilutive effect of stock options	807	—	—	—
Dilutive effect of RSUs	87	—	—	—
Dilutive effect of ESPP purchase options	4	—	—	—
Weighted average common shares outstanding—diluted	41,694	40,160	40,751	39,079
Net loss per share:				
Basic and diluted net income (loss) per common share	$0.06	$(0.49)	$(0.20)	$(1.01)

The following outstanding stock options, RSUs, conversion premiums on the Company's convertible senior notes and ESPP purchase options are antidilutive in the periods presented (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Weighted average number of stock options	3,918	5,092	5,094	5,102
Weighted average number of RSUs	367	375	483	364
Conversion premium on the 2019 Notes	—	9	—	817
Weighted average ESPP purchase options	5	36	33	37
Total	4,290	5,512	5,610	6,320

NOTE 12—INCOME TAXES

Income (loss) before income taxes is as follows (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2018	2017	2018	2017
Income (loss) before income taxes:				
Domestic	$592	$(18,950)	$(9,221)	$(38,269)
Foreign	2,007	(763)	1,175	(1,280)
Total income (loss) before income taxes	$2,599	$(19,713)	$(8,046)	$(39,549)

The Company recorded income tax expense of less than $0.1 million in both the three and six month periods ended June 30, 2018 and 2017, respectively. The tax provisions reflect current state income taxes. Due to net operating

losses, or NOLs, carried forward to 2018 and the repeal of the corporate minimum tax, no current federal income tax expense was recorded for 2018. The utilization of the Company's NOLs did not result in any deferred federal tax expense because there was a full valuation allowance recorded with respect to the NOLs. Due to net taxable losses in 2017, no current federal income tax

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expense was recorded in that year. The tax provisions do not reflect deferred tax expenses because the Company's deferred tax assets are fully offset by a valuation allowance.

During the six months ended June 30, 2017, the Company established a deferred tax liability of $26.5 million with an offset to additional paid-in capital resulting from the conversion feature of the 2022 Notes. The initial difference between the book value of convertible debt issued with a beneficial conversion feature and its tax basis is a temporary difference. The net effect of the deferred tax liability recorded to additional paid-in capital was zero because the Company has a full valuation allowance against its net deferred tax assets.

NOTE 13—COMMITMENTS AND CONTINGENCIES

Leases

The Company's leases for its research and development, warehouse and DepoCyt(e) manufacturing facility in San Diego, California all expire in August 2020, and its lease for its EXPAREL manufacturing facility in San Diego, California expires in December 2025. The Company's lease for its corporate headquarters in Parsippany, New Jersey expires in March 2028.

As of June 30, 2018, aggregate annual minimum payments due under the Company's lease obligations are as follows (in thousands):

Year	Aggregate Minimum Payments Due
2018 (remaining six months)	$ 3,933
2019	8,122
2020	7,604
2021	5,245
2022	5,366
2023 through 2028	19,577
Total	$ 49,847

Litigation

From time to time, the Company has been and may again become involved in legal proceedings arising in the ordinary course of its business, including those related to patents, product liability and government investigations. Except as described below, the Company is not presently a party to any legal proceedings which it believes to be material, and is not aware of any pending or threatened litigation against the Company which it believes could have a material adverse effect on its business, operating results, financial condition or cash flows.

In April 2015, the Company received a subpoena from the U.S. Department of Justice, U.S. Attorney's Office for the District of New Jersey, requiring the production of a broad range of documents pertaining to marketing and promotional practices related to EXPAREL. The Company is cooperating with the government's inquiry. The Company can make no assurances as to the time or resources that will need to be devoted to this inquiry or its final outcome, or the impact, if any, of this inquiry or any proceedings on its business, financial condition, results of operations and cash flows.

NOTE 14—COMMERCIAL PARTNERS AND OTHER AGREEMENTS

DepoCyt(e) Discontinuation

In June 2017, the Company's board of directors approved a decision to discontinue all future production of DepoCyt® (U.S. and Canada) and DepoCyte® (European Union) due to persistent technical issues specific to the DepoCyt(e) manufacturing process. As of June 30, 2017, the Company had ceased all production of DepoCyt(e).

In the three and six months ended June 30, 2018, the Company recorded a non-recurring charge of $0.2 million and $0.3 million, respectively, related to the discontinuation of its DepoCyt(e) manufacturing activities for lease costs, asset retirement obligations and other estimated exit costs.

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In the three and six months ended June 30, 2017, the Company recorded a non-recurring charge of $5.0 million related to the discontinuation of its DepoCyt(e) manufacturing activities, including $0.5 million for DepoCyt(e) related inventory, which was recorded in cost of goods sold, and $4.5 million for the remaining lease costs less an estimate of potential sublease income for the facility where DepoCyt(e) was manufactured, the write-off of property, plant and equipment, employee severance, asset retirement obligations and other estimated exit costs.

As of June 30, 2018, a summary of the Company's costs and reserves related to the DepoCyt(e) discontinuation are as follows (in thousands):

	Lease Costs	Asset Retirement Obligations and Other Discontinuation Costs	Total
Balance at December 31, 2017	$1,274	$ 236	$1,510
Charges incurred	216	36	252
Cash payments made	(668)	(31)	(699)
Other	80	16	96
Balance at June 30, 2018	$902	$ 257	$1,159

In April 2018, the Company received formal notice of the termination of a Supply Agreement and a Distribution Agreement (and all related agreements as subsequently amended) from Mundipharma International Corporation Limited and Mundipharma Medical Company, respectively. The Company may be required to make additional payments or incur additional costs relating to the DepoCyt(e) discontinuation which could be material to the Company's results of operations and/or cash flows in a given period.

Nuance Biotech Co. Ltd.

In June 2018, the Company entered into an agreement with Nuance Biotech Co. Ltd., or Nuance, a China-based specialty pharmaceutical company, to advance the development and commercialization of EXPAREL in China. Under the terms of the agreement, the Company agreed to be the sole supplier of EXPAREL to Nuance and has granted Nuance the exclusive rights to develop and commercialize EXPAREL in China. The Company received an upfront payment of $3.0 million in July 2018 and is eligible to receive future milestone payments of up to $60.0 million that are triggered by filing for and securing regulatory approval(s) and annual sales in China exceeding certain levels. The Company is also entitled to tiered royalties as a percentage of net sales.

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

This Quarterly Report on Form 10-Q and certain other communications made by us contain forward-looking statements within the meaning of Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, including statements about our growth and future operating results, discovery and development of products, strategic alliances and intellectual property. For this purpose, any statement that is not a statement of historical fact should be considered a forward-looking statement. We often use the words "believe," "anticipate," "plan," "expect," "intend," "may," and similar expressions to help identify forward-looking statements. We cannot assure you that our estimates, assumptions and expectations will prove to have been correct. These forward-looking statements include, among others, statements about: the success of our sales and manufacturing efforts in support of the commercialization of EXPAREL®(bupivacaine liposome injectable suspension) and our other products; the rate and degree of market acceptance of EXPAREL; the size and growth of the potential markets for EXPAREL and our ability to serve those markets; our plans to expand the use of EXPAREL to additional indications and opportunities, and the timing and success of any related clinical trials; the related timing and success of United States Food and Drug Administration, or FDA, supplemental New Drug Applications, or sNDA; the outcome of the U.S. Department of Justice, or DOJ, inquiry; the Company's plans to evaluate, develop and pursue additional DepoFoam®-based product candidates; clinical trials in support of an existing or potential DepoFoam-based product; our commercialization and marketing capabilities and the ability of the Company and Patheon UK Limited, or Patheon, to successfully and timely construct dedicated EXPAREL manufacturing suites. Important factors could cause our actual results to differ materially from those indicated or implied by forward-looking statements. We undertake no intention or obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, and readers should not rely on the forward-looking statements as representing our views as of any date subsequent to the date of the filing of this Quarterly Report on Form 10-Q.

These forward-looking statements involve known and unknown risks, uncertainties and other factors that may cause our actual results, levels of activity, performance or achievements to differ materially from those expressed or implied by these statements. These factors include items mentioned herein and the matters discussed and referenced in Part I-Item 1A. "Risk Factors" included in our Annual Report on Form 10-K for the year ended December 31, 2017 and in other reports as filed with the Securities and Exchange Commission, or SEC.

Unless the context requires otherwise, references to "Pacira," "we," the "Company," "us" and "our" in this Quarterly Report on Form 10-Q refer to Pacira Pharmaceuticals, Inc. and its subsidiaries. In addition, references in this Quarterly Report on Form 10-Q to DepoCyt(e) mean DepoCyt® when discussed in the context of the United States and Canada and DepoCyte® when discussed in the context of the European Union, or E.U.

Overview

Pacira is committed to driving innovation in postsurgical pain management by improving patient outcomes through the use of opioid-reducing strategies. Our product pipeline is based on our proprietary DepoFoam extended release drug delivery technology, for use primarily in hospitals and ambulatory surgery centers. EXPAREL, an opioid free, amide-type local anesthetic, is currently indicated for single-dose infiltration in adults to produce postsurgical local analgesia and as an interscalene brachial plexus nerve block to produce postsurgical regional analgesia. Since its initial approval in 2011 for single-dose infiltration, more than four million patients have been treated with EXPAREL. We drop-ship EXPAREL directly to the end-user based on orders placed to wholesalers or directly to us, and there is no product held by wholesalers.

We expect to continue to incur significant expenses as we pursue the expanded use of EXPAREL in additional indications and opportunities; advance our earlier-stage pipeline; seek FDA approvals for product candidates; develop our sales and marketing capabilities to prepare for their commercial launch; expand and enhance our manufacturing capacity for EXPAREL and support regulatory and legal matters.

Highlights and Recent Events

- In June 2018, we entered into an agreement with Nuance Biotech Co. Ltd., or Nuance, a China-based specialty pharmaceutical company, to advance the development and commercialization of EXPAREL in China. Under the terms of the agreement, we have agreed to be the sole supplier of EXPAREL to Nuance and have granted Nuance the exclusive rights to develop and commercialize EXPAREL in China. We received an upfront payment of $3.0 million in July 2018 and are eligible to receive future milestone payments of up to $60.0 million that are triggered by filing for and securing regulatory approval(s) and annual sales in China exceeding certain levels. We are also entitled to tiered royalties as a percentage of net sales.

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- In June 2018, we announced a partnership with MEDNAX, Inc., a national health solutions partner specializing in anesthesiology, neonatology, maternal-fetal medicine, other pediatric services, radiology and management services, to address the ongoing use of opioids during and after cesarean surgery by launching a national collaborative aimed at addressing the implementation of an Enhanced Recovery after Cesarean Surgery (ERACS™) program.
- In June 2018, we announced further collaboration with Aetna, one of the nation's leading diversified health care benefits companies. Aetna has updated its online provider directory, DocFind, to help members easily identify surgeons who are committed to offering opioid alternatives, including EXPAREL, to manage postsurgical pain.

EXPAREL

Interscalene brachial plexus block

Nerve block is a general term used to refer to the injection of local anesthetic onto a nerve or bundle of nerves for regional pain control. Traditionally, nerve blocks are single injections of short-acting anesthetics and as a result, have a limited duration of action. When extended pain management is required, a catheter has been used to deliver bupivacaine continuously using an external pump. EXPAREL is designed to provide extended pain management using a single injection.

Brachial plexus blocks are emerging as a mainstay of postsurgical pain control for upper extremity procedures. We believe the use of EXPAREL as an interscalene brachial plexus block offers the opportunity to:

- provide an alternative to catheters and pumps by turning off pain at the surgical site;
- further engage the anesthesiologist audience; and
- shift inpatient procedures to ambulatory surgery centers.

In April 2018, we announced that the FDA approved our sNDA to broaden the use of EXPAREL to include administration via interscalene brachial plexus block to produce postsurgical regional analgesia. With this approval, EXPAREL is the first long-acting, single-dose nerve block available for patients undergoing upper extremity surgeries, such as total shoulder arthroplasty or rotator cuff repair. The sNDA approval was based on positive data from a Phase 3 study of EXPAREL in brachial plexus block for shoulder surgeries, in which EXPAREL demonstrated statistical significance for the primary endpoint of cumulative pain scores over 48 hours as measured by the area under the curve ($P<0.0001$). EXPAREL also achieved statistical significance versus placebo for the study's key secondary endpoints as follows: total postsurgical opioid consumption through 48 hours ($P<0.0001$); opioid-free subjects through 48 hours ($P<0.01$) and time to first opioid rescue through 48 hours ($P<0.0001$).

Phase 4 Trials

We are investing in Phase 4 trials in key surgical procedures with EXPAREL as the foundation of a multimodal analgesic regimen. We are currently enrolling a study in cesarean section, and we are preparing to initiate trials in hip fracture and spine surgeries. In surgical settings where we are seeing positive outcomes for EXPAREL as part of an enhanced recovery after surgery, or ERAS, protocol (such as colorectal and breast reconstruction procedures), we are investing in training around the protocol and collecting real-world data on the standard-of-care without EXPAREL compared to an EXPAREL-based ERAS protocol. Our Phase 4 strategy is designed to support clinician education on procedure-specific best-practice care for improved patient outcomes and customer satisfaction within our approved indications.

Pediatrics

The Pediatric Research Equity Act requires pharmaceutical companies to study their products in children for the same use for which they are approved in adults. There is no long-lasting local anesthetic approved for use in children under the age of 12, meaning that pediatric patients currently have no approved alternatives to opioids for the management of severe postsurgical pain and are in need of additional pain control options.

We are working with the FDA to advance programs for infiltration as well as nerve block in the pediatric setting. We have completed our first pharmacokinetic and safety study in children aged 12 to 17 undergoing corrective spine surgery and are preparing to submit our protocol to the FDA for an extended pharmacokinetic and safety study that will include children aged 6 to 17 who are undergoing cardiovascular or spine surgeries.

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Product Pipeline

DepoFoam is used to extend the release of active drug substances. With this technology, we are currently developing DepoMeloxicam, or DepoMLX, a long-acting non-steroidal anti-inflammatory drug, or NSAID. DepoMLX is designed to treat moderate to severe pain as part of a non-opioid multimodal regimen. As a single-dose local administration, DepoMLX could provide a longer duration of pain relief at a significantly lower concentration of systemic NSAIDs, which are known to cause dose-dependent gastrointestinal side effects. Meloxicam, which is currently available as an oral formulation, is a commonly used NSAID on the market today.
We have an active Investigational New Drug (IND) application for DepoMLX and are in the process of determining the most appropriate next step for clinical development.
We are also evaluating other potential DepoFoam compounds, and formulation work is underway for a number of pipeline candidates.

Results of Operations

Comparison of the Three and Six Months Ended June 30, 2018 and 2017

Revenues

Net product sales are primarily sales of EXPAREL in the U.S. Other product sales include sales of our bupivacaine liposome injectable suspension to a third party licensee for use in animal health indications and sales of Depocyt(e) to third party licensees in the U.S. and Europe prior to the discontinuation of DepoCyt(e) production in June 2017. Licensing, milestone and royalty revenues are from our collaborative licensing agreements.

The following table provides information regarding our revenues during the periods indicated, including percent changes (dollar amounts in thousands):

	Three Months Ended June 30,		% Increase / (Decrease)	Six Months Ended June 30,		% Increase / (Decrease)
	2018	2017		2018	2017	
Net product sales:						
EXPAREL	$80,430	$69,773	15%	$154,464	$137,474	12%
Other product sales	287	366	(22)%	540	1,090	(50)%
Total net product sales	80,717	70,139	15%	155,004	138,564	12%
Collaborative licensing and milestone revenue	3,000	130	100% +	3,000	336	100% +
Royalty revenue	390	665	(41)%	710	1,317	(46)%
Total revenues	$84,107	$70,934	19%	$158,714	$140,217	13%

EXPAREL revenue grew 15% and 12% in the three and six months ended June 30, 2018, respectively, compared to the same periods in 2017, primarily due to increases in sales volumes of 20% and 17%, respectively, offset by a shift in product mix and an increase in chargebacks. The demand for EXPAREL has continued to increase as a result of the expansion of the EXPAREL label to include brachial plexus nerve block and the success of our co-promotion agreement with DePuy Synthes Sales, Inc., or DePuy Synthes, which are both driving growth in new and existing accounts due to the continued adoption of EXPAREL as a critical component of multimodal pain management strategies for soft tissue and orthopedic procedures.

Other product sales decreased 22% and 50% in the three and six months ended June 30, 2018, respectively, compared to the same periods in 2017. The decreases were primarily due to the discontinuation of DepoCyt(e) in June 2017,

partially offset by an increase in sales of our bupivacaine liposome injectable suspension to Aratana Therapeutics, Inc., or Aratana, for use in animal health indications.

Royalty revenue primarily reflects royalties earned on sales to Aratana. Royalty revenue decreased 41% and 46% in the three and six months ended June 30, 2018, respectively, compared to the same periods in 2017, primarily due to the discontinuation of DepoCyt(e), partially offset by increased royalties from Aratana.

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The increase in collaborative licensing and milestone revenue in the three and six months ended June 30, 2018 was the result of a $3.0 million upfront payment earned under our license agreement with Nuance for the development and commercialization of EXPAREL in China.

Cost of Goods Sold

Cost of goods sold primarily relates to the costs to produce, package and deliver our products to customers. These expenses include labor, raw materials, manufacturing overhead and occupancy costs, depreciation of facilities, royalty payments, quality control and engineering.

The following table provides information regarding our cost of goods sold and gross margin during the periods indicated, including percent changes (dollar amounts in thousands):

	Three Months Ended June 30,		% Increase / (Decrease)	Six Months Ended June 30,		% Increase / (Decrease)
	2018	2017		2018	2017	
Cost of goods sold	$20,916	$23,811	(12)%	$43,801	$48,392	(9)%
Gross margin	75 %	66 %		72 %	65 %	

The 9 and 7 percentage point improvements in our gross margins for the three and six months ended June 30, 2018 versus 2017, respectively, were primarily due to lower manufacturing costs per vial resulting from increased utilization of our facilities to manufacture EXPAREL, impacting gross margins by approximately 4% and 2%, respectively. In addition, gross margins improved by 3% in both the three and six months ended June 30, 2018 versus the same periods in 2017 as a result of scrapped lots of DepoCyt(e) that were expensed in the first six months of 2017 before the manufacture of the product was discontinued. The upfront payment earned under our license agreement with Nuance of $3.0 million also impacted gross margins by 1% in both the three and six months ended June 30, 2018 versus 2017, respectively. Excluding the $3.0 million upfront payment earned from Nuance, the gross margins were 74% and 72% in the three and six months ended June 30, 2018, respectively.

Research and Development Expenses

Research and development expenses primarily consist of costs related to clinical trials and related outside services, product development and other research and development costs, including Phase 4 trials that we are conducting to generate new data and best-practice administration techniques, and stock-based compensation expenses. Clinical development expenses include costs for clinical personnel, clinical trials performed by third-party contract research organizations, materials and supplies, database management and other third-party fees. Product development and other research and development expenses include development costs for our products and medical information expenses, which include personnel, equipment, materials and contractor costs for process development and product candidates, toxicology studies, development costs related to significant scale-ups of our manufacturing capacity, and facility costs for our research space. Stock-based compensation expense relates to the costs of stock option grants to employees and non-employees, awards of restricted stock units, or RSUs, and our employee stock purchase plan, or ESPP.

The following table provides information regarding our research and development expenses during the periods indicated, including percent changes (dollar amounts in thousands):

	Three Months Ended June 30,		% Increase / (Decrease)	Six Months Ended June 30,		% Increase / (Decrease)
	2018	2017		2018	2017	
Clinical development	$3,778	$12,674	(70)%	$8,963	$23,437	(62)%
Product development and other	7,510	5,535	36%	16,006	10,746	49%
Stock-based compensation	951	647	47%	1,648	1,304	26%
	$12,239	$18,856	(35)%	$26,617	$35,487	(25)%

Total research and development expense								
% of total revenues	15	%	27	%	17	%	25	%

Total research and development expense decreased 35% and 25% in the three and six months ended June 30, 2018 versus 2017, respectively.

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The decreases in clinical development expense in both the three and six months ended June 30, 2018 versus 2017 are primarily due to the prior completion of our two Phase 3 trials evaluating EXPAREL as a single-dose nerve block for prolonged regional analgesia. Enrollment in these studies began in the second quarter of 2016 and concluded in June 2017. There were also decreases in costs related to investigator-initiated studies and the completion of product-related bioequivalence trials. The decreases in clinical development expense were partially offset by increased clinical infrastructure spend, including personnel and an in-house clinical trial database in both periods presented. In the six month period ended June 30, 2018 versus 2017, the decrease was also partially offset by an increased investment supporting our sNDA submission for nerve block and expenses related to an FDA Anesthetic and Analgesic Drug Products Advisory Committee (AADPAC) meeting held in February 2018.

Product development and other expenses increased in the three and six months ended June 30, 2018 versus the same periods in 2017 primarily due to increased expenditures for expanding our EXPAREL manufacturing capacity in Swindon, England in partnership with Patheon and additional expenditures for DepoMLX.

Stock-based compensation increased $0.3 million in both the three and six months ended June 30, 2018 versus the same periods in 2017 primarily due to an increase in the number of awards granted in the second half of 2017 and the first half of 2018.

Selling, General and Administrative Expenses

Sales and marketing expenses primarily consist of compensation and benefits for our sales force and personnel that support our sales, marketing, medical and scientific affairs operations, commission payments to our marketing partners for the promotion and sale of EXPAREL, expenses related to communicating health outcome benefits of EXPAREL and educational programs for our customers. General and administrative expenses consist of compensation and benefits for legal, finance, regulatory, compliance, information technology, human resources, business development, executive management and other supporting personnel. It also includes professional fees for legal, audit, tax and consulting services. Stock-based compensation expense relates to the costs of stock option grants, RSU awards and our ESPP.

The following table provides information regarding our selling, general and administrative expenses during the periods indicated, including percent changes (dollar amounts in thousands):

	Three Months Ended June 30,		% Increase / (Decrease)	Six Months Ended June 30,		% Increase / (Decrease)
	2018	2017		2018	2017	
Sales and marketing	$27,118	$22,613	20%	$52,240	$47,788	9%
General and administrative	12,081	11,636	4%	24,667	23,214	6%
Stock-based compensation	5,050	5,303	(5)%	11,532	10,670	8%
Total selling, general and administrative expense	$44,249	$39,552	12%	$88,439	$81,672	8%
% of total revenues	53 %	56 %		56 %	58 %	

Total selling, general and administrative expenses increased 12% and 8% during the three and six months ended June 30, 2018 versus 2017, respectively.

Sales and marketing expenses increased 20% and 9% in the three and six months ended June 30, 2018 versus the same periods in 2017, respectively. We have expanded our public affairs campaign focused on driving policy change to improve patient access to non-opioid treatment options. There were also increases in selling and promotional activities to support the growth of EXPAREL, including initiatives and commissions related to our co-promotion agreement with DePuy Synthes, which are linked to incremental sales and vial mix, as well as additional marketing spend for the

commercial launch of EXPAREL as a brachial plexus nerve block that we expect to continue during the remainder of 2018. We are continuing our marketing investment in EXPAREL—including educational initiatives and programs to create product awareness within key surgical markets. We also continue to support multiple educational programs related to the impact of opioids and postsurgical pain management and our national advocacy campaign to educate patients about non-opioid treatment options.

General and administrative expenses increased 4% and 6% in the three and six months ended June 30, 2018 versus 2017, respectively, primarily due to legal expenditures related to a DOJ subpoena received in April 2015.

Stock-based compensation decreased $0.3 million in the three month period ended June 30, 2018 versus the same period in 2017, primarily due to an increase in open positions and accelerated stock-based compensation expense that occurred in the first quarter of 2018, partially offset by an increase in awards granted. Stock-based compensation increased $0.9 million in the

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six month period ended June 30, 2018 versus the same period in 2017, primarily due to additional awards granted and accelerated stock-based compensation expense.

Product Discontinuation Expenses

	Three Months Ended June 30,		% Increase / (Decrease)	Six Months Ended June 30,		% Increase / (Decrease)
	2018	2017		2018	2017	
Product discontinuation	$162	$4,495	(96)%	$252	$4,495	(94)%

In June 2017, we discontinued production of DepoCyt(e) due to persistent technical issues specific to the DepoCyt(e) manufacturing process and recorded a $5.0 million non-recurring charge, of which $0.5 million was related to DepoCyt(e) related inventory and recorded in cost of goods sold. The other $4.5 million charged to product discontinuation expense related to the remaining lease costs less an estimate of potential sublease income for the facility where DepoCyt(e) was manufactured, the write-off of property, plant and equipment, employee severance, asset retirement obligations and other estimated exit costs.

In the three and six months ended June 30, 2018, we recorded charges of $0.2 million and $0.3 million, respectively, related to the discontinuation of our DepoCyt(e) manufacturing activities. These charges relate to the remaining lease costs less an estimate of potential sublease income for the facility where DepoCyt(e) was manufactured, asset retirement obligations and other estimated exit costs.

Other Income (Expense)

The following table provides the components of other income (expense) during the periods indicated, including percent changes (dollar amounts in thousands):

	Three Months Ended June 30,		% Increase / (Decrease)	Six Months Ended June 30,		% Increase / (Decrease)
	2018	2017		2018	2017	
Interest income	$1,533	$1,224	25%	$2,906	$1,738	67%
Interest expense	(5,397)	(5,226)	3%	(10,553)	(7,815)	35%
Loss on early extinguishment of debt	—	(11)	(100)%	—	(3,732)	(100)%
Other, net	(78)	80	N/A	(4)	89	N/A
Total other expense, net	$(3,942)	$(3,933)	—%	$(7,651)	$(9,720)	(21)%

Total other expense, net remained flat in the three months ended June 30, 2018 versus 2017 due to a $0.2 million increase in amortization of debt discount related to our $345.0 million of 2.375% convertible senior notes due 2022, or 2022 Notes, and a $0.1 million increase in foreign exchange losses, offset by a $0.3 million increase in interest income due to higher overall returns on our investments.

Total other expense, net decreased by 21% in the six months ended June 30, 2018 versus the same period in 2017 due to a $3.7 million loss on early extinguishment of debt in the six months ended June 30, 2017 arising from the repurchase of $118.2 million of our 3.25% convertible senior notes due in 2019, or 2019 Notes. Interest income increased $1.2 million in the six months ended June 30, 2018 as a result of additional proceeds from the 2022 Notes, and interest expense increased $2.7 million versus 2017 due to the 2022 Notes issuance.

Income Tax Expense

The following table provides information regarding our income tax expense during the periods indicated, including percent changes (dollar amounts in thousands):

	Three Months Ended June 30,		% Increase / (Decrease)	Six Months Ended June 30,		% Increase / (Decrease)
	2018	2017		2018	2017	
Income tax expense	$35	$30	17%	$70	$60	17%
Effective tax rate	0 %	0 %		0 %	0 %	

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Income tax expense was less than $0.1 million in the three and six months ended both June 30, 2018 and 2017. The tax expense reflects current state income taxes. Due to net operating losses carried forward to 2018 and the repeal of the corporate minimum tax, no current federal income tax expense was recorded for 2018. Due to net taxable losses in 2017, no current federal income tax expense was recorded in that year. Since our deferred tax assets are fully offset by a valuation allowance, income tax expense does not reflect deferred tax expenses.

Liquidity and Capital Resources

Since our inception in December 2006, we have devoted most of our cash resources to manufacturing, research and development and selling, general and administrative activities related to the development and commercialization of EXPAREL. We are highly dependent on the commercial success of EXPAREL, which we launched in April 2012. We have financed our operations primarily with cash generated from product sales, the proceeds from the sale of equity and debt securities, borrowings under debt facilities and collaborative licensing and milestone revenue. As of June 30, 2018, we had an accumulated deficit of $395.9 million, cash and cash equivalents, short-term and long-term investments of $372.9 million and working capital of $402.0 million.

Summary of Cash Flows

The following table summarizes our cash flows from operating, investing and financing activities for the periods indicated (in thousands):

	Six Months Ended June 30,	
Condensed Consolidated Statement of Cash Flows Data:	2018	2017
Net cash provided by (used in):		
Operating activities	$11,021	$3,662
Investing activities	49,280	(204,986)
Financing activities	2,444	219,194
Net increase in cash and cash equivalents	$62,745	$17,870

Operating Activities

During the six months ended June 30, 2018, our net cash provided by operating activities was $11.0 million compared to $3.7 million during the six months ended June 30, 2017. The increase of $7.4 million was primarily attributable to a 12% increase in net product sales of EXPAREL, partially offset by the associated increased commissions related to our co-promotion agreement with DePuy Synthes, spending for our expanded public affairs campaign focused on driving policy change to improve patient access to those non-opioid treatment options, and increased legal expenditures.

Investing Activities

During the six months ended June 30, 2018, our net cash provided by investing activities was $49.3 million, which reflected $61.8 million of short-term and long-term investment maturities (net of purchases), partially offset by purchases of fixed assets of $7.8 million and contingent consideration payments of $4.7 million related to the March 2007 acquisition of Skyepharma Holding, Inc., or Skyepharma. Major fixed asset purchases included continuing expenditures for expanding our EXPAREL manufacturing capacity in Swindon, England in partnership with Patheon and facility upgrades at our Science Center Campus in San Diego, California.

During the six months ended June 30, 2017, our net cash used in investing activities was $205.0 million, which reflected $192.0 million of short-term investment purchases (net of maturities) primarily from the net proceeds of the 2022 Notes, purchases of fixed assets of $8.8 million and contingent consideration payments of $4.2 million related to the March 2007 acquisition of Skyepharma. Major fixed asset purchases included continuing expenditures for expanding our EXPAREL manufacturing capacity in Swindon, England in partnership with Patheon and facility upgrades at our Science Center Campus.

Financing Activities

During the six months ended June 30, 2018, our net cash provided by financing activities was $2.4 million, which consisted of proceeds from the exercise of stock options of $1.5 million and $1.0 million from the issuance of shares under our ESPP.

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During the six months ended June 30, 2017, our net cash provided by financing activities was $219.2 million, which consisted of proceeds from the issuance of the 2022 Notes of $345.0 million, partially offset by $11.0 million of debt issuance and financing costs. In addition, a portion of the proceeds from the 2022 Notes was used to retire $118.2 million in principal of the 2019 Notes and for $0.3 million in related costs. Proceeds from the exercise of stock options were $2.6 million and proceeds from the issuance of shares under our ESPP were $1.1 million.

2022 Convertible Senior Notes

On March 13, 2017, we completed a private placement of $345.0 million in aggregate principal amount of our 2022 Notes, and entered into an indenture, or 2022 Indenture, with respect to the 2022 Notes. The 2022 Notes accrue interest at a fixed rate of 2.375% per annum, payable semiannually in arrears on April 1 and October 1 of each year. The 2022 Notes mature on April 1, 2022. At June 30, 2018, the outstanding principal on the 2022 Notes was $345.0 million.

On or after October 1, 2021, until the close of business on the second scheduled trading day immediately preceding April 1, 2022, holders may convert their 2022 Notes at any time. Upon conversion, holders will receive the principal amount of their 2022 Notes and any excess conversion value. For both the principal and excess conversion value, holders may receive cash, shares of our common stock or a combination of cash and shares of our common stock, at our option. The initial conversion rate for the 2022 Notes is 14.9491 shares of common stock per $1,000 principal amount, which is equivalent to an initial conversion price of approximately $66.89 per share of our common stock. The conversion rate will be subject to adjustment in some events but will not be adjusted for any accrued and unpaid interest.

Prior to the close of business on the business day immediately preceding October 1, 2021, holders may convert the 2022 Notes under certain circumstances, including if during any given calendar quarter, our stock price closes at or above 130% of the conversion price then applicable during a period of at least 20 out of the last 30 consecutive trading days of the previous quarter.

While the 2022 Notes are currently classified on our consolidated balance sheet at June 30, 2018 as long-term debt, the future convertibility and resulting balance sheet classification of this liability will be monitored at each quarterly reporting date and will be analyzed dependent upon market prices of our common stock during the prescribed measurement periods. In the event that the holders of the 2022 Notes have the right to convert the 2022 Notes at any time during the prescribed measurement period, the 2022 Notes would then be considered a current obligation and classified as such.

Prior to April 1, 2020, we may not redeem the 2022 Notes. On or after April 1, 2020, we may redeem for cash, shares of our common stock or a combination of cash and shares of our common stock, at our option, all or part of the 2022 Notes if the last reported sale price (as defined in the 2022 Indenture) of our common stock has been at least 130% of the conversion price then in effect for at least 20 trading days (whether or not consecutive) during any 30 consecutive trading-day period ending within five trading days prior to the date on which we provide notice of redemption.

See Note 7, Debt, to our condensed consolidated financial statements included herein for further discussion of the 2022 Notes and our other indebtedness.

Future Capital Requirements

We believe that our existing cash and cash equivalents, short-term investments, long-term investments and cash received from product sales will be sufficient to enable us to fund our operating expenses, capital expenditure requirements, payment of the principal on any conversions of our 2022 Notes and to service our indebtedness through at least August 2, 2019. Our future use of operating cash and capital requirements will depend on many

forward-looking factors, including, but not limited to, the following:

- our ability to successfully continue to expand the commercialization of EXPAREL;
- the cost and timing of expanding our manufacturing facilities for EXPAREL and other product candidates, including costs associated with certain technical transfer activities and the construction of manufacturing suites at Patheon's facility;
- the timing of and extent to which the holders of our 2022 Notes elect to convert their notes;
- the cost and timing of potential milestone payments to Skyepharma, which could be up to an aggregate of $36.0 million if certain milestones pertaining to net sales of DepoBupivacaine products, including EXPAREL, are met, or upon the first commercial sale in a major E.U. country;

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- costs related to legal and regulatory issues;
- the costs of performing additional clinical trials for EXPAREL, including the pediatric trials required by the FDA as a condition of approval;
- the costs for the development and commercialization of other product candidates; and
- the extent to which we acquire or invest in products, businesses and technologies, including our investment in TELA Bio, Inc., or TELA Bio, for which we may be required to invest up to an additional $10.0 million under certain performance scenarios or upon our own election.

We may require additional debt or equity financing to meet our future operating and capital requirements. We have no committed external sources of funds, and additional equity or debt financing may not be available on acceptable terms, if at all.

Off-Balance Sheet Arrangements

We do not have any material off-balance sheet arrangements as of June 30, 2018, except for operating leases, nor do we have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities.

Critical Accounting Policies and Use of Estimates

See Note 2, Summary of Significant Accounting Policies, to our condensed consolidated financial statements included herein for a discussion of recently issued accounting pronouncements and their impact or future potential impact on our financial results, if determinable. For a description of critical accounting policies that affect our significant judgments and estimates used in the preparation of our consolidated financial statements, refer to our most recent Annual Report on Form 10-K for the year ended December 31, 2017.

Revenue Recognition

Our sources of revenue include (i) sales of EXPAREL in the U.S.; (ii) sales of our bupivacaine liposome injectable suspension product for use in animal health indications in the U.S.; (iii) royalties based on sales of our bupivacaine liposome injectable suspension product for use in animal health indications; and (iv) license fees and milestone payments. Product revenue is recognized when control of the promised goods are transferred to the customers, in an amount that reflects the consideration that we expect to be entitled to in exchange for transferring those goods.

Net Product Sales

We sell EXPAREL through a drop-ship program under which orders are processed through wholesalers based on orders of the product placed by end-users which include hospitals, ambulatory surgery centers and doctors. EXPAREL is delivered directly to the end-user without the wholesaler ever taking physical possession of the product. We record EXPAREL revenue at the time the product is delivered to the end-user. We also recognize revenue from products manufactured and supplied to commercial partners upon shipment, such as our bupivacaine liposome injectable suspension product for use in animal health indications. Prior to the shipment of manufactured products, we conduct initial product release and stability testing in accordance with the FDA’s current Good Manufacturing Practices. Revenues from sales of products are recorded net of returns allowances, prompt payment discounts, wholesaler service fees and volume rebates and chargebacks. The calculation of some of these items requires management to make estimates based on sales data, contracts and other related information that may become known in the future. We review the adequacy of our provisions on a quarterly basis.

Returns Allowances

We allow customers to return product that is damaged or received in error. In addition, we allow EXPAREL to be returned beginning six months prior to, and twelve months following product expiration. We estimate our sales returns reserve using the expected value method based on our historical return rates and related product return data. The returns reserve is recorded at the time of sale as a reduction to gross product sales and an increase in accrued expenses.

Prompt Payment Discounts

The prompt payment reserve is based upon discounts offered to wholesalers as an incentive to meet certain payment terms. We accrue discounts to wholesalers using the most likely amount method based on contractual terms of agreements and historical experience. We account for these discounts at the time of sale as a reduction to gross product sales and a reduction to accounts receivable.

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Wholesaler Service Fees

Our customers include major and regional wholesalers with whom we have contracted a fee for service based on a percentage of gross product sales. This fee for service is recorded as a reduction to gross product sales and an increase to accrued expenses at the time of sale, and is recorded using the most likely amount method based on the contracted percentage.

Volume Rebates and Chargebacks

Volume rebates and chargeback reserves are recorded using the most likely amount method based upon contracted discounts and promotional offers we provide to certain end-users. Volume rebates are recorded at the time of sale as a reduction to gross product sales and an increase in accrued expenses. Chargeback reserves are recorded at the time of sale as a reduction to gross product sales and a reduction to accounts receivable.

The following tables provide a summary of activity with respect to our sales related allowances and accruals for the six months ended June 30, 2018 and 2017 (in thousands):

June 30, 2018	Returns Allowances	Prompt Payment Discounts	Wholesaler Service Fees	Volume Rebates and Chargebacks	Total
Balance at December 31, 2017	$ 821	$ 657	$ 839	$ 696	$3,013
Provision	326	3,180	2,439	2,899	8,844
Payments/Credits	(427)	(3,171)	(2,428)	(2,807)	(8,833)
Balance at June 30, 2018	$ 720	$ 666	$ 850	$ 788	$3,024

June 30, 2017	Returns Allowances	Prompt Payment Discounts	Wholesaler Service Fees	Volume Rebates and Chargebacks	Total
Balance at December 31, 2016	$ 1,346	$ 595	$ 735	$ 1,124	$3,800
Provision	361	2,829	2,134	2,040	7,364
Payments/Credits	(612)	(2,861)	(2,258)	(1,857)	(7,588)
Balance at June 30, 2017	$ 1,095	$ 563	$ 611	$ 1,307	$3,576

Total reductions of gross product sales from sales-related allowances and accruals were $8.8 million and $7.4 million, or 5.4% and 5.1% of gross product sales for the six months ended June 30, 2018 and 2017, respectively. The overall increase in sales-related allowances and accruals as a percentage of gross product sales was directly related to an increase in chargebacks driven by higher volume.

Contractual Obligations

There are no material changes in our contractual obligations relating to our indebtedness, lease obligations and purchase obligations from those reported in our Annual Report on Form 10-K for the year ended December 31, 2017. For more information on our contractual obligations and commercial commitments, see Part II, Item 7 in our Annual Report on Form 10-K for the year ended December 31, 2017.

Item 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

The primary objective of our cash, cash equivalent and investment activities is to preserve principal while at the same time maximizing the income that we receive from our investments without significantly increasing risk. We invest in corporate bonds, commercial paper and asset-backed securities, which are reported at fair value. These securities are subject to interest rate risk. This means that a change in prevailing interest rates may cause the principal amount of the investment to fluctuate. For example, if we hold a security that was issued with a fixed interest rate at the then-prevailing rate and the interest rate later rises, we expect that the fair value of our investment will decline. A hypothetical 100 basis point increase in interest rates would have reduced the fair value of our available-for-sale securities at June 30, 2018 by approximately $1.0 million.

In March 2017, we issued $345.0 million in aggregate principal amount of our 2022 Notes, which mature in April 2022. Holders may convert their 2022 Notes prior to maturity under certain circumstances. Upon conversion, holders

will receive the principal amount of the 2022 Notes and any excess conversion value in cash, shares of our common stock or a combination of cash and shares, at our option. The fair value of the 2022 Notes is impacted by both the fair value of our common stock and interest rate fluctuations. As of June 30, 2018, the estimated fair value of the 2022 Notes was $934 per $1,000 principal

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amount. See Note 7, Debt, to our condensed consolidated financial statements included herein for further discussion of the 2022 Notes. At June 30, 2018, $345.0 million of principal remains outstanding on the 2022 Notes.

Additionally, our accounts receivable are concentrated with three large regional wholesalers of pharmaceutical products. In the event of non-performance or non-payment, there may be a material adverse impact on our financial condition, results of operations or net cash flow.

Item 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15(b) under the Exchange Act, our management, including our Chief Executive Officer and Chairman and our Chief Financial Officer, conducted an evaluation of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this report. As defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, disclosure controls and procedures are controls and other procedures which are designed to ensure that information required to be disclosed by us in the reports we file or submit 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 us in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our Chief Executive Officer and Chairman and our Chief Financial Officer, as appropriate, to allow timely decisions regarding required disclosure.

Based on that evaluation, our Chief Executive Officer and Chairman and our Chief Financial Officer concluded that our disclosure controls and procedures were effective as of June 30, 2018.

Changes in Internal Control Over Financial Reporting

There have been no changes in our internal control over financial reporting that occurred during the quarter ended June 30, 2018 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Inherent Limitations on Effectiveness of Controls

Our management, including the Chief Executive Officer and Chairman and our Chief Financial Officer, does not expect that our disclosure controls or our internal control over financial reporting will prevent or detect all errors and all fraud. A control system, no matter how well designed and operated, can provide only reasonable, not absolute, assurance that the control system's objectives will be met. The design of a control system must reflect the fact that there are resource constraints, and the benefits of controls must be considered relative to their costs. Further, because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that misstatements due to error or fraud will not occur or that all control issues and instances of fraud, if any, within our company have been detected. These inherent limitations include the realities that judgments in decision-making can be faulty and that breakdowns can occur because of simple error or mistake. Controls can also be circumvented by the individual acts of some persons, by collusion of two or more people or by management override of the controls. The design of any system of controls is based in part on certain assumptions about the likelihood of future events, and there can be no assurance that any design will succeed in achieving its stated goals under all potential future conditions. Projections of any evaluation of controls effectiveness to future periods are subject to risks. Over time, controls may become inadequate because of changes in conditions or deterioration in the degree of compliance with policies or procedures.

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PART II — OTHER INFORMATION

Item 1. LEGAL PROCEEDINGS

From time to time, we have been and may again become involved in legal proceedings arising in the ordinary course of our business. Except as described below, we are not presently a party to any litigation or legal proceedings that we believe to be material and we are not aware of any pending or threatened litigation against us that we believe could have a material adverse effect on our business, operating results, financial condition or cash flows.

In April 2015, we received a subpoena from the U.S. Department of Justice, U.S. Attorney's Office for the District of New Jersey, requiring the production of a broad range of documents pertaining to marketing and promotional practices related to EXPAREL. We are cooperating with the government's inquiry. We can make no assurances as to the time or resources that will need to be devoted to this inquiry or its final outcome, or the impact, if any, of this inquiry or any proceedings on our business, financial condition, results of operations and cash flows.

Item 1A. RISK FACTORS

You should carefully consider the factors discussed in Part I, Item 1A. "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2017, which could materially affect our business, financial condition, cash flows or future results. There have been no material changes in our risk factors included in our Annual Report on Form 10-K for the year ended December 31, 2017. The risks described in our Annual Report on Form 10-K for the year ended December 31, 2017 are not the only risks facing our company. Additional risks and uncertainties not currently known to us or that we currently deem to be immaterial also may materially adversely affect our business, financial condition or future results.

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

None.

Item 3. DEFAULTS UPON SENIOR SECURITIES

None.

Item 4. MINE SAFETY DISCLOSURES

Not applicable.

Item 5. OTHER INFORMATION

Not applicable.

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Item 6. EXHIBITS

The exhibits listed below are filed or furnished as part of this report.

Exhibit Number	Description
10.1	Executive Employment Agreement, dated March 13, 2013, between the Registrant and Richard Scranton, M.D.*†
10.2	Amendment No. 1 to Executive Employment Agreement, dated June 30, 2015, between the Registrant and Richard Scranton, M.D.*†
31.1	Certification of Chief Executive Officer and Chairman pursuant to Rule 13a-14(a) and 15d-14(a), as amended.*
31.2	Certification of Chief Financial Officer pursuant to Rule 13a-14(a) and 15d-14(a), as amended.*
32.1	Certification of Chief Executive Officer and Chairman pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
32.2	Certification of Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.**
101	The following materials from the Quarterly Report on Form 10-Q of Pacira Pharmaceuticals, Inc. for the quarter ended June 30, 2018, formatted in XBRL (eXtensible Business Reporting Language): (i) the Condensed Consolidated Balance Sheets; (ii) the Condensed Consolidated Statements of Operations; (iii) the Condensed Consolidated Statements of Comprehensive Income (Loss); (iv) the Condensed Consolidated Statement of Stockholders' Equity; (v) the Condensed Consolidated Statements of Cash Flows; and (vi) the Condensed Notes to Consolidated Financial Statements.*

* Filed herewith.

** Furnished herewith.

† Denotes management contract or compensatory plan or arrangement.

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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.

PACIRA PHARMACEUTICALS, INC.
(REGISTRANT)

Dated: August 2, 2018 /s/ DAVID STACK
David Stack
Chief Executive Officer and Chairman
(Principal Executive Officer)

Dated: August 2, 2018 /s/ CHARLES A. REINHART, III
Charles A. Reinhart, III
Chief Financial Officer
(Principal Financial Officer)