

ARENA PHARMACEUTICALS INC
Form 10-Q
May 09, 2013

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 March 31, 2013

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)

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

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

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 <input checked="" type="checkbox"/>	Accelerated filer <input type="checkbox"/>
Non-accelerated filer <input type="checkbox"/> (Do not check if a smaller reporting company)	Smaller reporting company <input type="checkbox"/>

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

The number of shares of common stock outstanding as of the close of business on April 30, 2013:

Class	Number of Shares Outstanding
Common Stock, \$0.0001 par value	217,777,073

ARENA PHARMACEUTICALS, INC.

INDEX

PART I FINANCIAL INFORMATION

Item 1.	<u>Financial Statements</u>	1
	<u>Condensed Consolidated Balance Sheets As of March 31, 2013, and December 31, 2012</u>	1
	<u>Condensed Consolidated Statements of Operations and Comprehensive Loss Three Months Ended March 31, 2013, and 2012</u>	2
	<u>Condensed Consolidated Cash Flow Statements Three Months Ended March 31, 2013, and 2012</u>	3
	<u>Notes to Unaudited Condensed Consolidated Financial Statements</u>	4
Item 2.	<u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u>	11
Item 3.	<u>Quantitative and Qualitative Disclosures About Market Risk</u>	19
Item 4.	<u>Controls and Procedures</u>	19

PART II OTHER INFORMATION

Item 1.	<u>Legal Proceedings</u>	19
Item 1A.	<u>Risk Factors</u>	19
Item 6.	<u>Exhibits</u>	42
	<u>Signatures</u>	43

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

Arena Pharmaceuticals®, Arena® and our corporate logo are registered service marks of Arena. CART and BRL Screening are unregistered service marks of Arena. BELVIQ® is a registered trademark of 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.

BELVIQ is the trade name for lorcaserin hydrochloride in the United States. While BELVIQ (lorcaserin HCl) may in the future be marketed outside of the United States as BELVIQ or under a different trade name, we use BELVIQ in this report to refer to the finished drug product for lorcaserin hydrochloride or, depending on the context, lorcaserin hydrochloride or other solid state forms of lorcaserin.

PART I. FINANCIAL INFORMATION**Item 1. Financial Statements.****Arena Pharmaceuticals, Inc.****Condensed Consolidated Balance Sheets****(In thousands)**

	March 31, 2013 (Unaudited)	December 31, 2012¹
Assets		
Current assets:		
Cash and cash equivalents	\$ 136,250	\$ 156,091
Accounts receivable	1,484	5,556
Inventory	7,179	6,058
Prepaid expenses and other current assets	3,756	3,454
Total current assets	148,669	171,159
Land, property and equipment, net	73,869	75,417
Acquired technology and other intangibles, net	10,068	10,611
Other non-current assets	4,051	4,019
Total assets	\$ 236,657	\$ 261,206
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable and other accrued liabilities	\$ 6,135	\$ 7,123
Accrued compensation	2,901	3,087
Current portion of deferred revenues	15,449	15,453
Current portion of derivative liabilities	993	2,587
Current portion of lease financing obligations	1,758	1,664
Total current liabilities	27,236	29,914
Deferred rent	149	122
Deferred revenues, less current portion	46,332	47,282
Derivative liabilities, less current portion	10,190	12,455
Lease financing obligations, less current portion	72,328	72,794
Commitments and contingencies and subsequent events		
Stockholders' equity:		
Common stock	22	22
Additional paid-in capital	1,283,672	1,281,426
Accumulated other comprehensive income	3,902	5,489
Accumulated deficit	(1,207,174)	(1,188,298)
Total stockholders' equity	80,422	98,639
Total liabilities and stockholders' equity	\$ 236,657	\$ 261,206

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- ¹ The balance sheet data at December 31, 2012, 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.

Arena Pharmaceuticals, Inc.

Condensed Consolidated Statements of Operations and Comprehensive Loss

(In thousands, except per share data)

(Unaudited)

	Three months ended March 31,	
	2013	2012
Revenues:		
Manufacturing services	\$ 765	\$ 1,292
Collaborative agreements	1,608	897
Total revenues	2,373	2,189
Operating Expenses:		
Cost of manufacturing services	1,645	791
Cost of products sold	473	0
Research and development	14,008	14,470
General and administrative	7,251	6,355
Amortization of acquired technology and other intangibles	0	176
Total operating expenses	23,377	21,792
Loss from operations	(21,004)	(19,603)
Interest and Other Income (Expense):		
Interest income	24	15
Interest expense	(1,787)	(3,031)
Gain (Loss) from valuation of derivative liabilities	3,859	(2,375)
Loss on extinguishment of debt	0	(1,670)
Other	32	87
Total interest and other income (expense), net	2,128	(6,974)
Net loss	(18,876)	(26,577)
Deemed dividend related to beneficial conversion feature of convertible preferred stock	0	(2,824)
Net loss allocable to common stockholders	\$ (18,876)	\$ (29,401)
Net loss per share allocable to common stockholders:		
Basic	\$ (0.09)	\$ (0.18)
Diluted	\$ (0.09)	\$ (0.18)
Shares used in calculating net loss per share allocable to common stockholders:		
Basic	217,503	164,213
Diluted	217,503	164,213
Comprehensive Loss:		
Net loss	\$ (18,876)	\$ (26,577)
Foreign currency translation gain (loss)	(1,588)	1,688

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Comprehensive loss	\$ (20,464)	\$ (24,889)
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See accompanying notes to unaudited condensed consolidated financial statements.

Arena Pharmaceuticals, Inc.

Condensed Consolidated Cash Flow Statements

(In thousands)

(Unaudited)

	Three months ended March 31,	
	2013	2012
Operating Activities		
Net loss	\$ (18,876)	\$ (26,577)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,950	2,405
Amortization of acquired technology and other intangibles	99	176
Share-based compensation	1,785	1,407
(Gain) Loss from valuation of derivative liabilities	(3,859)	2,375
Amortization of prepaid financing costs	34	85
Accretion of note payable to Deerfield	0	814
Loss on extinguishment of debt	0	1,670
Changes in assets and liabilities:		
Accounts receivable	4,013	(353)
Inventory	(1,300)	0
Prepaid expenses and other assets	(333)	(748)
Accounts payable and accrued liabilities	(810)	(2,637)
Deferred revenues	(954)	(822)
Deferred rent	27	(45)
Net cash used in operating activities	(18,224)	(22,250)
Investing Activities		
Purchases of land, property and equipment	(1,266)	(274)
Other non-current assets	(52)	50
Net cash used in investing activities	(1,318)	(224)
Financing Activities		
Principal payments on lease financing obligations	(372)	(288)
Principal payments on note payable to Deerfield	0	(5,000)
Proceeds from issuance of common stock	450	41,283
Proceeds from issuance of preferred stock	0	16,463
Net cash provided by financing activities	78	52,458
Effect of exchange rate changes on cash	(377)	577
Net increase (decrease) in cash and cash equivalents	(19,841)	30,561
Cash and cash equivalents at beginning of period	156,091	57,632
Cash and cash equivalents at end of period	\$ 136,250	\$ 88,193

See accompanying notes to unaudited condensed consolidated financial statements.

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, 2012, as filed with the Securities and Exchange Commission, or SEC, from which we derived our balance sheet as of December 31, 2012. 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 February 2013, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, No. 2013-02, Comprehensive Income (Topic 220) Clarifying Reporting of Amounts Reclassified Out of Accumulated Other Comprehensive Income. Under ASU No. 2013-02, companies are required to provide information about the amounts reclassified out of accumulated other comprehensive income by component. In addition, companies are required to present, either on the face of the financial statements or in the accompanying notes, significant amounts reclassified out of accumulated other comprehensive income by the respective line items of net income, but only if the amount reclassified is required to be reclassified to net income in its entirety in the same reporting period. For amounts that are not required to be reclassified in their entirety to net income, companies are required to cross-reference to other disclosures that provide additional detail on those amounts. ASU No. 2013-02 is effective prospectively for reporting periods beginning after December 15, 2012. ASU No. 2013-02 did not impact our disclosures because the balance included in accumulated other comprehensive income related only to foreign currency translation, for which there were no reclassifications in any periods reported.

In March 2013, the FASB issued ASU No. 2013-05, Parent's Accounting for the Cumulative Translation Adjustment upon Derecognition of Certain Subsidiaries or Groups of Assets within a Foreign Entity or of an Investment in a Foreign Entity, which requires the release of any related cumulative translation adjustment into net income when a parent ceases to have a controlling financial interest in a subsidiary or group of assets that is a business within a foreign entity. ASU No. 2013-05 is effective prospectively for fiscal years, and interim periods within those years, beginning after December 15, 2013. We do not expect the adoption of ASU No. 2013-05 to have a material impact on our consolidated financial statements.

The preparation of financial statements in accordance with GAAP requires our management to make estimates and assumptions that affect amounts reported in the financial statements and notes thereto. 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.

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The following tables present our valuation hierarchy for our financial assets and liabilities that are measured at fair value on a recurring basis as of March 31, 2013, and December 31, 2012, in thousands:

Fair Value Measurements at March 31, 2013				
	Balance at March 31, 2013	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<i>Assets:</i>				
Money market funds and cash equivalents ¹	\$ 118,770	\$ 118,770	\$ 0	\$ 0
<i>Liabilities:</i>				
Warrants	\$ 11,183	\$ 0	\$ 0	\$ 11,183

Fair Value Measurements at December 31, 2012				
	Balance at December 31, 2012	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
<i>Assets:</i>				
Money market funds and cash equivalents ¹	\$ 143,747	\$ 143,747	\$ 0	\$ 0
<i>Liabilities:</i>				
Warrants	\$ 15,042	\$ 0	\$ 0	\$ 15,042

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

The following table presents the activity for our derivative liabilities, which are classified as Level 3 in our valuation hierarchy, during the three months ended March 31, 2013, in thousands:

	Significant Unobservable Inputs (Level 3)
Balance at December 31, 2012	\$ 15,042
Gain from valuation of derivative liabilities	(3,859)
Balance at March 31, 2013	\$ 11,183

3. Inventory

Upon receiving FDA approval of BELVIQ in June 2012, we began to capitalize inventory costs for BELVIQ, which were recorded as research and development expenses prior to such approval. All of our inventory, which is stated at the lower of cost (using a first-in, first-out basis) or market, relates to BELVIQ. Our inventory consisted of the following as of March 31, 2013, and December 31, 2012, in thousands:

	March 31, 2013	December 31, 2012
Raw materials	\$ 484	\$ 423

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Work in process	2,325	4,184
Finished goods	4,370	1,451
Total inventory	\$ 7,179	\$ 6,058

4. Accounts Payable and Other Accrued Liabilities

Accounts payable and other accrued liabilities consisted of the following as of March 31, 2013, and December 31, 2012, in thousands:

	March 31, 2013	December 31, 2012
Accounts payable	\$ 2,456	\$ 3,884
Accrued expenses	2,371	2,006
Accrued clinical and preclinical study fees	545	566
Loss provision	688	482
Other accrued liabilities	75	185
Total accounts payable and other accrued liabilities	\$ 6,135	\$ 7,123

5. Derivative Liabilities

In June 2006 and August 2008, we issued seven-year warrants, which we refer to as the Series B Warrants, to purchase 829,856 and 1,106,344 shares of our common stock, respectively, at an exercise price of \$15.49 and \$7.71 per share, respectively. The Series B Warrants are related to our Series B Convertible Preferred Stock, which we redeemed in 2008 and is no longer outstanding. The warrants contain an anti-dilution provision and, as a result of certain subsequent equity issuances at prices below the adjustment price of \$6.72 defined in the Series B Warrants, as of March 31, 2013, the number of shares issuable upon exercise of the outstanding June 2006 and August 2008 Series B Warrants was increased to 1,467,405 and 1,965,418, respectively, and the exercise price was reduced to \$8.76 and \$4.34 per share, respectively. The Series B Warrants are recorded as derivative liabilities on our condensed consolidated balance sheets.

Our derivative liabilities consisted of the following, as of March 31, 2013, and December 31, 2012, in thousands:

	March 31, 2013	December 31, 2012
Series B Warrants - current portion	\$ 993	\$ 2,587
Series B Warrants, less current portion	10,190	12,455
Total derivative liabilities	\$ 11,183	\$ 15,042

Our outstanding warrants are revalued on each balance sheet date, with changes in the fair value between reporting periods recorded as other income or expense. The June 2006 and August 2008 Series B Warrants were valued at March 31, 2013, and December 31, 2012, using the Black-Scholes option pricing model and the following assumptions:

	March 31, 2013		December 31, 2012	
	June 2006 Series B Warrants	August 2008 Series B Warrants	June 2006 Series B Warrants	August 2008 Series B Warrants
Risk-free interest rate	0.1%	0.3%	0.1%	0.3%
Dividend yield	0%	0%	0%	0%
Expected volatility	55%	81%	66%	93%
Expected life (years)	0.25	2.37	0.50	2.62

We also previously recorded a derivative liability for a formerly outstanding right to require us to accelerate principal payments under our formerly outstanding loan from certain Deerfield entities. Until this right was terminated in May 2012, such right was revalued on each balance sheet date.

The change in the fair value of our derivative liabilities between reporting periods is recorded in the interest and other income (expense) section of our condensed consolidated statements of operations and comprehensive loss. We recognized the following gain (loss) in the three months ended March 31, 2013, and 2012, in thousands:

	Three months ended March 31,	
	2013	2012
Series B Warrants	\$ 3,859	\$ (2,430)
Deerfield acceleration right	0	55
Total gain (loss) from valuation of derivative liabilities	\$ 3,859	\$ (2,375)

6. Marketing and Supply Agreement with Eisai Inc.

In May 2012, our wholly owned subsidiary, Arena Pharmaceuticals GmbH, or Arena GmbH, and Eisai Inc., or Eisai, entered into the Amended and Restated Marketing and Supply Agreement, or Eisai Agreement, for BELVIQ, which amended and restated the original marketing and

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supply agreement the parties entered into in July 2010. This amendment expanded Eisai's exclusive rights to commercialize BELVIQ to include, in addition to the United States and its territories and possessions, most of North and South America, including Mexico, Canada and Brazil, subject to applicable regulatory approval in the additional territories. Under this agreement, we provide services related to development and regulatory activities, and we also manufacture and sell BELVIQ to Eisai. We are also entitled to receive upfront payments, milestone payments based on the achievement of regulatory filings and approvals, one-time purchase price adjustment payments and other payments, and payments from sales of BELVIQ. Revenues from the upfront payments we received of \$50.0 million when we entered into the original agreement and \$5.0 million when we entered into the amended agreement were deferred, as we determined that the exclusive rights did not have standalone value without our ongoing development and regulatory activities. These payments are being recognized ratably as revenue over the periods in which we expect the services to be rendered, which are approximately 16 years and 13 years, respectively.

In November 2012, we received \$11.6 million for BELVIQ product supply delivered to Eisai pursuant to an initial order under the Eisai Agreement, which has been recorded as deferred revenues until earned. At March 31, 2013, our condensed consolidated balance sheet included \$15.0 million and \$41.8 million for the current and non-current portion, respectively, of the total deferred revenues attributable to Eisai.

In the three months ended March 31, 2013, we recognized a \$0.5 million milestone earned upon Eisai filing for regulatory approval of BELVIQ in Mexico. We are also entitled to receive from Eisai up to \$119.0 million of additional non-refundable milestone payments, consisting of \$65.0 million upon the final scheduling designation of the US Drug Enforcement Administration, or DEA, for BELVIQ and other milestone payments totaling \$54.0 million based on achievement of regulatory filings and approvals. Under the milestone method of revenue recognition, we will recognize revenue for the amount payable to us for achieving each substantive milestone payment, if any, in the period the milestone is achieved. See Note 11.

The following table summarizes the revenues we have recognized under the Eisai Agreement in the three months ended March 31, 2013, and 2012, in thousands:

	Three months ended	
	March 31, 2013	2012
Milestone payments	\$ 500	\$ 0
Amortization of upfront payments	861	859
Reimbursements of development and patent expenses	134	0
Total	\$ 1,495	\$ 859

We manufacture and sell BELVIQ to Eisai for marketing and distribution in the United States and, subject to applicable regulatory approval, in the additional territories under our agreement for a purchase price starting at 31.5% and 30.75%, respectively, of Eisai's aggregate annual net sales (which are the gross invoiced sales less certain deductions described in the Eisai Agreement, including for certain taxes, credits, allowances, discounts, rebates, chargebacks and other items) in all of such territories on an aggregate basis. The purchase price will increase on a tiered basis in the United States and in the additional territories to as high as 36.5% and 35.75%, respectively, on the portion of Eisai's annual net sales exceeding \$750.0 million, subject to reduction (for sales in a particular country), including in the event of generic competition in the applicable country. The Eisai Agreement includes payments by Eisai if annual minimum sales requirements in the additional territories are not met during the first ten years after initial commercial sale in Mexico, Canada or Brazil. In addition, we are eligible to receive up to an aggregate of \$1.19 billion in one-time purchase price adjustment payments and other payments based on Eisai's annual net sales of BELVIQ in all of the territories under our agreement on an aggregate basis, with the first and last amounts payable with annual net 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 sales of up to \$1.0 billion. We are also eligible to receive up to an additional \$185.0 million in one-time purchase price adjustment payments based on Eisai's annual net sales of BELVIQ in the non-US territories under our agreement, with the first and last amounts payable upon first achievement of annual net sales of \$100.0 million and \$1.0 billion, respectively, in such territories.

With respect to the post-marketing studies Eisai and we committed to conduct as part of the FDA approval of BELVIQ, Eisai and we will be responsible for 90% and 10%, respectively, of the expenses for the cardiovascular outcomes trial, and we will share equally with Eisai the expenses of certain pediatric studies. Eisai is responsible for regulatory activities related to the BELVIQ New Drug Application, or NDA, and for the regulatory activities for obtaining regulatory approval in any country in the additional territories. If the regulatory authority for a country in the additional territories requires development work before or following approval of BELVIQ in such country, Eisai and we will be responsible for 90% and 10%, respectively, of the expenses for such work, with the exception of the expenses for stability testing, which we will share equally with Eisai.

Eisai will indemnify Arena GmbH for losses resulting from certain third-party claims, including for (a) Eisai's negligence, willful misconduct or violation of law, except for US product liability claims, (b) Eisai's breach of the Eisai Agreement or related agreements, except for US product liability claims, (c) certain uses or misuses of BELVIQ, (d) certain governmental investigations of Eisai related to BELVIQ, and (e) infringement relating to Eisai's use of certain trademarks related to BELVIQ. Arena GmbH will indemnify Eisai for losses resulting from US product liability claims or from certain third-party claims, including for (i) Arena GmbH's negligence, willful misconduct, failure to comply with law, breach of any agreement with a third party with respect to product development prior to the effective date of the original agreement with Eisai, (ii) Arena GmbH's negligence or willful misconduct with respect to certain uses or misuses of BELVIQ outside of the agreement, (iii) certain uses or misuses of BELVIQ after the term of the agreement or in any territory no longer under the agreement, (iv) Arena GmbH's negligence, willful misconduct or violation of law, (v) Arena GmbH's breach of the Eisai Agreement or related agreements; (vi) certain infringement of intellectual rights of a third party; and (vii) infringement relating to Eisai's use of certain trademarks related to BELVIQ. In addition, each of Arena GmbH and Eisai will share equally in losses resulting from third-party product liability claims in the territories added with the Eisai Agreement, except to the extent caused by one party's negligence, willful misconduct, violation of law or breach or default of the Eisai Agreement or certain other agreements between the parties. We are unable to predict the maximum potential amount of any future payment for such product liability indemnification provisions. As of March 31, 2013, we have not incurred any significant costs under these indemnification provisions.

Eisai may terminate the Eisai Agreement with respect to the United States or any country in the additional territories following the later of the expiration of all issued BELVIQ patents in such country and 12 years after the first commercial sale of BELVIQ in such country. Either party has the right to terminate the Eisai Agreement early in certain circumstances, including (a) if the other party is in material breach, (b) for commercialization concerns, and (c) for certain intellectual property infringement. Eisai also has the right to terminate the Eisai Agreement early in its entirety or with respect to each country in certain circumstances, including (i) termination in a country if sales of generic equivalents of BELVIQ in such country exceed sales of BELVIQ in that country (based on volume), and (ii) if Eisai is acquired by a company that has a product that competes with BELVIQ. In addition, we can terminate the Eisai Agreement early in its entirety or with respect to each country in the additional territories in certain circumstances, including termination in each country if Eisai does not satisfy certain regulatory filing and commercialization diligence requirements in such country.

7. Share-based Activity

Share-based Compensation

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

	Three months ended March 31,	
	2013	2012
Cost of products sold	\$ 17	\$ 0
Research and development	725	167
General and administrative	1,043	1,240
Total share-based compensation expense	\$ 1,785	\$ 1,407

Upon receiving FDA approval for BELVIQ in June 2012, we began to capitalize into inventory share-based compensation related to awards granted to BELVIQ manufacturing employees, which will subsequently be recognized as cost of products sold when the related inventory is sold. A total of \$66,000 of share-based compensation was capitalized as of March 31, 2013.

Share-based Award Activity

The following table summarizes our stock option activity during the three months ended March 31, 2013:

	Options	Weighted-Average Exercise Price
Outstanding at January 1, 2013	13,841,860	\$ 4.44
Granted	1,402,915	8.53
Exercised	(97,694)	3.07
Forfeited/cancelled/expired	(101,586)	3.98
Outstanding at March 31, 2013	15,045,495	\$ 4.84

There was no activity with respect to the 165,000 outstanding restricted stock unit awards, or RSUs, which have a service condition, during the three months ended March 31, 2013.

In the three months ended March 31, 2013, we granted our executive officers Total Stockholder Return, or TSR, performance restricted stock unit, or PRSU, awards. The PRSUs may be earned and converted into outstanding shares of our common stock based on the TSR of our common stock relative to the TSR over a three-year performance period beginning March 1, 2013, of the NASDAQ Biotech Index. In the aggregate, the target number of shares of common stock that may be earned under the PRSUs is 780,000; however, the actual number of shares that may be earned ranges from 0% to 200% of such amount.

As these awards contain a market condition, we used a Monte Carlo simulation model to estimate the grant-date fair value of the PRSUs, and determined related share-based compensation expense. The table below sets forth the assumptions used to value the awards and the estimated grant-date fair value:

Risk-free interest rate	0.4%
Dividend yield	0%
Expected volatility	89%
Remaining performance period (years)	2.99
Estimated fair value per share of PRSUs granted	\$ 7.50

8. Concentration 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 is the exclusive distributor and our only customer for BELVIQ in most of North and South America, and Ildong is the exclusive distributor and our only customer for BELVIQ in South Korea. We also produce drug products for Siegfried AG, or Siegfried, under a manufacturing services agreement, and all of our manufacturing services revenues are attributable to Siegfried.

Percentages of our total revenues are as follows:

	Three months ended March 31,	
	2013	2012
Eisai Agreement	63.0%	39.2%
Manufacturing services agreement with Siegfried	32.2%	59.0%

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Other collaborative agreements, including Ildong	4.8%	1.8%
Total percentage of revenues	100.0%	100.0%

9. Net Loss Per Share

We calculate basic and diluted net loss per share allocable to common stockholders using the weighted-average number of shares of common stock outstanding during the period, less any shares subject to repurchase or forfeiture. There were no shares of our common stock outstanding subject to repurchase or forfeiture for the three months ended March 31, 2013, or 2012.

Since we are in a net loss position, we have excluded outstanding stock options, RSUs and PRSUs, all of which are subject to forfeiture, as well as warrants and unvested restricted stock in our deferred compensation plan, from our calculation of diluted net loss per share, and our diluted net loss per share is the same as our basic net loss per share. The table below presents the potentially dilutive securities that would have been included in our calculation of diluted net loss per share allocable to common stockholders if they were not antidilutive for the periods presented.

	Three months ended March 31,	
	2013	2012
Stock options	5,961,308	255,226
Warrants	981,576	2,475,894
RSUs	3,187	0
Unvested restricted stock	79,169	79,169
Total	7,025,240	2,810,289

Because the market condition for the TSR PSUs was not satisfied at March 31, 2013, such securities are excluded from the table above.

10. 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 have been 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 are seeking unspecified monetary damages and other relief. On November 19, 2010, eight prospective lead plaintiffs filed motions to consolidate, appoint a lead plaintiff, and appoint lead counsel. The Court took the motions to consolidate under submission on January 14, 2011. 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 December 30, 2011, we filed a motion to dismiss the consolidated amended complaint. On March 28, 2013, the Court granted our motion to dismiss the consolidated amended complaint without prejudice, and plaintiff has until May 13, 2013, to file a new consolidated amended complaint. In addition to the class actions, a complaint involving similar legal and factual issues has been brought by at least one individual stockholder and is pending in federal court. On December 30, 2011, we filed a motion to dismiss the stockholder's complaint. On March 29, 2013, the Court granted our motion to dismiss, in part without prejudice, and plaintiff has until May 13, 2013, to file a new amended complaint. We intend to defend against any claims advanced in these proceedings and to seek dismissal of any new amended complaints. Due to the early stage of these proceedings, we are not able to predict or reasonably estimate the ultimate outcome or possible losses relating to these claims.

11. Subsequent Event

On May 8, 2013, the DEA published its final rule placing BELVIQ into Schedule IV of the Controlled Substances Act, which is effective 30 days after such date. Following the effective date, BELVIQ will be available to patients in the United States by prescription, and we will receive \$65.0 million in milestone payments from Eisai under the Eisai Agreement.

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, 2012, or 2012 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, which involve a number of risks and uncertainties. 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, potential, continue, likely, or opportunity, the negative of these words or other similar words. 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.

BELVIQ® is the trade name for lorcaserin hydrochloride in the United States. While BELVIQ (lorcaserin HCl) may in the future be marketed outside of the United States as BELVIQ or under a different trade name, we use BELVIQ in this Quarterly Report to refer to the finished drug product for lorcaserin hydrochloride or, depending on the context, lorcaserin hydrochloride or other solid state forms of lorcaserin.

OVERVIEW AND RECENT DEVELOPMENTS

We are a biopharmaceutical company focused on discovering, developing and commercializing novel drugs that target G protein-coupled receptors to address unmet medical needs. 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 June 27, 2012, the US Food and Drug Administration, or FDA, approved our internally discovered drug, BELVIQ, for chronic weight management in adults who are overweight with a comorbidity or obese. In connection with such approval, the FDA recommended that BELVIQ be classified by the US Drug Enforcement Administration, or DEA, as a scheduled drug. On May 8, 2013, the DEA published its final rule placing BELVIQ into Schedule IV of the Controlled Substances Act, which we expect will be effective on June 7, 2013. Following the effective date, BELVIQ will be available to patients in the United States by prescription, and we will receive \$65.0 million in milestone payments from Eisai under the Amended and Restated Marketing and Supply Agreement, or Eisai Agreement, between Eisai and our wholly owned subsidiary, Arena Pharmaceuticals GmbH, or Arena GmbH. We also expect to receive additional payments from Eisai in 2013 from sales of BELVIQ.

Under the Eisai Agreement, Eisai has the marketing and distribution rights for BELVIQ in most of North and South America, including the United States, Mexico, Canada and Brazil. Under the Marketing and Supply Agreement between Arena GmbH and Ildong Pharmaceutical Co., Ltd., or Ildong, herein referred to as the Ildong BELVIQ Agreement, Ildong has the marketing and distribution rights for BELVIQ in South Korea. We continue to own rights to market and distribute BELVIQ outside of these territories. The marketing of BELVIQ is subject to regulatory approval for the particular territory.

Eisai and Ildong are responsible for filing applications for regulatory approval of BELVIQ under our collaborations. In March 2013, Eisai filed an application for regulatory approval of BELVIQ in Mexico, and we expect that Eisai will also submit applications this year for regulatory approval of BELVIQ in Canada and Brazil. In addition, as part of its planned submission for regulatory approval of BELVIQ in South Korea, Ildong has filed a clinical trial application for BELVIQ in South Korea for a pharmacokinetic study, which we expect will be initiated this month.

We intend to seek regulatory approval of BELVIQ in additional territories that are not currently under collaboration. Outside of our collaborations, we filed a marketing authorization application, or MAA, for regulatory approval of BELVIQ in Switzerland. In February 2013, Swissmedic provided feedback to our MAA in the form of a list of questions with major objections. We have responded to the list of questions in writing.

We also filed an MAA for regulatory approval of BELVIQ in the European Union, which we subsequently decided to withdraw. In January 2013, we received the Day 180 List of Outstanding Issues from the European Medicines Agency, or EMA, Committee for Medicinal Products for Human Use, or CHMP, which identified major objections that needed to be addressed before the CHMP could recommend BELVIQ for marketing approval in the European Union. In accordance with the CHMP's process, we were asked to respond in writing, we were invited by the CHMP to provide an oral explanation, and we expected the CHMP to reach its final opinion at nominal Day 210, which, accounting for anticipated clock stoppages during the regulatory process, we expected to occur in the first half of 2013. Following our written response to the Day 180 List of Outstanding Issues and our April 2013 oral explanation, the CHMP's view was that certain major objections remained outstanding that precluded a recommendation for approval of the BELVIQ MAA at such time. We did not believe we could resolve the major objections related to the results of nonclinical studies prior to the time we expected the CHMP to issue its final opinion, and, therefore, we decided to withdraw the BELVIQ MAA for the European Union. We are evaluating submitting in Europe at a later date.

In addition to commercializing BELVIQ as a monotherapy for chronic weight management, we intend to explore BELVIQ's therapeutic potential in combination with other drugs and for other indications. We also intend to utilize our GPCR-focused discovery and development approach to selectively advance other of our internally discovered, oral drug candidates, which include (i) APD811, an agonist of the prostacyclin receptor intended for the treatment of pulmonary arterial hypertension, which is in Phase 1; (ii) temanogrel, an inverse agonist of the serotonin 2A receptor intended for the treatment of thrombotic diseases, which has completed single- and multiple-ascending dose Phase 1 trials and is expected to complete an additional Phase 1 trial in healthy volunteers and potentially a Phase 2a proof-of-concept trial in patients under our Co-Development and License Agreement with Ildong; (iii) APD334, an agonist of the $5HT_{1D}$ receptor intended for the treatment of a number of conditions related to autoimmune diseases, which is in Phase 1; and (iv) APD371, an agonist of the cannabinoid receptor 2 intended for the treatment of pain, which is in preclinical development. Our research and development pipeline also includes GPR119 agonists intended for the treatment of type 2 diabetes. With respect to APD811, in April 2013, we initiated dosing of an additional cohort in the Phase 1 multiple-dose clinical trial of APD811 to optimize the dosing regimen prior to potentially initiating a Phase 2 clinical trial.

Developing marketed drugs is a long, uncertain and expensive process, and our ability to achieve our goals, including commercializing BELVIQ in the United States, obtaining regulatory approval of, and commercializing, BELVIQ in additional territories, conducting required post-marketing and potentially other studies of BELVIQ, and advancing our drug candidates, depends on numerous factors, many of which we do not control. We will continue to seek to balance the high costs of research, development and manufacturing against the need to sustain our operations long enough to commercialize the results of our efforts and attain profitability.

We will use substantial cash to achieve our goals. To date, we have not generated any revenues from the sale of BELVIQ or any of our drug candidates, and BELVIQ will not be available to patients until the DEA's final scheduling designation is effective. We may continue to incur substantial losses, and do not expect to generate consistent positive operating cash flows for at least the short term. Accordingly, we will need to receive additional funds under our existing collaborative agreements, under future collaborative agreements for BELVIQ or one or more of our drug candidates or programs, or by raising additional funds through equity, debt or other financing transactions.

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

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

Source of revenue	Three months ended	
	March 31,	
	2013	2012
Amortization of upfront payments from Eisai	\$ 0.9	\$ 0.9
Manufacturing services agreement with Siegfried	0.8	1.3
Milestone payment from Eisai		