ARENA PHARMACEUTICALS INC
Form 10-Q
May 09, 2016
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended March 31, 2016
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to
Commission File Number: 000-31161

ARENA PHARMACEUTICALS, INC.
(Exact name of registrant as specified in its charter)

| | |
|---|---|
| Delaware | 23-2908305 |
| (State or other jurisdiction of incorporation or organization) | (I.R.S. Employer Identification No.) |
| 6154 Nancy Ridge Drive, San Diego, CA | 92121 |
| (Address of principal executive offices) | (Zip Code) |

858.453.7200
(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. ý Yes ¨ No
Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, or a smaller reporting company. See the definitions of "large accelerated filer," "accelerated filer" and "smaller reporting company" in Rule 12b-2 of the Exchange Act.

| | |
|---|---|
| Large accelerated filer ý | Accelerated filer ¨ |
| Non-accelerated filer ¨ (Do not check if a smaller reporting company) | Smaller reporting company ¨ |

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

The number of shares of common stock outstanding as of the close of business on May 5, 2016:

| Class | Number of Shares Outstanding |
| --- | --- |
| Common Stock, $0.0001 par value | 243,044,672 |

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TRADEMARKS AND CERTAIN TERMS

Arena Pharmaceuticals®, Arena® and our corporate logo are registered service marks of Arena. BELVIQ® and BELVIQ XR® are registered trademarks of our wholly owned subsidiary, Arena Pharmaceuticals GmbH. Any other brand names or trademarks appearing in this Quarterly Report on Form 10-Q are the property of their respective holders.

In this Quarterly Report on Form 10-Q, "Arena Pharmaceuticals," "Arena," "we," "us" and "our" refer to Arena Pharmaceutica Inc., and our wholly owned subsidiaries on a consolidated basis, unless the context otherwise provides. "APD" is an abbreviation for Arena Pharmaceuticals Development.

Lorcaserin has been approved for marketing in the United States and South Korea for weight management, and is being commercialized under the brand name BELVIQ (which is pronounced as "BEL-VEEK").

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PART I. FINANCIAL INFORMATION
Item 1. Financial Statements.

ARENA PHARMACEUTICALS, INC.
Condensed Consolidated Balance Sheets
(In thousands)

| | March 31, 2016 (Unaudited) | December 31, 2015[1] |
|---|---|---|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | $ 139,533 | $ 156,184 |
| Accounts receivable | 6,166 | 4,934 |
| Inventory | 9,054 | 9,502 |
| Prepaid expenses and other current assets | 5,362 | 4,218 |
| Total current assets | 160,115 | 174,838 |
| Land, property and equipment, net | 71,003 | 71,828 |
| Intangibles, net | 7,945 | 7,775 |
| Other non-current assets | 2,301 | 2,351 |
| Total assets | $ 241,364 | $ 256,792 |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable and other accrued liabilities | $ 8,190 | $ 10,127 |
| Accrued clinical and preclinical study fees | 3,349 | 3,286 |
| Payable to Eisai | 13,583 | 12,080 |
| Current portion of deferred revenues | 22,243 | 21,425 |
| Current portion of lease financing obligations | 3,108 | 2,978 |
| Total current liabilities | 50,473 | 49,896 |
| Deferred rent | 494 | 470 |
| Deferred revenues, less current portion | 88,389 | 87,617 |
| Lease financing obligations, less current portion | 64,450 | 65,267 |
| Commitments and contingencies | | |
| Stockholders' equity: | | |
| Common stock | 24 | 24 |
| Additional paid-in capital | 1,433,890 | 1,430,917 |
| Accumulated other comprehensive income (loss) | 1,412 | (1,179) |
| Accumulated deficit | (1,397,768) | (1,376,220) |
| Total stockholders' equity | 37,558 | 53,542 |
| Total liabilities and stockholders' equity | $ 241,364 | $ 256,792 |

[1] The balance sheet data at December 31, 2015, has been derived from audited financial statements at that date. It does not include, however, all of the information and notes required by US generally accepted accounting principles for complete financial statements.

See accompanying notes to unaudited condensed consolidated financial statements.

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ARENA PHARMACEUTICALS, INC.
Condensed Consolidated Statements of Operations and Comprehensive Loss
(In thousands, except per share data)
(Unaudited)

| | Three months ended March 31, | |
|---|---|---|
| | 2016 | 2015 |
| Revenues: | | |
| Net product sales | $3,518 | $6,618 |
| Other Eisai collaborative revenue | 3,226 | 2,136 |
| Toll manufacturing | 1,023 | 346 |
| Other collaborative revenue | 2,080 | 3,156 |
| Total revenues | 9,847 | 12,256 |
| Operating Costs and Expenses: | | |
| Cost of product sales | 2,428 | 3,191 |
| Cost of toll manufacturing | 1,188 | 402 |
| Research and development | 18,502 | 21,968 |
| General and administrative | 6,924 | 8,439 |
| Total operating costs and expenses | 29,042 | 34,000 |
| Loss from operations | (19,195) | (21,744) |
| Interest and Other Income (Expense): | | |
| Interest income | 88 | 34 |
| Interest expense | (1,679) | (1,696) |
| Loss from valuation of derivative liabilities | 0 | (1,549) |
| Other | (762) | 660 |
| Total interest and other expense, net | (2,353) | (2,551) |
| Net loss | $(21,548) | $(24,295) |
| Net loss per share: | | |
| Basic | $(0.09) | $(0.10) |
| Diluted | $(0.09) | $(0.10) |
| Shares used in calculating net loss per share: | | |
| Basic | 242,876 | 235,703 |
| Diluted | 242,876 | 235,703 |
| Comprehensive Loss: | | |
| Net loss | $(21,548) | $(24,295) |
| Foreign currency translation gain (loss) | 2,591 | (145) |
| Comprehensive loss | $(18,957) | $(24,440) |

See accompanying notes to unaudited condensed consolidated financial statements.

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ARENA PHARMACEUTICALS, INC.
Condensed Consolidated Statements of Cash Flows
(In thousands)
(Unaudited)

| | Three months ended March 31, | |
|---|---|---|
| | 2016 | 2015 |
| Operating Activities | | |
| Net loss | $(21,548) | $(24,295) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation and amortization | 2,356 | 2,425 |
| Amortization of intangibles | 67 | 27 |
| Share-based compensation | 2,809 | 3,833 |
| Loss from valuation of derivative liabilities | 0 | 1,549 |
| Amortization of prepaid financing costs | 34 | 34 |
| Gain on sale of equipment | (135) | 0 |
| Changes in assets and liabilities: | | |
| Accounts receivable | (1,067) | (8,612) |
| Inventory | 973 | (197) |
| Prepaid expenses and other assets | (1,112) | 257 |
| Payables and accrued liabilities | (966) | (6,711) |
| Deferred revenues | 986 | 8,644 |
| Deferred rent | 24 | 29 |
| Net cash used in operating activities | (17,579) | (23,017) |
| Investing Activities | | |
| Purchases of property and equipment | (247) | (1,069) |
| Proceeds from sale of property and equipment | 135 | 0 |
| Net cash used in investing activities | (112) | (1,069) |
| Financing Activities | | |
| Principal payments on lease financing obligations | (687) | (570) |
| Proceeds from issuance of common stock | 127 | 101,979 |
| Net cash provided by (used in) financing activities | (560) | 101,409 |
| Effect of exchange rate changes on cash | 1,600 | 449 |
| Net increase (decrease) in cash and cash equivalents | (16,651) | 77,772 |
| Cash and cash equivalents at beginning of period | 156,184 | 163,209 |
| Cash and cash equivalents at end of period | $139,533 | $240,981 |

See accompanying notes to unaudited condensed consolidated financial statements.

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ARENA PHARMACEUTICALS, INC.
Notes to Unaudited Condensed Consolidated Financial Statements
1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Arena Pharmaceuticals, Inc., which include our wholly owned subsidiaries, should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2015, as filed with the Securities and Exchange Commission, or SEC, from which we derived our balance sheet as of December 31, 2015. The accompanying financial statements have been prepared in accordance with US generally accepted accounting principles, or GAAP, for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, since they are interim statements, the accompanying financial statements do not include all of the information and notes required by GAAP for complete financial statements. The accompanying financial statements reflect all adjustments, consisting of normal recurring adjustments, that are, in the opinion of our management, necessary to a fair statement of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year.

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, No. 2014-09, “Revenue from Contracts with Customers.” ASU No. 2014-09 outlines a comprehensive revenue recognition model and supersedes most current revenue recognition guidance. ASU No. 2014-09 is effective for annual reporting periods, and interim periods within those periods, beginning after December 15, 2017. ASU No. 2014-09 allows for two methods of adoption: (a) “full retrospective” adoption, meaning the standard is applied to all periods presented, or (b) “modified retrospective” adoption, meaning the cumulative effect of applying ASU No. 2014-09 is recognized as an adjustment to the opening retained earnings balance for the year of implementation. We have not yet selected an adoption method as we are currently evaluating the impact of ASU No. 2014-09 on our consolidated financial statements.

In August 2014, the FASB issued ASU No. 2014-15, “Presentation of Financial Statements – Going Concern: Disclosure of Uncertainties about an Entity’s Ability to Continue as a Going Concern.” Under GAAP, continuation of a reporting entity as a going concern is presumed as the basis for preparing financial statements unless and until the entity’s liquidation becomes imminent. Preparation of financial statements under this presumption is commonly referred to as the going concern basis of accounting. If and when an entity’s liquidation becomes imminent, financial statements should be prepared under the liquidation basis of accounting. Even when an entity’s liquidation is not imminent, there may be conditions or events that raise substantial doubt about the entity’s ability to continue as a going concern. In those situations, financial statements should continue to be prepared under the going concern basis of accounting, but ASU No. 2014-15 should be followed to determine whether to disclose information about any relevant conditions and events. ASU No. 2014-15 is effective for the annual reporting period ending after December 15, 2016, and for annual and interim periods thereafter. We do not expect the adoption of ASU No. 2014-15 to have a material impact on our consolidated financial statements.

In January 2016, the FASB issued ASU No. 2016-01, “Recognition and Measurement of Financial Assets and Financial Liabilities.” ASU No. 2016-01 supersedes and amends the guidance to classify equity securities with readily determinable fair values into different categories (that is, trading or available-for-sale) and require equity securities to be measured at fair value with changes in the fair value recognized through net income. The amendments allow equity investments that do not have readily determinable fair values to be remeasured at fair value either upon the occurrence of an observable price change or upon identification of an impairment. The amendments also require enhanced disclosures about those investments. ASU No. 2016-01 is effective for annual reporting periods, and interim periods within those periods, beginning after December 15, 2017, and calls for prospective application, with early application permitted. We do not expect the adoption of ASU No. 2016-01 to have a material impact on our consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, “Leases.” ASU No. 2016-02 amends the accounting guidance for leases. The amendments contain principles that will require lessees to recognize most leases on the balance sheet by recording a right-of-use asset and a lease liability, unless the lease is a short-term lease that has an accounting lease term of twelve months or less. The amendments also contain other changes to the current lease guidance that may

result in changes to how entities determine which contractual arrangements qualify as a lease, the accounting for executory costs such as property taxes and insurance, as well as which lease origination costs will be capitalizable. The new standard also requires expanded quantitative and qualitative disclosures. ASU No. 2016-02 is effective for annual reporting periods, and interim periods within those periods, beginning after December 15, 2018, with early adoption permitted. ASU No. 2016-02 requires the use of the modified retrospective transition method, whereby the new guidance will be applied at the beginning of the earliest period presented in the financial statements of the period of adoption. We are currently evaluating the impact of ASU No. 2016-02 on our consolidated financial statements.

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In March 2016, the FASB issued ASU No. 2016-09, “Improvements to Employee Share-Based Payment Accounting.” ASU No. 2016-09 is designed to simplify several aspects of accounting for share-based payment award transactions, including income tax consequences, classification of awards as either equity or liabilities, classification on the statement of cash flows and forfeiture rate calculations. ASU No. 2016-09 is effective for annual reporting periods, and interim periods within those periods, beginning after December 15, 2016, with early adoption permitted. We are currently evaluating the impact of ASU No. 2016-09 on our consolidated financial statements.

The preparation of financial statements in accordance with GAAP requires our management to make estimates and assumptions that affect the reported amounts (including assets, liabilities, revenues and expenses) and related disclosures. The amounts reported could differ under different estimates and assumptions.

2. Fair Value Disclosures

We measure our financial assets and liabilities at fair value, which is defined as the exit price, or the amount that would be received from selling an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

We use the following three-level valuation hierarchy that maximizes the use of observable inputs and minimizes the use of unobservable inputs to value our financial assets and liabilities:

Level 1 - Observable inputs such as unadjusted quoted prices in active markets for identical instruments.

Level 2 - Quoted prices for similar instruments in active markets or inputs that are observable for the asset or liability, either directly or indirectly.

Level 3 - Significant unobservable inputs based on our assumptions.

The following tables present our valuation hierarchy for our financial assets and liabilities that are measured at fair value on a recurring basis, in thousands:

| | Fair Value Measurements at March 31, 2016 | | | |
|---|---|---|---|---|
| | Balance | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Money market funds[1] | $98,168 | $ 98,168 | $ 0 | $ 0 |

| | Fair Value Measurements at December 31, 2015 | | | |
|---|---|---|---|---|
| | Balance | Quoted Prices in Active Markets (Level 1) | Significant Other Observable Inputs (Level 2) | Significant Unobservable Inputs (Level 3) |
| Assets: | | | | |
| Money market funds[1] | $113,080 | $ 113,080 | $ 0 | $ 0 |

(1) Included in cash and cash equivalents on our condensed consolidated balance sheets.

3. Inventory

Inventory consisted of the following, in thousands:

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Raw materials | $ 2,724 | $ 2,487 |
| Work in process | 2,977 | 2,781 |
| Finished goods at Arena GmbH | 0 | 165 |
| Finished goods at Eisai | 2,720 | 3,309 |
| Finished goods at Ildong | 633 | 760 |

| | | |
|---|---|---|
| Total inventory | $ 9,054 | $ 9,502 |

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4. Land, Property and Equipment

Land, property and equipment consisted of the following, in thousands:

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Cost | $172,002 | $172,729 |
| Less accumulated depreciation and amortization | (100,999 ) | (100,901 ) |
| Land, property and equipment, net | $71,003 | $71,828 |

5. Accounts Payable and Other Accrued Liabilities

Accounts payable and other accrued liabilities consisted of the following, in thousands:

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Accounts payable | $1,891 | $ 2,078 |
| Accrued compensation | 5,177 | 5,118 |
| Accrued workforce reduction expenses | 78 | 1,793 |
| Other accrued liabilities | 1,044 | 1,138 |
| Total accounts payable and other accrued liabilities | $8,190 | $ 10,127 |

6. Marketing and Supply Agreement with Eisai

In November 2013, our wholly owned subsidiary, Arena Pharmaceuticals GmbH, or Arena GmbH, and Eisai Inc. and Eisai Co., Ltd. (collectively with Eisai Inc., Eisai) entered into the Second Amended and Restated Marketing and Supply Agreement, or Eisai Agreement. The Eisai Agreement expanded Eisai's exclusive commercialization rights for lorcaserin to all of the countries in the world, except for South Korea, Taiwan, Australia, New Zealand and Israel. Lorcaserin is approved in the United States and marketed as BELVIQ for chronic weight management in adults who are overweight with a comorbidity or obese, and was made available to patients by prescription in the United States by Eisai in June 2013. In addition to providing commercialization rights, which are subject to applicable regulatory approval, we manufacture and sell lorcaserin to Eisai and provide Eisai with services related to development and regulatory activities. Under the Eisai Agreement, we have received an upfront payment and payments from sales of lorcaserin, and are entitled to receive payments from future sales of lorcaserin, milestone payments based on the achievement of regulatory filings and approvals, one-time purchase price adjustment payments and other payments. Prior to entering into the Eisai Agreement, Arena GmbH and Eisai Inc. entered into the original marketing and supply agreement in July 2010, under which we granted Eisai Inc. exclusive commercialization rights for lorcaserin solely in the United States and its territories and possessions. In May 2012, Arena GmbH and Eisai Inc. amended and restated such agreement by entering into the first amended agreement, which expanded Eisai Inc.'s exclusive commercialization rights to include most of North and South America.

The following table summarizes the revenues we recognized under our collaboration with Eisai for the periods presented, in thousands:

| | Three months ended March 31, | |
|---|---|---|
| | 2016 | 2015 |
| Net product sales | $2,459 | $4,436 |
| Amortization of upfront payments | 1,885 | 1,885 |
| Reimbursement of development expenses | 1,231 | 191 |
| Reimbursement of patent and trademark expenses | 110 | 60 |
| Subtotal other Eisai collaborative revenue | 3,226 | 2,136 |
| Total | $5,685 | $6,572 |

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The following table summarizes the deferred revenues under our collaboration with Eisai, in thousands:

| | March 31, 2016 | December 31, 2015 |
|---|---|---|
| Upfront payments | $85,048 | $86,933 |
| Net product sales | 7,426 | 10,754 |
| Total deferred revenues attributable to Eisai | 92,474 | 97,687 |
| Less current portion | (14,967) | (18,295) |
| Deferred revenues attributable to Eisai, less current portion | $77,507 | $79,392 |

Upfront and Milestone Payments.

In connection with entering into the Eisai Agreement, we received from Eisai an upfront payment of $60.0 million. This payment is in addition to the $50.0 million and $5.0 million in upfront payments we received from Eisai in connection with entering into the original agreement and the first amended agreement, respectively. Revenues from these upfront payments were deferred, as we determined that the exclusive rights did not have standalone value without our ongoing development and regulatory activities. Accordingly, these payments are recognized ratably as revenue over the periods in which we expect the services to be rendered, which are approximately 15 years for the Eisai Agreement and first amended agreement and 16 years for the original agreement. In addition to the upfront payments, we have received from Eisai a total of $86.5 million in milestones payments, and we are eligible to receive up to an aggregate of $176.0 million in additional regulatory and development milestone payments.

Product Purchase Price and Purchase Price Adjustment Payments.

We manufacture lorcaserin at our facility in Switzerland, and sell lorcaserin to Eisai for Eisai's commercialization in the United States for a purchase price starting at 31.5% of Eisai's aggregate annual net product sales (which are the gross invoiced sales less certain deductions described in the Eisai Agreement), or the Eisai Product Purchase Price. Subject to regulatory approval, the Eisai Product Purchase Price starts at 27.5% and 30.75% of Eisai's annual aggregate net product sales in (i) Europe, China and Japan, and (ii) the other territories under the Eisai Agreement, respectively. The Eisai Product Purchase Price will increase on a tiered basis with increasing sales, and is subject to reduction (for sales in a particular territory), including in the event of generic competition in the applicable territory. The revenue we recognize for BELVIQ product revenue related to the redemption of vouchers and product samples is based on our cost of goods sold.

In addition to payments for purchases of lorcaserin, we are eligible to receive up to an aggregate of $1.56 billion in one-time purchase price adjustment payments and other payments. These payments include up to an aggregate of $1.19 billion that are based on Eisai's annual net product sales of lorcaserin in all of the territories under the Eisai Agreement on an aggregate basis, with the first and last amounts payable with annual net product sales of $250.0 million and $2.5 billion, respectively. Of these payments, Eisai will pay us a total of $330.0 million for annual net product sales of up to $1.0 billion. The $1.56 billion also includes $370.0 million in one-time purchase price adjustment payments we are eligible to receive based on annual net product sales in the non-US territories. In addition, we are also eligible to receive certain payments by Eisai if certain annual minimum sales requirements in Mexico, Canada and Brazil are not met during the first ten years after initial commercial sale in such territories.

The amount that Eisai pays us for lorcaserin product supply is based on Eisai's estimated price at the time the order is shipped, which is Eisai's estimate of the Eisai Product Purchase Price, and is subject to change on April 1 and October 1 of each year. At the end of Eisai's fiscal year (March 31), the estimated price paid to us for product that Eisai sold to their distributors is compared to the Eisai Product Purchase Price of such product, and the difference is either refunded back to Eisai (for overpayments) or paid to us (for underpayments). On a monthly basis, Eisai provides us the total amount of net product sales for the month, details of the total deductions from gross to net product sales and the sales in units. We recognize our revenues monthly based on our percentage of Eisai's monthly net product sales figures. When the revenues we recognize differ from the estimated price that Eisai paid us for such product, the difference is reclassified from deferred revenues to a receivable or payable account, as appropriate. We also adjust the deferred revenues balance for the product supply held at Eisai based on, among other information provided to us, the most current Eisai Product Purchase Price, with the difference reclassified from deferred revenues to a receivable or payable account.

The Eisai Product Purchase Price for the product Eisai has sold to date has been lower than the estimated price that Eisai paid us for such product, primarily due to an increase in deductions from savings cards and returns, partially offset by a decrease in vouchers. Subsequent to the end of Eisai's fiscal year, we refund the portion of these excess payments, which primarily comprises the $13.6 million classified as Payable to Eisai on our condensed consolidated balance sheet at March 31, 2016, related to product sold by Eisai to their distributors through March 31.

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Development Payments.

In connection with the US approval of BELVIQ, the US Food and Drug Administration, or FDA, is requiring (i) an evaluation as part of the cardiovascular outcomes trial, or CVOT, of the effect of long-term treatment with BELVIQ on the incidence of major adverse cardiovascular events, or MACE, in overweight and obese patients with cardiovascular disease or multiple cardiovascular risk factors and (ii) the conduct of postmarketing studies to assess the safety and efficacy of BELVIQ for weight management in obese pediatric and adolescent patients. In addition to the FDA-required studies, we and Eisai have prioritized the development and approval of a once-daily formulation of lorcaserin, which we refer to as BELVIQ XR, and the FDA has accepted for filing our submission for the marketing approval of BELVIQ XR. Eisai and we have also prioritized potentially exploring, including as part of the CVOT, BELVIQ's effect on conversion to type 2 diabetes and improvements in cardiovascular outcomes.

The chart below summarizes the general agreement regarding cost sharing between Eisai and us for significant development activities under the Eisai Agreement. In addition, Eisai or we may from time to time conduct approved development of lorcaserin at such party's own expense.

Cost Sharing for Development with Eisai

| | United States | Rest of North and South America | Remaining Territories |
|---|---|---|---|
| BELVIQ<br>- Pre-approval* | Not Applicable | General<br>Eisai: 90%; Arena: 10%<br><br>Certain stability work Eisai: 50%; Arena: 50% | Up to a total of $100.0 million**<br>- Eisai: 50%; Arena: 50%<br><br>Thereafter, Eisai: 100% |
| BELVIQ<br>- Post-approval* | General<br>Eisai: 90%; Arena 10%<br><br>Non-FDA required portion of CVOT<br>Up to $80.0 million -<br>Eisai: 50%; Arena: 50%<br>Thereafter, Eisai: 100%<br><br>Certain pediatric studies<br>Eisai: 50%; Arena: 50% | General<br>Eisai: 90%; Arena: 10%<br><br>Certain stability work<br>Eisai: 50%; Arena: 50% | Up to a total of $50.0 million<br>- Eisai: 50%; Arena: 50%<br><br>Thereafter, Eisai: 90%; Arena: 10% |
| Lorcaserin products other than BELVIQ<br>- Pre-approval | Up to a total of $250.0 million (as reduced by up to $80.0 million for non-FDA required portion of CVOT)**<br>- Eisai: 50%; Arena: 50% | | |
| Lorcaserin products other than BELVIQ<br>- Post-approval | Up to a total of $100.0 million in the aggregate across all additional products<br>- Eisai: 50%; Arena: 50%<br><br>Eisai: 90%; Arena: 10% | | Therea |

* Development required by a regulatory authority, with the exception of the non-FDA required portions of the CVOT.

** Under the collaborative agreement, the amount for BELVIQ pre-approval in the Remaining Territories was decreased and the amount for lorcaserin products other than BELVIQ pre-approval was increased by such amount.

Certain Other Terms.

Please refer to our Annual Report on Form 10-K for the year ended December 31, 2015, for additional information regarding termination, indemnification, product liability, certain limitations and other provisions included in the Eisai Agreement.

7. Marketing and Supply Agreement with Ildong

In November 2012, Arena GmbH and Ildong Pharmaceutical Co., Ltd., or Ildong, entered into the Marketing and Supply Agreement, or Ildong Agreement. Under this agreement, we granted Ildong exclusive rights to commercialize BELVIQ in South Korea for weight loss or weight management in obese and overweight patients. We also provide certain services and manufacture and sell BELVIQ to Ildong. Ildong has agreed not to conduct activities outside of our agreement related to the

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approval or commercialization of any other pharmaceutical product for weight loss, weight management or obesity in South Korea, with the exception of phentermine.

In connection with entering into the Ildong Agreement, we received from Ildong an upfront payment of $5.0 million, less withholding taxes. Revenues from this upfront payment were deferred, as we determined that the exclusive rights did not have standalone value without our ongoing development and regulatory activities. Accordingly, this payment is recognized ratably as revenue over the period in which we expect the services to be rendered, which is approximately 14 years. In addition to the upfront payment, we received a milestone payment of $3.0 million, less withholding taxes, in March 2015, which we earned upon the February 2015 approval of BELVIQ for marketing in South Korea for weight management.

We manufacture BELVIQ at our facility in Switzerland, and sell BELVIQ to Ildong for a purchase price starting at the higher of the defined minimum amount or 35% of Ildong's annual net product sales (which are the gross invoiced sales less certain deductions described in the Ildong Agreement), or the Ildong Product Purchase Price. The Ildong Product Purchase Price increases on a tiered basis up to the higher of the defined minimum amount or 45% on the portion of annual net product sales exceeding $15.0 million. However, in no event will the Ildong Product Purchase Price be less than a defined minimum amount adjusted annually based on a consumer price index. For the three months ended March 31, 2016, the Ildong Product Purchase Price equaled the defined minimum amount (which exceeded the amounts calculated using the applicable percentages for the applicable tiers of Ildong's annual net product sales for this period). If certain annual net product sales amounts are not met, we can convert Ildong's right to commercialize BELVIQ in South Korea to be non-exclusive. We recognized revenues from our portion of Ildong net product sales of BELVIQ of $1.1 million and $2.2 million for the three months ended March 31, 2016, and 2015, respectively.

8. Share-based Activity

Share-based Compensation.

We recognized share-based compensation expense as follows, in thousands:

| | Three months ended March 31, | |
|---|---|---|
| | 2016 | 2015 |
| Cost of product sales | $20 | $0 |
| Research and development | 1,763 | 2,056 |
| General and administrative | 1,026 | 1,777 |
| Total share-based compensation expense | $2,809 | $3,833 |
| Total share-based compensation expense capitalized into inventory | $37 | $62 |

Share-based Award Activity.

The following table summarizes our stock option activity during the three months ended March 31, 2016, in thousands (except per share data):

| | Options | Weighted-Average Exercise Price |
|---|---|---|
| Outstanding at January 1, 2016 | 16,407 | $ 5.01 |
| Granted | 8,786 | 1.55 |
| Exercised | (26) | 1.52 |
| Forfeited/cancelled/expired | (373) | 12.63 |
| Outstanding at March 31, 2016 | 24,794 | $ 3.64 |

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The following table summarizes activity with respect to our time-based restricted stock unit awards, or RSUs, during the three months ended March 31, 2016, in thousands (except per share data):

| | RSUs | Weighted-Average Grant-Date Fair Value |
|---|---|---|
| Unvested at January 1, 2016 | 273 | $ 4.67 |
| Granted | 0 | |
| Vested | (70 ) | 4.11 |
| Forfeited/cancelled | 0 | |
| Unvested at March 31, 2016 | 203 | $ 4.87 |

During the three months ended March 31, 2016, the remaining Total Stockholder Return, or TSR, performance restricted stock unit, or PRSU, awards that we had granted to our executive officers in March 2013 were forfeited without any earnout based on the TSR of our common stock relative to the TSR of the NASDAQ Biotechnology Index over the three-year performance period that began on March 1, 2013. In the aggregate, the target number of shares of common stock that could have been earned under the PRSUs granted in March 2013 was 780,000. Except for those cancelled due to employment separation from Arena, the PRSU awards issued in March 2014 and March 2015 are still outstanding at March 31, 2016.

9. Concentrations of Credit Risk and Major Customers

Financial instruments, which potentially subject us to concentrations of credit risk, consist primarily of cash and cash equivalents. We limit our exposure to credit loss by holding our cash primarily in US dollars or, from time to time, placing our cash and investments in US government, agency and government-sponsored enterprise obligations and in corporate debt instruments that are rated investment grade, in accordance with an investment policy approved by our Board of Directors.

Eisai and Ildong are the exclusive distributors of BELVIQ in the United States and South Korea, respectively, which are the only jurisdictions for which BELVIQ has received regulatory approval for marketing. We also produce drug products for Siegfried AG, or Siegfried, and, to a lesser extent, another third party under toll manufacturing agreements.

In May 2015, Arena GmbH and Roivant Sciences, Ltd., or Roivant, entered into a Development, Marketing and Supply Agreement, or Axovant Agreement, under which Arena GmbH granted Roivant exclusive worldwide rights to develop and commercialize nelotanserin, subject to regulatory approval. In October 2015, Roivant assigned the Axovant Agreement to its subsidiary, Axovant Sciences Ltd., or Axovant. We also provide certain services and will manufacture and sell nelotanserin to Axovant.

In December 2015, we and Boehringer Ingelheim GmbH, or Boehringer Ingelheim, entered into an exclusive agreement, or Boehringer Ingelheim Agreement, to conduct joint research to identify drug candidates targeting an undisclosed GPCR that belongs to the group of orphan central nervous system, or CNS, receptors.

Percentages of our total revenues are as follows:

| | Three months ended March 31, | |
|---|---|---|
| | 2016 | 2015 |
| Eisai Agreement (See Note 6) | 57.7 % | 53.6 % |
| Boehringer Ingelheim Agreement | 13.6 % | 0.0 % |
| Ildong Agreement (See Note 7) | 11.6 % | 43.0 % |
| Toll manufacturing agreements | 10.4 % | 2.8 % |
| Axovant Agreement | 6.0 % | 0.0 % |
| Other collaborative agreements | 0.7 % | 0.6 % |
| Total percentage of revenues | 100.0% | 100.0% |

10. Net Loss Per Share

We calculate basic and diluted net loss per share using the weighted-average number of shares of common stock outstanding during the period.

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Since we are in a net loss position, in addition to excluding potentially dilutive out-of-the money securities, we exclude from our calculation of diluted net loss per share all potentially dilutive in-the-money (i) stock options, (ii) RSUs, (iii) PRSUs, (iv) unvested restricted stock in our deferred compensation plan and (v) our previously outstanding warrant, and our diluted net loss per share is the same as our basic net loss per share.

The following table presents the weighted-average number of potentially dilutive securities that were excluded from our calculation of diluted net loss per share for the periods presented, in thousands:

| | Three months ended March 31, | |
|---|---|---|
| | 2016 | 2015 |
| Stock options | 19,091 | 15,949 |
| RSUs and unvested restricted stock | 314 | 512 |
| Warrant | 0 | 131 |
| Total | 19,405 | 16,592 |

Because the market conditions for the PRSUs were not satisfied at March 31, 2016, and March 31, 2015, such securities are excluded from the table above.

11. Legal Proceedings

Beginning on September 20, 2010, a number of complaints were filed in the US District Court for the Southern District of California against us and certain of our current and former employees and directors on behalf of certain purchasers of our common stock. The complaints were brought as purported stockholder class actions, and, in general, include allegations that we and certain of our current and former employees and directors violated federal securities laws by making materially false and misleading statements regarding our BELVIQ program, thereby artificially inflating the price of our common stock. The plaintiffs sought unspecified monetary damages and other relief. On August 8, 2011, the Court consolidated the actions and appointed a lead plaintiff and lead counsel. On November 1, 2011, the lead plaintiff filed a consolidated amended complaint. On March 28, 2013, the Court dismissed the consolidated amended complaint without prejudice. On May 13, 2013, the lead plaintiff filed a second consolidated amended complaint. On November 5, 2013, the Court dismissed the second consolidated amended complaint without prejudice as to all parties except for Robert E. Hoffman, who was dismissed from the action with prejudice. On November 27, 2013, the lead plaintiff filed a motion for leave to amend the second consolidated amended complaint. On March 20, 2014, the Court denied plaintiff's motion and dismissed the second consolidated amended complaint with prejudice. On April 18, 2014, the lead plaintiff filed a notice of appeal, and on August 27, 2014, the lead plaintiff filed his appellate brief in the US Court of Appeals for the Ninth Circuit. On October 24, 2014, we filed our answering brief in response to the lead plaintiff's appeal. On December 5, 2014, the lead plaintiff filed his reply brief. A panel of the US Court of Appeals for the Ninth Circuit heard oral argument on the appeal on May 4, 2016. Due to the stage of these proceedings, we are not able to predict or reasonably estimate the ultimate outcome or possible losses relating to these claims.

12. Restructuring Charges

In October 2015, we committed to a reduction in our US workforce of approximately 35%, or a total of approximately 80 employees, which we substantially completed by December 31, 2015. In November 2015, we committed to a reduction in our Swiss workforce of approximately 17%, or a total of approximately 14 employees, which we plan to substantially complete by the end of the second quarter of 2016. As a result of these workforce reductions, we recorded a restructuring charge in the fourth quarter of 2015 for termination benefits of $4.0 million. At March 31, 2016, $3.9 million of this charge has been paid, resulting in a remaining accrual of $0.1 million.

13. Subsequent Events

On May 6, 2016, our Board of Directors appointed Amit D. Munshi as our President, Chief Executive Officer and interim principal financial officer, effective May 11, 2016. Mr. Munshi will also join our Board of Directors following our 2016 Annual Stockholders' Meeting. Harry F. Hixson, Jr., Ph.D., who has served as our interim Chief Executive Officer and interim principal financial officer since October 2015 and as a director since 2004, will remain on our Board of Directors.

In connection with such appointment, our Board of Directors' Compensation Committee approved an inducement stock option grant to Mr. Munshi to purchase 3,800,000 shares of our common stock under our 2013 Long-Term Incentive Plan, as amended on May 6, 2016, to reserve an additional 3,800,000 shares of common stock. The nonstatutory stock options will have

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a seven-year term and will vest over four years, with 25% of the shares subject to vesting one year after grant and the remainder of the shares vesting quarterly over the following three years in equal installments, subject to his continued service through the applicable vesting dates and possible acceleration in specified circumstances.

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

This discussion and analysis should be read in conjunction with our financial statements and notes thereto included in this quarterly report on Form 10-Q, or Quarterly Report, and the audited consolidated financial statements and notes thereto included in our annual report on Form 10-K for the year ended December 31, 2015, or 2015 Annual Report, as filed with the Securities and Exchange Commission, or SEC. Operating results are not necessarily indicative of results that may occur in future periods.

This Quarterly Report includes forward-looking statements that involve a number of risks, uncertainties and assumptions. These forward-looking statements can generally be identified as such because the context of the statement will include words such as "may," "will," "intend," "plan," "believe," "anticipate," "expect," "estimate," "predict," "continue," "likely," or "opportunity," the negative of these words or other similar words. Similarly, statements that describe our plans, strategies, intentions, expectations, objectives, goals or prospects and other statements that are not historical facts are also forward-looking statements. For such statements, we claim the protection of the Private Securities Litigation Reform Act of 1995. Readers of this Quarterly Report are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the time this Quarterly Report was filed with the SEC. These forward-looking statements are based largely on our expectations and projections about future events and future trends affecting our business, and are subject to risks and uncertainties that could cause actual results to differ materially from those anticipated in the forward-looking statements. These risks and uncertainties include, without limitation, the risk factors identified in our SEC reports, including this Quarterly Report. In addition, past financial or operating performance is not necessarily a reliable indicator of future performance, and you should not use our historical performance to anticipate results or future period trends. We can give no assurances that any of the events anticipated by the forward-looking statements will occur or, if any of them do, what impact they will have on our results of operations and financial condition. Except as required by law, we undertake no obligation to update publicly or revise our forward-looking statements.

OVERVIEW AND RECENT DEVELOPMENTS

We are a biopharmaceutical company focused on discovering, developing and commercializing novel, small molecule drugs that target G protein-coupled receptors, or GPCRs. To date, our efforts have resulted in one approved drug, lorcaserin (which is marketed for weight management under the brand name "BELVIQ"), and a pipeline of compounds in various stages of research, development and clinical trials, all of which were internally discovered by our scientists. Our US operations are located in San Diego, California, and our operations outside of the United States, including our commercial manufacturing facility, are located in Zofingen, Switzerland.

On May 6, 2016, our Board of Directors appointed Amit D. Munshi as our President, Chief Executive Officer and interim principal financial officer, effective May 11, 2016. Mr. Munshi will also join our Board of Directors following our 2016 Annual Stockholders' Meeting. Harry F. Hixson, Jr., Ph.D., who has served as our interim Chief Executive Officer and interim principal financial officer since October 2015 and as a director since 2004, will remain on our Board of Directors.

We are currently focusing our activities and resources primarily on the following activities:

- Advancing our proprietary clinical programs:
  - APD334 - a modulator of the sphingosine 1-phosphate subtype 1, or $S1P_1$, receptor - including our ongoing Phase 2 clinical trial for ulcerative colitis, and potentially exploring additional indications beyond inflammatory bowel disease
  - Ralinepag - an agonist of the prostacyclin receptor - including our ongoing Phase 2 clinical trial for pulmonary arterial hypertension, or PAH
  - APD371 - an agonist of the cannabinoid-2, or $CB_2$, receptor - which recently completed a Phase 1 multiple-ascending dose clinical trial with favorable results
- Pursuing strategic collaborations for certain clinical and pre-clinical programs
- Discovering and developing additional pre-clinical drug candidates

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- Supporting Eisai Inc. and Eisai Co., Ltd. (collectively, Eisai) and our other collaborators in their efforts with respect to BELVIQ, including their work to:
  - Advance the major adverse cardiovascular events, or MACE, diabetes conversion, MACE plus and other endpoints of the ongoing BELVIQ cardiovascular outcomes trial, or CVOT (also known as the CAMELLIA study)
  - Obtain regulatory approval (initially in the United States) for a once-daily formulation of BELVIQ, which we refer to as BELVIQ XR
  - Obtain regulatory approval in additional territories for BELVIQ and BELVIQ XR
- Collaborating with Axovant Sciences Ltd., or Axovant, in advancing nelotanserin, an orally available inverse agonist of the serotonin 2A receptor, which is in (i) a Phase 2 clinical trial in Lewy body dementia patients who experience frequent visual hallucinations, and (ii) a separate Phase 2 clinical trial to evaluate nelotanserin as a potential treatment for REM behavior disorder in patients with dementia with Lewy bodies
- Conducting joint research with Boehringer Ingelheim International GmbH, or Boehringer Ingelheim, under our collaboration to identify and advance drug candidates targeting a GPCR that belongs to the group of orphan central nervous system, or CNS, receptors

In general, developing drugs and obtaining marketing approval is a long, uncertain and expensive process, and our ability to execute on our plans and achieve our goals depends on numerous factors, many of which we do not control. To date, we have generated limited revenues from sales of BELVIQ and other sources. We expect to continue to incur substantial net losses for at least the short term as we advance our clinical development programs, support Eisai and our other collaborators in their efforts with respect to BELVIQ, continue our research efforts to discover and develop additional drug candidates, and manufacture BELVIQ for commercial sale and studies.

We expect our cash used in operations will be slightly lower in 2016 as compared to 2015 due to cost savings from the workforce reductions we effected at the end of 2015 and by continuing to implement cost control measures. However, we will need to receive additional funds under our existing collaborative agreements, under any new collaborative agreements we may enter into in the future (including for one or more of our drug candidates or programs), or by raising additional funds through equity, debt or other financings. We will continue to monitor and evaluate the level of our expenditures, and may further adjust our expenditures based upon a variety of factors, such as our prioritization decisions, available cash, ability to obtain additional cash through collaborations and other sources, the results of our development and research programs, the timing and costs related to our clinical trials, nonclinical studies and regulatory decisions, as well as the economic environment.

We refer you to our previously filed SEC reports for a more complete discussion of certain of our recent developments.

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RESULTS OF OPERATIONS

We are providing the following summary of our revenues, research and development expenses and general and administrative expenses to supplement the more detailed discussion below. The dollar values in the following tables are in millions.

Revenues

| | Three months ended March 31, | |
|---|---|---|
| Source of revenue | 2016 | 2015 |
| Arena’s portion of Eisai net product sales | $2.5 | $4.4 |
| Amortization of upfront payments from Eisai | 1.9 | 1.9 |
| Collaborative agreement with Boehringer Ingelheim | 1.3 | 0.0 |
| Reimbursement of development expenses and patent and trademark expenses from Eisai | 1.3 | 0.3 |
| Arena’s portion of Ildong net product sales | 1.1 | 2.2 |
| Toll manufacturing agreements | 1.0 | 0.3 |
| Other collaborative agreements | 0.6 | 0.1 |
| Amortization of upfront payment from Ildong | 0.1 | 0.1 |
| Milestone payment from Ildong | 0.0 | |