

AVEO PHARMACEUTICALS INC

Form 10-Q

August 09, 2011

Table of Contents

**UNITED STATES**  
**SECURITIES AND EXCHANGE COMMISSION**

Washington, DC 20549

**FORM 10-Q**

(Mark One)

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

For the quarterly period ended June 30, 2011

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 001-34655

**AVEO PHARMACEUTICALS, INC.**

(Exact name of registrant as specified in its charter)

Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

**Delaware**  
(State or other jurisdiction of  
incorporation or organization)

**04-3581650**  
(I.R.S. Employer  
Identification No.)

**75 Sidney Street, Cambridge, Massachusetts 02139**  
(Address of principal executive offices) (zip code)

**(617) 299-5000**  
(Registrant's telephone number, including area code)

(Former name, former address and former fiscal year, if changed since last report)

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

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

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

Large accelerated filer  Accelerated filer   
Non-accelerated filer  (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  No

Number of shares of the registrant's Common Stock, \$0.001 par value, outstanding on August 1, 2011: 43,100,459

**Table of Contents**

**AVEO PHARMACEUTICALS, INC.**

**FORM 10-Q**

**FOR THE QUARTER ENDED JUNE 30, 2011**

**TABLE OF CONTENTS**

	<b>Page No.</b>
<b><u>PART I. FINANCIAL INFORMATION</u></b>	<b>3</b>
<b>Item 1. <u>Financial Statements</u></b>	<b>3</b>
<u>Condensed Consolidated Balance Sheets as of June 30, 2011 and December 31, 2010</u>	3
<u>Condensed Consolidated Statements of Operations for the Three and Six Months Ended June 30, 2011 and 2010</u>	4
<u>Condensed Consolidated Statements of Cash Flows for the Six Months Ended June 30, 2011 and 2010</u>	5
<u>Notes to Condensed Consolidated Financial Statements</u>	6
<b>Item 2. <u>Management's Discussion and Analysis of Financial Condition and Results of Operations</u></b>	<b>23</b>
<b>Item 3. <u>Quantitative and Qualitative Disclosures About Market Risk</u></b>	<b>42</b>
<b>Item 4. <u>Controls and Procedures</u></b>	<b>42</b>
<b><u>PART II. OTHER INFORMATION</u></b>	<b>43</b>
<b>Item 1A. <u>Risk Factors</u></b>	<b>43</b>
<b>Item 2. <u>Unregistered Sales of Equity Securities and Use of Proceeds</u></b>	<b>65</b>
<b>Item 5. <u>Other Information</u></b>	<b>65</b>
<b>Item 6. <u>Exhibits</u></b>	<b>65</b>
<u>Signatures</u>	66

**Table of Contents****PART I. FINANCIAL INFORMATION****Item 1. Financial Statements.****AVEO PHARMACEUTICALS, INC.****Condensed Consolidated Balance Sheets****(in thousands, except par value amounts)***(unaudited)*

	June 30, 2011	December 31, 2010
<b>Assets</b>		
Current assets:		
Cash and cash equivalents	\$ 81,013	\$ 45,791
Marketable securities	183,295	94,407
Accounts receivable	28,770	391
Prepaid expenses and other current assets	9,294	4,864
<b>Total current assets</b>	<b>302,372</b>	<b>145,453</b>
Marketable securities	32,476	
Property and equipment, net	5,008	4,532
Other assets	230	456
Restricted cash	705	607
<b>Total assets</b>	<b>\$ 340,791</b>	<b>\$ 151,048</b>
<b>Liabilities and stockholders equity</b>		
Current liabilities:		
Accounts payable	\$ 12,938	\$ 9,247
Accrued expenses	10,277	10,121
Loans payable, net of discount	6,039	5,766
Deferred revenue	2,230	16,693
Other liabilities	1,249	
Deferred rent	268	266
<b>Total current liabilities</b>	<b>33,001</b>	<b>42,093</b>
Loans payable, net of current portion and discount	17,815	17,636
Deferred revenue, net of current portion	20,331	16,509
Deferred rent, net of current portion	446	553
Other liabilities	1,238	2,487
Stockholders equity:		
Preferred stock, \$.001 par value: 5,000 shares authorized at June 30, 2011 and December 31, 2010, respectively; no shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively		
Common stock, \$.001 par value: 100,000 shares authorized at June 30, 2011 and December 31, 2010, respectively; 42,901 and 35,604 shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively	43	36
Additional paid-in capital	424,732	308,268
Accumulated other comprehensive income (loss)	64	(20)
Accumulated deficit	(156,879)	(236,514)

Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

Total stockholders' equity	267,960	71,770
Total liabilities and stockholders' equity	\$ 340,791	\$ 151,048

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

**Table of Contents****AVEO PHARMACEUTICALS, INC.****Condensed Consolidated Statements of Operations****(in thousands, except per share amounts)***(unaudited)*

	<b>Three Months Ended June 30,</b>		<b>Six Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>	<b>2011</b>	<b>2010</b>
Collaboration revenue	\$ 26,554	\$ 15,622	\$ 160,168	\$ 26,503
Operating expenses:				
Research and development	25,078	25,997	63,095	48,615
General and administrative	6,371	3,835	15,599	6,588
	31,449	29,832	78,694	55,203
Income (loss) from operations	(4,895)	(14,210)	81,474	(28,700)
Other income and expense:				
Other income (expense), net	11	(582)	(45)	130
Interest expense	(946)	(725)	(1,958)	(1,332)
Interest income	99	28	164	35
Other (expense) income, net	(836)	(1,279)	(1,839)	(1,167)
Net income (loss)	\$ (5,731)	\$ (15,489)	\$ 79,635	\$ (29,867)
Basic net income (loss) per share				
Net income (loss)	\$ (0.16)	\$ (0.50)	\$ 2.19	\$ (1.60)
Weighted average number of common shares outstanding	36,849	30,822	36,318	18,649
Diluted net income (loss) per share				
Net income (loss)	\$ (0.16)	\$ (0.50)	\$ 2.09	\$ (1.60)
Weighted average number of common shares and dilutive common share equivalents outstanding	36,849	30,822	38,120	18,649

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

**Table of Contents****AVEO PHARMACEUTICALS, INC.****Condensed Consolidated Statements of Cash Flows****(in thousands)****(unaudited)**

	<b>Six Months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
<b>Operating activities</b>		
Net income (loss)	\$ 79,635	\$ (29,867)
Adjustments to reconcile net income (loss) to net cash provided by (used in) operating activities:		
Depreciation and amortization	765	643
Stock-based compensation	2,593	1,914
Non-cash interest expense	462	893
Deferred rent	(105)	(73)
Loss on disposal of property and equipment		1
Remeasurement of warrants to purchase convertible preferred stock		(713)
Amortization of premium on investments	1,633	22
Changes in operating assets and liabilities:		
Accounts receivable	(28,379)	280
Prepaid expenses and other current assets	(4,441)	(4,637)
Other noncurrent assets	226	1,320
Restricted cash	(98)	
Accounts payable	3,691	3,477
Accrued expenses	156	316
Deferred revenue	(10,641)	(2,508)
Net cash provided by (used in) operating activities	45,497	(28,932)
<b>Investing activities</b>		
Purchases of property and equipment	(1,241)	(408)
Purchases of marketable securities	(200,749)	(77,021)
Proceeds from maturities and sales of marketable securities	77,836	6,000
Net cash used in investing activities	(124,154)	(71,429)
<b>Financing activities</b>		
Proceeds from issuance of common stock, net of issuance costs	112,165	80,309
Proceeds from exercise of stock options and issuance of common stock	1,714	502
Proceeds from refinancing of loans payable		7,555
Principal payments on loans payable		(3,278)
Net cash provided by financing activities	113,879	85,088
Net increase (decrease) in cash and cash equivalents	35,222	(15,273)
Cash and cash equivalents at beginning of period	45,791	45,290
Cash and cash equivalents at end of period	\$ 81,013	\$ 30,017
<b>Supplemental cash flow and noncash investing and financing</b>		
Issuance of warrants in conjunction with loan	\$	\$ 780
Cash paid for interest	\$ 1,504	\$ 914

Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

Cash paid for income taxes	\$	\$
----------------------------	----	----

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



---

**Table of Contents**

**AVEO Pharmaceuticals, Inc.**

**Notes to Condensed Consolidated Financial Statements**

**(Unaudited)**

**(1) Organization**

AVEO Pharmaceuticals, Inc. (the Company) is a cancer therapeutics company committed to discovering, developing and commercializing targeted cancer therapies to impact patients' lives. The Company's product candidates are directed against important mechanisms, or targets, known or believed to be involved in cancer. Tivozanib, the Company's lead product candidate currently in phase 3 clinical development, which the Company recently partnered with Astellas Pharma Inc. and its wholly-owned direct subsidiaries (Astellas), is designed to provide an optimal blockade of the vascular endothelial growth factor, or VEGF, pathway by inhibiting all three VEGF receptors: VEGF receptors 1, 2 and 3. The Company also has a pipeline of monoclonal antibodies, including ficlatuzumab, a product candidate that is currently in phase 2 clinical development, derived from its Human Response Platform, a novel method of building preclinical models of human cancer. As used throughout these unaudited, condensed consolidated financial statements, the terms AVEO, we, us, and our refer to the business of AVEO Pharmaceuticals Inc. and its subsidiary.

**(2) Basis of Presentation**

These condensed consolidated financial statements include the accounts of the Company and its wholly-owned subsidiary. The Company has eliminated all significant intercompany accounts and transactions in consolidation.

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals and revisions of estimates, considered necessary for a fair presentation of the accompanying condensed consolidated financial statements have been included. Interim results for the three and six months ended June 30, 2011 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2011 or any other future period.

The information presented in the condensed consolidated financial statements and related footnotes at June 30, 2011, and for the three and six months ended June 30, 2011 and 2010, is unaudited and the condensed consolidated balance sheet amounts and related footnotes at December 31, 2010 have been derived from the Company's audited financial statements. For further information, refer to the consolidated financial statements and accompanying footnotes included in the Company's annual report on Form 10-K for the fiscal year ended December 31, 2010, which was filed with the U.S. Securities and Exchange Commission on March 11, 2011.

**(3) Significant Accounting Policies**

***Basic and Diluted Income (Loss) per Common Share***

The Company reports earnings per share in accordance with Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 260, *Earnings Per Share* (ASC 260), which establishes standards for computing and presenting earnings per share. Basic earnings per share is computed by dividing net income (loss) available to common shareholders by the weighted average number of common shares outstanding during the period. Preferred shares are not included in the calculation of net income (loss) per share until their conversion to common shares. Diluted earnings per share is computed by dividing net income available to common shareholders by the weighted-average number of common shares and dilutive common share equivalents then outstanding. Potential common share equivalents consist of the incremental common shares issuable upon the exercise of stock options and warrants. Under the treasury stock method, unexercised in-the-money stock options are assumed to be exercised at the beginning of the period or at issuance, if later. The assumed proceeds are then used to purchase common shares at the average market price during the period. Share-based payment awards that entitle their holders to receive non-forfeitable dividends before vesting are considered participating securities and are included in the calculation of basic and diluted earnings per share. Common share equivalents have not been included in the net loss per share computation in the three months ended June 30, 2011 and 2010 and the six months ended June 30, 2010 because their effect is anti-dilutive.

**Table of Contents**

Basic and diluted earnings per share for the three and six months ended June 30, 2011 and 2010 are as follows:

	Three Months Ended June 30, 2011 (in thousands, except per share data)		Six Months Ended June 30, 2011 (in thousands, except per share data)	
<b>Basic earnings per share</b>				
Net income (loss)	\$ (5,731)	\$ (15,489)	\$ 79,635	\$ (29,867)
Income allocated to participating securities			(113)	
Income (loss) available to common stockholders	(5,731)	(15,489)	79,522	(29,867)
Basic weighted average common shares outstanding	36,849	30,822	36,318	18,649
Basic earnings (loss) per share	\$ (0.16)	\$ (0.50)	\$ 2.19	\$ (1.60)
<b>Diluted earnings per share</b>				
Net income (loss)	\$ (5,731)	\$ (15,489)	\$ 79,635	\$ (29,867)
Income allocated to participating securities			(103)	
Income (loss) available to common stockholders	(5,731)	(15,489)	79,532	(29,867)
Weighted average common shares outstanding	36,849	30,822	36,318	18,649
Diluted potential common shares			1,802	
Diluted weighted average common shares and potential common shares	36,849	30,822	38,120	18,649
Diluted earnings (loss) per share	\$ (0.16)	\$ (0.50)	\$ 2.09	\$ (1.60)

**Stock-Based Compensation**

The fair value of all stock-based awards is recognized in the Company's statements of operations on a straight-line basis over their requisite service periods based on their grant date fair values as calculated using the measurement and recognition provisions of FASB ASC Topic 718, *Stock Compensation*. During the three and six months ended June 30, 2011 and 2010, respectively, the Company recorded the following stock-based compensation expense:

	Three Months Ended June 30, 2011 (in thousands)		Six Months Ended June 30, 2011 (in thousands)	
Research and development	\$ 583	\$ 421	\$ 1,130	\$ 779
General and administrative	828	677	1,463	1,135
	\$ 1,411	\$ 1,098	\$ 2,593	\$ 1,914

Allocations to research and development expenses and general and administrative expenses are based upon the department to which the associated employee reported. No related tax benefits of the stock-based compensation expense have been recognized. Stock-based awards issued to non-employees are recorded at their fair values, and are periodically revalued as the equity instruments vest and are recognized as expense over the related service period.

**Revenue Recognition**

The Company's revenues are generated primarily through collaborative research, development and commercialization agreements. The terms of these agreements generally contain multiple elements, or deliverables, which may include (i) licenses, or options to obtain licenses, to the

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

Company's technology, (ii) research and development activities to be performed on behalf of the collaborative partner and (iii) in certain cases, services in connection with the manufacturing of pre-clinical and clinical material. Payments to the Company under these arrangements typically include one or more of the following: non-refundable, up-front license fees; option exercise fees; funding of research and/or development efforts; milestone payments; and royalties on future product sales.

Effective January 1, 2011, the Company adopted Accounting Standards Update (ASU) No. 2009-13, *Multiple-Deliverable Revenue Arrangements*, which amends ASC Topic 605-25, *Revenue Recognition - Multiple Element Arrangements*. In addition, effective January 1, 2011, the Company adopted ASU No. 2010-17, *Revenue Recognition - Milestone Method*. Refer to *New Accounting Pronouncements* below for additional discussion of these standards and their impact on the Company's accounting for collaborative research, development and commercialization agreements.

## **Table of Contents**

When evaluating multiple element arrangements, the Company considers whether the deliverables under the arrangement represent separate units of accounting. This evaluation requires subjective determinations and requires management to make judgments about the individual deliverables and whether such deliverables are separable from the other aspects of the contractual relationship. In determining the units of accounting, management evaluates certain criteria, including whether the deliverables have standalone value, based on the consideration of the relevant facts and circumstances for each arrangement. The consideration received is allocated among the separate units of accounting, and the applicable revenue recognition criteria are applied to each of the separate units.

The Company typically receives up-front, non-refundable payments when licensing its intellectual property in conjunction with a research and development agreement. When management believes the license to its intellectual property does not have stand-alone value from the other deliverables to be provided in the arrangement, the Company generally recognizes revenue attributed to the license on a straight-line basis over the Company's contractual or estimated performance period, which is typically the term of the Company's research and development obligations. If management cannot reasonably estimate when the Company's performance obligation ends, then revenue is deferred until management can reasonably estimate when the performance obligation ends. When management believes the license to its intellectual property has stand-alone value, the Company generally recognizes revenue attributed to the license upon delivery. The periods over which revenue should be recognized are subject to estimates by management and may change over the course of the research and development agreement. Such a change could have a material impact on the amount of revenue the Company records in future periods.

Payments or reimbursements resulting from the Company's research and development efforts for those arrangements where such efforts are considered as deliverables are recognized as the services are performed and are presented on a gross basis so long as there is persuasive evidence of an arrangement, the fee is fixed or determinable, and collection of the related receivable is reasonably assured. Amounts received prior to satisfying the above revenue recognition criteria are recorded as deferred revenue in the accompanying balance sheets.

At the inception of each agreement that includes milestone payments, the Company evaluates whether each milestone is substantive and at risk to both parties on the basis of the contingent nature of the milestone, specifically reviewing factors such as the scientific and other risks that must be overcome to achieve the milestone, as well as the level of effort and investment required. Revenues from milestones, if they are nonrefundable and deemed substantive, are recognized upon successful accomplishment of the milestones. Milestones that are not considered substantive are accounted for as license payments and recognized on a straight-line basis over the remaining period of performance.

### ***Principles of Consolidation***

The Company's condensed consolidated financial statements include the Company's accounts and the accounts of the Company's wholly-owned subsidiary, AVEO Pharma Limited. All intercompany transactions have been eliminated.

### ***Research and Development Expenses***

Research and development expenses are charged to expense as incurred. Research and development expenses consist of costs incurred in performing research and development activities, including personnel-related costs, stock-based compensation, facilities, research-related overhead, clinical trial costs, manufacturing costs and other contracted services, license fees, and other external costs.

Nonrefundable advance payments for goods and services that will be used in future research and development activities are expensed when the activity has been performed or when the goods have been received rather than when the payment is made in accordance with the provisions of ASC Topic 730, *Research and Development*.

### ***Cash and Cash Equivalents***

The Company considers highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. Cash equivalents at June 30, 2011 and December 31, 2010 consist of money market funds, commercial paper, corporate bonds and U.S. government agency securities.

### ***Marketable Securities***

Marketable securities at June 30, 2011 and December 31, 2010 primarily consist of U.S. treasuries, U.S. government agency securities, a foreign government agency security, commercial paper and corporate debt maintained by an investment manager. Credit risk is reduced as a result of the Company's policy to limit the amount invested in any one issue. Marketable securities consist



**Table of Contents**

primarily of investments which have original maturities at the date of purchase in excess of three months, but not longer than 24 months. The Company classifies these investments as available-for-sale. Unrealized gains and losses are included in other comprehensive income as a component of stockholders' equity until realized. The cost of securities sold is based on the specific identification method. There were no realized gains or losses recognized on the sale or maturity of securities during the three and six months ended June 30, 2011 and 2010.

Available-for-sale securities at June 30, 2011 and December 31, 2010 consist of the following:

	Amortized Cost	Unrealized Gains	Unrealized Losses	Fair Value
	(in thousands)			
<b>June 30, 2011:</b>				
Corporate debt securities (Due within 1 year)	\$ 138,623	\$ 125	\$ (42)	\$ 138,706
Corporate debt security (Due after 1 year through 2 years)	5,119		(25)	5,094
U.S. Treasuries (Due within 1 year)	7,101	5		7,106
Government agency securities (Due within 1 year)	33,437	3	(1)	33,439
Government agency securities (Due after 1 year through 2 years)	27,384	9	(11)	27,382
Foreign government agency security (Due within 1 year)	4,043	1		4,044
	\$ 215,707	\$ 143	\$ (79)	\$ 215,771
<b>December 31, 2010:</b>				
Corporate debt securities (Due within 1 year)	\$ 71,615	\$ 19	\$ (27)	\$ 71,607
U.S. Treasury (Due within 1 year)	5,178		(1)	5,177
Government agency securities (Due within 1 year)	13,503		(6)	13,497
Foreign government agency security (Due within 1 year)	4,131		(5)	4,126
	\$ 94,427	\$ 19	\$ (39)	\$ 94,407

The aggregate fair value of securities in an unrealized loss position for less than 12 months at June 30, 2011 was \$65.4 million, representing twenty nine securities. The aggregate fair value of securities in an unrealized loss position for greater than 12 months at June 30, 2011 was \$21.5 million, representing four securities. The unrealized loss was caused by a temporary change in the market for those securities. There was no change in the credit risk of the securities. To determine whether an other-than-temporary impairment exists, the Company performs an analysis to assess whether it intends to sell, or whether it would more likely than not be required to sell, the security before the expected recovery of the amortized cost basis. Where the Company intends to sell a security, or may be required to do so, the security's decline in fair value is deemed to be other-than-temporary and the full amount of the unrealized loss is recorded in the statement of operations as an other-than-temporary impairment charge. When this is not the case, the Company performs additional analysis on all securities with unrealized losses to evaluate losses associated with the creditworthiness of the security. Credit losses are identified where the Company does not expect to receive cash flows, based on using a single best estimate, sufficient to recover the amortized cost basis of a security and these are recognized in other income (expense), net.

Marketable securities in an unrealized loss position at June 30, 2011 and December 31, 2010 consists of the following:

	Aggregate Fair Value	Unrealized Losses
	(in thousands)	
<b>June 30, 2011:</b>		
Corporate debt securities (Due within 1 year)	\$ 55,666	\$ (42)
Corporate debt security (Due after 1 year through 2 years)	5,094	(25)
Government agency securities (Due within 1 year)	9,754	(1)
Government agency securities (Due after 1 year through 2 years)	16,372	(11)
	\$ 86,886	\$ (79)

	<b>Aggregate Fair Value</b>	<b>Unrealized Losses</b>
	(in thousands)	
<b>December 31, 2010:</b>		
Corporate debt securities (Due in less than 1 year)	\$ 27,536	\$ (27)
U.S. Treasury (Due in less than 1 year)	5,177	(1)
Government agency securities (Due in less than 1 year)	13,497	(6)
Foreign government agency security (Due in less than 1 year)	4,126	(5)
	\$ 50,336	\$ (39)

**Table of Contents**

Based on consideration of those factors described in the previous paragraph, the Company does not believe an other-than temporary impairment exists with respect to those securities in an unrealized loss position at June 30, 2011.

**Concentrations of Credit Risk**

Financial instruments that potentially subject the Company to credit risk primarily consist of cash and cash equivalents and available-for-sale marketable securities. The Company maintains deposits in federally insured financial institutions in excess of federally insured limits.

Management believes that the Company is not exposed to significant credit risk due to the financial position of the depository institutions in which those deposits are held.

The Company's credit risk related to marketable securities is reduced as a result of the Company's policy to limit the amount invested in any one issue.

**Fair Value Measurements**

The carrying amounts of the Company's financial instruments not required to be measured at fair value, which include accounts receivable, accounts payable, and loans payable, approximate their fair values at June 30, 2011 and December 31, 2010.

The Company records cash equivalents, marketable securities and warrants to purchase preferred stock at fair value. ASC Topic 820, *Fair Value Measurements and Disclosures*, establishes a fair value hierarchy for those instruments measured at fair value that distinguishes between fair value measurements based on market data (observable inputs) and those based on the Company's own assumptions (unobservable inputs). The hierarchy consists of three levels:

Level 1 Quoted market prices in active markets for identical assets or liabilities. Assets utilizing Level 1 inputs include U.S. government securities.

Level 2 Inputs other than Level 1 inputs that are either directly or indirectly observable, such as quoted market prices, interest rates and yield curves. Assets utilizing Level 2 inputs include government agency securities, including direct issuance bonds, and corporate bonds. These assets are valued using third party pricing sources which generally use interest rates and yield curves observable at commonly quoted intervals of similar assets as observable inputs for pricing.

Level 3 Unobservable inputs developed using estimates and assumptions developed by the Company, which reflect those that a market participant would use. The Company currently has no assets or liabilities valued with Level 3 inputs.

The following tables summarize the cash equivalents and marketable securities measured at fair value on a recurring basis in the accompanying condensed consolidated balance sheets as of June 30, 2011 and December 31, 2010.

	Fair Value Measurements of Cash Equivalents and Marketable Securities as of June 30, 2011			
	Level 1	Level 2	Level 3	Total
	(in thousands)			
Cash equivalents	\$ 71,622	\$ 6,206	\$	\$ 77,828
Marketable securities	7,105	208,666		215,771
	\$ 78,727	\$ 214,872	\$	\$ 293,599



**Fair Value Measurements of Cash Equivalents and  
Marketable**

**Securities as of December 31, 2010**

	<b>Level 1</b>	<b>Level 2</b>	<b>Level 3</b>	<b>Total</b>
	<b>(in thousands)</b>			
Cash equivalents	\$ 28,767	\$ 14,015	\$	\$ 42,782
Marketable securities	5,177	89,230		94,407
	\$ 33,944	\$ 103,245	\$	\$ 137,189

**Table of Contents*****Property and Equipment***

Property and equipment are stated at cost and are depreciated using the straight-line method over the estimated useful lives of the respective assets. Maintenance and repair costs are charged to expense as incurred.

***Long-lived Assets***

The Company reviews long-lived assets, including property and equipment, for impairment whenever changes in business circumstances indicate that the carrying amount of the asset may not be fully recoverable. The Company has not recognized any impairment losses through June 30, 2011.

***Comprehensive Income (Loss)***

Comprehensive income (loss) is defined as the change in equity of a business enterprise during a period from transactions and other events and circumstances from non-owner sources. Accumulated other comprehensive income (loss) as of June 30, 2011 and 2010 consists entirely of unrealized gains/(losses) on available-for-sale securities.

	<b>Six months Ended June 30,</b>	
	<b>2011</b>	<b>2010</b>
	<b>(in thousands)</b>	
Net income (loss)	\$ 79,635	\$ (29,867)
Net unrealized gains on marketable securities	84	16
<b>Comprehensive income (loss)</b>	<b>\$ 79,719</b>	<b>\$ (29,851)</b>

***Income Taxes***

The Company provides for income taxes using the liability method. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax bases of assets and liabilities, and are measured using the enacted tax rates and laws that will be in effect when the differences are expected to reverse.

***Segment and Geographic Information***

Operating segments are defined as components of an enterprise engaging in business activities for which discrete financial information is available and regularly reviewed by the chief operating decision maker in deciding how to allocate resources and in assessing performance. The Company views its operations and manages its business in one operating segment and the Company operates in only one geographic segment.

***Use of Estimates***

The preparation of financial statements in conformity with accounting principles generally accepted in the United States requires the Company's management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. Actual results could differ from those estimates.

***New Accounting Pronouncements***

Effective January 1, 2011, the Company adopted ASU 2009-13, which amends ASC Topic 605-25 to eliminate the residual method of allocation for multiple-deliverable revenue arrangements and requires that arrangement consideration be allocated at the inception of an arrangement to all deliverables using the relative selling price method. ASU 2009-13 also establishes a selling price hierarchy for determining the selling price of a deliverable, which includes: (1) vendor-specific objective evidence ( VSOE ) if available; (2) third-party evidence ( TPE ) if VSOE is not available; and (3) estimated selling price if neither VSOE nor TPE is available.



---

**Table of Contents**

Prior to the adoption of ASU 2009-13, ASC Topic 605-25 required that the fair value of an undelivered item be determined by reference to VSOE or TPE. This was difficult to determine when a deliverable was not individually sold because of its unique features. Prior to the adoption of ASU 2009-13, if the fair value of the undelivered elements in the arrangement was not determinable, then revenue was generally deferred and recognized over the delivery period of the longest deliverable or when fair value was determined for the undelivered elements. The Company has elected to prospectively apply the provisions of ASU 2009-13 to all multiple-deliverable revenue arrangements entered into or materially modified after January 1, 2011. The adoption of ASU 2009-13 had a material impact on the Company's financial position and results of operations for the three and six months ended June 30, 2011 as discussed in Note 4, Collaborations and License Agreements.

On January 1, 2011, the Company adopted ASU 2010-17, which codified a method of revenue recognition that has been common practice. This guidance concludes that the milestone method is a valid application of the proportional performance model when applied to research or development arrangements. Accordingly, an entity can make an accounting policy election to recognize a payment that is contingent upon the achievement of a substantive milestone in its entirety in the period in which the milestone is achieved. Because the Company's revenue recognition policy for milestone payments is generally consistent with ASU 2010-17, the adoption of this standard did not have a material effect on the Company's condensed consolidated financial position, results of operations or cash flows for the three and six months ended June 30, 2011. This standard may impact the Company's accounting for any milestone payments received in future periods.

***Subsequent Events***

The Company has evaluated all events or transactions that occurred after June 30, 2011 up through the date the Company issued these financial statements.

**(4) Collaborations and License Agreements*****Astellas Pharma Inc.***

On February 16, 2011, the Company, together with its wholly owned subsidiary, entered into a Collaboration and License Agreement with Astellas (the Astellas Agreement), pursuant to which the Company and Astellas will develop and commercialize tivozanib, AVEO's product candidate currently in phase 3 clinical development, for the treatment of a broad range of cancers, including renal cell carcinoma (RCC) and breast and colorectal cancers. Under the terms of the Astellas Agreement, AVEO and Astellas will share responsibility for continued development and commercialization of tivozanib in North America and in Europe under a joint development plan and a joint commercialization plan, respectively. Throughout the rest of the world (the Royalty Territory), excluding Asia, where Kyowa Hakko Kirin (KHK) has retained all development and commercialization rights, Astellas has an exclusive, royalty-bearing license to develop and commercialize tivozanib. The terms of the Astellas Agreement are subject to the Company's obligations to KHK under a license agreement entered into with KHK in 2006 pursuant to which AVEO acquired exclusive rights to develop and commercialize tivozanib worldwide outside of Asia.

The Company will have lead responsibility for formulating the commercialization strategy for North America under the joint commercialization plan, with each of the Company and Astellas responsible for conducting fifty percent (50%) of the sales efforts and medical affairs activities in North America. Astellas will have lead responsibility for commercialization activities in Europe under the joint commercialization plan, with each of the Company and Astellas responsible for conducting fifty percent (50%) of the medical affairs activities in the major European countries. All costs associated with each party's conduct of development and commercialization activities (including clinical manufacturing and commercial manufacturing costs, if any) in North America and Europe, and any resulting profits or losses, will be shared equally between the parties.

Under the Astellas Agreement, the Company received an initial cash payment of \$125 million, comprised of a \$75 million license fee and \$50 million in research and development funding. The Company retained net proceeds of approximately \$97.6 million of the initial cash payment from Astellas, after payments to KHK and strategic, legal and financial advisors. The Company is also eligible to receive from Astellas an aggregate of approximately \$1.3 billion in potential milestone payments, comprised of (i) up to \$575 million in milestone payments upon achievement of specified clinical development and regulatory milestone events, including up to \$90 million in milestone payments in connection with specified regulatory filings, and receipt of marketing approvals, for tivozanib to treat RCC in the United States and Europe, and (ii) up to approximately \$780 million in milestone payments upon the achievement of specified sales events. In addition, if tivozanib is successfully developed and launched in the Royalty Territory, Astellas will be required to pay to AVEO tiered, double digit royalties on net sales of tivozanib in the Royalty Territory, if any, subject to offsets under certain circumstances. The Company is required to pay KHK low to mid teen royalties on its net sales in North America, and 30% of certain amounts the Company may receive from Astellas in connection with Astellas' development and commercialization activities in Europe and the Royalty Territory, including up-front license fees, milestone payments and royalties.

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

Unless terminated earlier in accordance with its terms, the Astellas Agreement expires (a) with respect to the Royalty Territory, on a country by-country basis, upon the latest to occur of: (i) the expiration of the last-to-expire valid claim of an AVEO patent or joint patent covering the composition of tivozanib, (ii) the expiration of the last-to-expire valid claim of an AVEO patent or joint

**Table of Contents**

patent covering the use of tivozanib, but only for so long as no generic competition exists in such country, and (iii) twelve years from first commercial sale of tivozanib in such country, and (b) with respect to North America and Europe as a whole, upon the expiration of all payment obligations between the parties related to development and commercialization of tivozanib in North America and Europe. After the second anniversary of the effective date of the Astellas Agreement, Astellas has the right to terminate the Astellas Agreement, in its entirety or solely with respect to the Royalty Territory, at any time upon 180 days prior written notice to the Company. Either party may terminate the Astellas Agreement with respect to a specified territory or country as set forth in the Astellas Agreement, if the other party fails to cure a material breach related to such territory or country, as applicable. The Company may also terminate the Astellas Agreement in its entirety upon a patent-related challenge by Astellas, its affiliates or sublicensees, if such patent-related challenge is not withdrawn within 30 days following the Company's notice to Astellas of such termination. There are no refund provisions in the Astellas Agreement that have financial consequences that impact the Company.

The Company is accounting for the joint development and commercialization activities in North America and Europe as a joint risk sharing collaboration in accordance with ASC Topic 808, *Collaborative Arrangements*. Accordingly, the joint development and commercialization activities in North America and Europe were separated from the other deliverables included in the Astellas Agreement. In addition, these activities were not deemed to be separate deliverables under the Astellas Agreement, and accordingly, none of the up-front consideration was attributed to the joint development and commercialization activities in North America and Europe.

Payments from Astellas with respect to Astellas' share of tivozanib development and commercialization costs incurred by the Company pursuant to the joint development plan are recorded as a reduction to research and development expense and general and administrative expense in the accompanying condensed consolidated financial statements due to the joint risk sharing nature of the activities in North America and Europe. As a result of the cost-sharing provisions in the Astellas Agreement, the Company reduced research and development expense by \$6.1 million and \$12.3 million during the three and six months ended June 30, 2011, respectively, and general and administrative expense by \$0.2 million and \$0.4 million during the three and six months ended June 30, 2011, respectively. Included in the Company's accounts receivable balance on the consolidated balance sheet at June 30, 2011 is \$12.5 million for amounts due from Astellas pursuant to the cost-sharing provisions. The Company has received \$6.2 million of this amount subsequent to June 30, 2011.

Activities under the Astellas Agreement outside of the joint development and commercialization activities in North America and Europe, including the co-exclusive license to develop and commercialize tivozanib in North America and Europe that was delivered prior to the initiation of the collaborative activities in North America and Europe, were evaluated under ASC Topic 605-25 (as amended by ASU 2009-13) to determine if they represented a multiple element revenue arrangement. The Astellas Agreement includes the following deliverables: (1) a co-exclusive license to develop and commercialize tivozanib in North America and Europe (the License Deliverable); (2) a combined deliverable comprised of an exclusive royalty-bearing license to develop and commercialize tivozanib in the Royalty Territory and the Company's obligation to provide access to clinical and regulatory information resulting from the activities in North America and Europe to Astellas for its development and commercialization of tivozanib in the Royalty Territory (the Royalty Territory Deliverable); and (3) the Company's obligation to supply clinical material to Astellas for development of tivozanib in the Royalty Territory (the Clinical Material Deliverable). All of these deliverables were deemed to have stand-alone value and to meet the criteria to be accounted for as separate units of accounting under ASC Topic 605-25. Factors considered in this determination included, among other things, the subject of the licenses and the research and development and commercial capabilities of Astellas.

The Company allocated the up-front consideration of \$125 million to the deliverables based on management's best estimate of selling price of each deliverable using the relative selling price method as the Company did not have VSOE or TPE of selling price for such deliverables. The Company's best estimate of selling price considered discounted cash flow models, the key assumptions of which included the market opportunity for commercialization of tivozanib in North America and Europe and the Royalty Territory, the development costs and market opportunity for the expansion of tivozanib into other solid tumor types, and the time to commercialization of tivozanib for all potential oncology indications. The Company allocated up-front consideration of \$120.2 million to the License Deliverable and up-front consideration of \$4.8 million to the Royalty Territory Deliverable. The relative selling price of the Company's obligation under the Clinical Material Deliverable had *de minimus* value.

The Company recorded the \$120.2 million relative selling price of the License Deliverable as collaboration revenue during the three months ended March 31, 2011 upon delivery of the license, and deferred approximately \$4.8 million of revenue representing the relative selling price of the Royalty Territory Deliverable. The Company is recording the \$4.8 million of revenue attributed to the Royalty Territory Deliverable ratably over the Company's period of performance through April 2022, the remaining patent life of tivozanib. The Company recorded approximately \$107,000 and \$161,000 of revenue during the three and six months ended June 30, 2011, respectively, associated with the Royalty Territory Deliverable.



**Table of Contents**

The Company believes the development and approval milestones that may be received under the Astellas Agreement are consistent with the definition of a milestone included in ASU 2010-17 and, accordingly, the Company will recognize payments related to the achievement of such milestones, if any, as revenue upon receipt. Factors considered in this determination included scientific and regulatory risks that must be overcome to achieve each milestone, the level of effort and investment required to achieve each milestone, and the monetary value attributed to each milestone.

The adoption of ASU 2009-13 on January 1, 2011 materially affected the Company's accounting for the Astellas Agreement. Prior to the adoption of ASU 2009-13, the Royalty Territory Deliverable would not have met the criteria to be considered a separate unit of accounting because neither VSOE nor TPE of fair value exists for this deliverable. Accordingly, the entire arrangement consideration of \$125 million would have been deferred at the inception of the arrangement and recognized ratably over the Company's period of performance through April 2022, the remaining patent life of tivozanib. If the Astellas Agreement had been accounted for prior to the adoption of ASU 2009-13, the Company would have recognized revenue of \$2.8 million and \$4.2 million during the three and six months ended June 30, 2011, respectively.

***Centocor Ortho Biotech Inc. (Centocor)***

In May 2011, the Company entered into an exclusive license agreement (the Centocor License Agreement) with Centocor Ortho Biotech Inc. (Centocor), for the worldwide development and commercialization of the Company's internally-discovered antibodies targeting the RON receptor (Recepteur d'Origine Nantais), including the grant to Centocor of an exclusive, worldwide license to the Company's proprietary RON-driven tumor models. The Company also granted Centocor a nonexclusive, non-sublicensable, worldwide license to the Company's proprietary list of human genes intended to predict correlation of response to RON-targeted antibodies, (the RON index). Centocor is responsible for all clinical development, manufacturing and commercialization activities and costs. Subject to an agreed-upon research plan and budget, Centocor will also fund certain research for a three-year term to be conducted by the Company, including translational research studies using the Company's proprietary Human Response Platform to identify biomarkers for patients most likely to benefit from treatment with RON targeted antibodies.

In connection with the Centocor License Agreement, the Company received a one-time cash payment in the amount of \$7.5 million and a separate equity investment in the amount of approximately \$7.5 million through the purchase by Johnson & Johnson Development Corporation, an affiliate of Centocor, of 438,340 newly issued shares of the Company's common stock at a purchase price of \$17.11 per share. Milestone payments for the successful development and commercialization of a RON-targeted antibody, if all approvals in multiple indications and all sales milestones are achieved, could total, in the aggregate, \$540 million. Upon commercialization, the Company is eligible to receive tiered double-digit royalty payments on Centocor's net sales of any RON-targeted antibody, as a percentage of net sales. Centocor's royalty obligations in a particular country begin on the date of first commercial sale of a product in that country, and end on the later of 10 years after the date of first commercial sale of the product in that country or the date of the last to expire of the issued patents covering the product in that country. All milestone payments and royalties will be reduced by a certain percentage if Centocor develops or commercializes a RON-targeted antibody which has incorporated significant, meaningful improvements made after a specified period by Centocor to the antibodies delivered by the Company. The royalties will also be reduced by a certain percentage on a country-by-country basis upon the entry of a generic competitor.

The Centocor License Agreement will remain in effect until the expiration of all of Centocor's royalty obligations to the Company, determined on a product-by-product and country-by-country basis. Prior to the filing of an investigational new drug application with the FDA or a similar application filed with another regulatory authority outside of the United States (IND Submission), Centocor has the right to terminate the Centocor License Agreement at will upon 90 days written notice to the Company. After IND Submission, Centocor may terminate the Centocor License Agreement at will upon 180 days written notice to the Company. Either party has the right to terminate the Centocor License Agreement in connection with an insolvency event involving the other party or a material breach of the Centocor License Agreement by the other party that remains uncured for a specified cure period. In the event that Centocor terminates the Centocor License Agreement at will, or if the Company terminates the Centocor License Agreement due to Centocor's material breach or insolvency, worldwide rights to the development, manufacture, and commercialization RON-targeted antibodies revert back to the Company. There are no refund provisions in the Centocor License Agreement that have financial consequences that impact the Company.

As noted above, Johnson & Johnson Development Corporation paid \$7.5 million for 438,340 shares of the Company's common stock at a purchase price of \$17.11 per share, which reflected the average of the daily volume weighted average prices for the Company's common stock for the 30 consecutive trading days ending on May 26, 2011. This weighted average sales price of \$17.11 per share resulted in a \$1.22 per share discount from the May 31, 2011 closing price of \$18.33 per share, or a discount of \$534,775 from the fair market value of the common stock on the effective date of the Centocor License Agreement. The Company determined this transaction was not within the scope of ASC 605-25 and, accordingly, the Company recorded the sale of common stock to Johnson & Johnson Development Corporation at fair value based on the closing price of the Company's stock on May 31, 2011 of \$18.33 per share.





---

**Table of Contents**

The remaining activities under the Centocor License Agreement were evaluated under ASC Topic 605-25 (as amended by ASU 2009-13) to determine if they represented a multiple element revenue arrangement. The Company determined that the Centocor License Agreement included the following deliverables:

Exclusive, sublicensable commercialization and development license related to RON antibodies (the RON license );

Non-exclusive license to use the Company's RON index (the RON Index license ); and

The Company's obligation to provide research services.

The Company determined that each deliverable had stand-alone value upon delivery and therefore represents a separate unit of accounting. Factors considered in this determination included, among other things, the subject of the licenses and the research and development and commercial capabilities of Centocor.

The Company excluded the fair value of the common stock purchased by Johnson & Johnson Development Corporation from the arrangement consideration to be allocated to the identified deliverables and allocated the remaining \$7.0 million of up-front consideration attributable to the deliverables based on the relative selling price method. The Company determined the estimated selling price for the RON license and the RON Index license based on management's best estimate of selling price as the Company did not have VSOE or TPE of selling price for those deliverables. The Company's best estimate of selling price for the RON license and RON Index license considered discounted cash flow models, the key assumptions of which included the market opportunity for commercialization of a potential product candidate using the RON receptor worldwide, an estimate of costs related to phase 1, 2 and 3 clinical studies with certain multiplication factors related to the probability of success, and the time to commercialization of a potential product candidate. This analysis used various assumptions that are typical for similarly staged monoclonal antibodies and other reasonable cost assumptions in determining research and development, and sales, general & administrative costs. As the relative selling price of the RON license and RON Index license (the delivered items) exceeds the up-front consideration attributable to the deliverables of \$7.0 million, the entire up-front payment was recognized as revenue upon delivery of the licenses during the three months ended June 30, 2011.

The Company will record revenue related to research and development services as the services are delivered at the contractual rate, which approximates fair value for those services.

The Company may be entitled to receive future milestone payments totaling \$540 million. The Company has elected to recognize all milestone payments as revenue once the milestones have been triggered if the milestone is deemed to be substantive. The Company believes the development, approval and sales milestones that may be received under the Centocor License Agreement are consistent with the definition of a milestone included in ASU 2010-17 and, accordingly, the Company will recognize payments related to the achievement of such milestones, if any, as revenue upon receipt. Factors considered in this determination included scientific and regulatory risks that must be overcome to achieve each milestone, the level of effort and investment required to achieve each milestone, and the monetary value attributed to each milestone.

The adoption of ASU 2009-13 did not materially affect the Company's accounting for the Centocor License Agreement.

***Schering-Plough (now Merck)***

In March 2007, the Company entered into an agreement with Schering-Plough Corporation, or Schering-Plough (now Merck & Co., Inc., or Merck), through its subsidiary Schering Corporation, acting through its Schering-Plough Research Institute division, under which the Company granted Merck exclusive, worldwide rights to develop and commercialize all of the Company's monoclonal antibody antagonists of hepatocyte growth factor, or HGF, including ficlatuzumab, for therapeutic and prophylactic use in humans and for veterinary use. The Company also granted Merck an exclusive, worldwide license to related biomarkers for diagnostic use. The Company also conducted translational research using its Human Response Platform to guide the clinical development of ficlatuzumab. Merck was responsible for all costs related to the clinical development of ficlatuzumab and clinical and commercial manufacturing. On September 28, 2010, the Company received notice from Merck of termination of the collaboration agreement effective as of December 27, 2010, at which point the Company became responsible for the performance and funding of all future research, development, manufacturing and commercialization activities for ficlatuzumab.

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

Under the agreement, Merck paid the Company an up-front payment of \$7.5 million in May 2007, which was being amortized over the Company's period of substantial involvement, which was initially estimated to be through completion of the first phase 2 proof-of-concept trial for ficlatuzumab (which was expected to be the first half of 2012), but was adjusted to reflect the termination of the agreement effective on December 27, 2010. In June 2010, the Company earned and received an \$8.5 million milestone payment in connection with the enrollment of patients in the Company's phase 2 clinical trial of ficlatuzumab under the agreement. Since the \$8.5 million milestone payment earned in June 2010 was considered substantive and at risk, it was included in revenue for the year ended December 31, 2010.

**Table of Contents**

In March 2011, in connection with the transition of responsibility for the ficlatuzumab program from Merck back to the Company, the Company made a \$10.2 million payment to Merck for the purchase of a supply of ficlatuzumab to support ongoing clinical studies. The Company has taken title to all of this material as of June 30, 2011 and, pursuant to the provisions of ASC Topic 730, has recognized \$1.1 million as a research and development expense during the three months ended March 31, 2011, and \$9.1 million as research and development expense during the three months ended June 30, 2011, when title passed to the Company.

***OSI Pharmaceuticals (OSI)***

In September 2007, the Company entered into a collaboration and license agreement with OSI Pharmaceuticals, Inc., (a wholly-owned subsidiary of Astellas US Holding Inc., a holding company owned by Astellas Pharma Inc.) or OSI, which provided for the use of the Company's proprietary *in vivo* models by the Company's scientists at its facilities, use of the Company's bioinformatics tools and other target validation and biomarker research to further develop and advance OSI's small molecule drug discovery and translational research related to cancer and other diseases. In July 2009, the Company and OSI expanded the strategic partnership, and the Company granted OSI a non-exclusive license to use the Company's proprietary bioinformatics platform, and non-exclusive perpetual licenses to use bioinformatics data and the Company's proprietary gene index related to a specific target pathway. Further, as part of the expanded strategic partnership, the Company granted OSI an option, exercisable upon payment of an option fee, to receive non-exclusive perpetual rights to certain elements of the Company's Human Response Platform and to use the Company's bioinformatics platform, and the Company granted OSI the right to obtain certain of its tumor models and tumor archives.

The Company accounts for the OSI arrangement pursuant to ASC Topic 605-25. The deliverables under the arrangement include use of the Company's proprietary *in vivo* models, research and development services provided using the Company's proprietary *in vivo* models by the Company's scientists at its facilities, use of the Company's bioinformatics tools and other target validation and biomarker research to further develop and advance OSI's small molecule drug discovery, translational research related to cancer and other diseases and a non-exclusive license to use the Company's proprietary bioinformatics platform, and non-exclusive perpetual licenses to use bioinformatics data and a Company's proprietary gene index related to a specific target pathway. Since these services were provided using the Company's proprietary technology, management concluded the arrangement should be accounted for as a single unit of accounting.

Under the agreement, OSI paid the Company an up-front payment of \$7.5 million, which was recorded in deferred revenue and was amortized over the Company's period of substantial involvement, which ended in July 2011 (the date the Company satisfied its performance obligations under the OSI arrangement). OSI also paid the Company \$2.5 million for the first year of research program funding, which was recorded in deferred revenue and was recognized as revenue over the performance period and, thereafter, OSI made research payments of \$625,000 per quarter through July 2009. In addition, OSI purchased 1,833,334 shares of Series C Convertible Preferred Stock, at a per share price of \$3.00, resulting in gross proceeds to the Company of \$5.5 million. The Company determined that the price paid of \$3.00 per share by OSI included a premium of \$0.50 over the price per share of the Company's Series D Convertible Preferred Stock sold in April 2007; accordingly, the Company is recognizing the premium of \$917,000 as additional license revenue on a straight-line basis over the period of substantial involvement. In connection with the initial public offering consummated by the Company in March 2010 and the related 1:4 reverse stock split of the common stock, each four shares of outstanding Series C Convertible Preferred Stock were converted into one share of common stock.

In consideration for the additional rights provided for pursuant to the July 2009 expanded agreement, OSI paid the Company an up-front payment of \$5.0 million, which was recorded in deferred revenue was being amortized over the Company's remaining period of substantial involvement, which ended in July 2011. OSI also agreed to fund research costs through June 30, 2011. In addition, OSI purchased 3,750,000 shares of Series E Convertible Preferred Stock, at a per share price of \$4.00, resulting in gross proceeds to the Company of \$15.0 million. In connection with the initial public offering consummated by the Company in March 2010 and the related 1:4 reverse stock split of the common stock, each four shares of outstanding Series E Convertible Preferred Stock were converted into one share of common stock. The Company determined that the price of \$4.00 per share paid by OSI included a premium of \$1.04 per share over the fair value of the Series E Convertible Preferred Stock of \$2.96 as calculated by the Company in its retrospective stock valuation. The valuation used the Market Approach to estimate the Company's enterprise value and the Probability Weighted Expected Return Method (PWERM) to allocate the enterprise value to each class of the Company's equity securities; accordingly, the Company recognized the premium of \$3,900,000 as additional license revenue on a straight-line basis over the period of substantial involvement, which ended in July 2011.

Under the July 2009 expanded agreement, if all applicable milestones are achieved, payments for the successful achievement of discovery, development and commercialization milestones could total, in the aggregate, over \$94.0 million for each target and its associated products. In addition, the Company is eligible to receive up to \$3.0 million for certain research milestones, and up to \$24.0 million in biomarker related milestones. In March 2011, the Company earned \$1.5 million related to achieving certain of these



---

**Table of Contents**

research milestones under the agreement. These research milestones are not considered to be at risk and substantive, therefore, the \$1.5 million in payments are being deferred and will be recognized on a straight-line basis over the remaining estimated period of substantial involvement, which ended in July 2011. Upon commercialization of products under the agreement, the Company is eligible to receive tiered royalty payments on sales of products by OSI, its affiliates and sublicensees. All milestones earned to date are for selection of targets, delivery of models, delivery of tumor archives or delivery of cell lines.

In November 2010, OSI exercised its option under the July 2009 expanded agreement providing the right for OSI to license certain elements of the Company's proprietary technology platform, including components of the Human Response Platform for the identification/characterization of novel epithelial-mesenchymal transition agents and proprietary patient selection biomarkers, in support of OSI's clinical development programs. The Company did not consider the option granted to OSI in July 2009 as a deliverable as there was significant uncertainty that this option would ultimately be exercised. The Company received \$12.5 million upon delivery of the notice of option exercise, and completed the transfer of the relevant technology to OSI in July 2011. The remaining \$12.5 million was paid in July 2011 following the successful transfer of the applicable technology. The Company has deferred the initial \$12.5 million payment, and is recognizing the full \$25.0 million relating to the option exercise by OSI over the technology transfer period. The Company recorded a corresponding receivable of \$11.0 million for amounts due from OSI pursuant to the July 2009 expanded agreement that is included in accounts receivable on the condensed consolidated balance sheet at June 30, 2011. This amount was paid in July 2011.

The Company believes the application of the provisions of ASU 2009-13 to this arrangement would not change the units of accounting under the arrangement or the manner in which the Company recognizes revenue for the arrangement.

***Biogen Idec International GmbH (Biogen Idec)***

In March 2009, the Company entered into an exclusive option and license agreement with Biogen Idec International GmbH, a subsidiary of Biogen Idec Inc., collectively referred to herein as "Biogen Idec", regarding the development and commercialization of the Company's discovery-stage ErbB3-targeted antibodies for the potential treatment and diagnosis of cancer and other diseases outside of the United States, Canada and Mexico.

The Company accounts for the Biogen Idec arrangement pursuant to ASC Topic 605-25. The deliverables under the arrangement include an option for a co-exclusive, world-wide license to develop and manufacture ErbB3 antibody products and an option for an exclusive license to commercialize ErbB3 antibody products in all countries in the world other than the United States, Canada and Mexico. The Company determined that these deliverables did not have standalone value due to the fact that the program was still in preclinical development and required the Company's experience to advance development of the product. As such, the Company determined that the agreement should be accounted for as one unit of accounting.

Under the terms of the agreement, Biogen Idec paid the Company an upfront cash payment of \$5.0 million in March 2009, which is being amortized over the Company's period of substantial involvement, defined as the twenty-year patent life of the development candidate. In addition, Biogen Idec purchased 7,500,000 shares of Series E Convertible Preferred Stock at a per share price of \$4.00, resulting in gross proceeds to the Company of \$30.0 million. In connection with the initial public offering consummated by the Company in March 2010 and the related 1:4 reverse stock split of the common stock, each four shares of outstanding Series E Convertible Preferred Stock were converted into one share of common stock. The Company determined that the price of \$4.00 paid by Biogen Idec included a premium of \$1.09 per share over the fair value of the Series E Convertible Preferred Stock of \$2.91 as calculated by the Company in its retrospective stock valuation. The valuation used the Market Approach to estimate the Company's enterprise value and the PWERM to allocate the enterprise value to each class of the Company's equity securities; accordingly, the Company is recognizing the premium of \$8,175,000 as revenue on a straight-line basis over the period of substantial involvement. The Company received a \$5.0 million milestone payment for achievement of the first pre-clinical discovery milestone under the agreement in June 2009 which was not considered at risk and was therefore deferred and is being recognized over the period of substantial involvement. The Company earned a second \$5.0 million milestone payment upon selection of a development candidate in March 2010. This milestone was considered substantive and at risk and was included in revenue for the quarter ended March 31, 2010. The Company earned a third \$5.0 million milestone payment based on achieving the GLP toxicology initiation milestone in June 2011. This milestone was considered substantive and at risk and was included in revenue for the quarter ended June 30, 2011. The Company could also receive an option exercise fee and regulatory milestone payments of \$50.0 million in the aggregate if Biogen Idec exercises its option to obtain exclusive rights to commercialize ErbB3 antibody products in its territory. The Company considers these milestone payments to be consistent with the definition of a milestone included in ASU 2010-17 and, accordingly, will recognize payments related to the achievement of such milestones, if any, as revenue upon receipt. Factors considered in this determination included scientific and regulatory risks that must be overcome to achieve each milestone, the level of effort and investment required to achieve each milestone, and the monetary value attributed to each milestone.



**Table of Contents**

If Biogen Idec exercises its exclusive option under the agreement, Biogen Idec will pay the Company royalties on Biogen Idec's sales of ErbB3 antibody products in its territory, and the Company will pay Biogen Idec royalties on the Company's sale of ErbB3 antibody products in the United States, Canada and Mexico.

The Company believes the application of the provisions of ASU 2009-13 would not change the units of accounting under the arrangement or the manner in which the Company recognizes revenue for the arrangement.

***Kirin Brewery Co. Ltd. (KHK)***

In December 2006, the Company entered into an exclusive license agreement with Kirin Brewery Co. Ltd. (now Kyowa Hakko Kirin) ( KHK ) to research, develop, manufacture and commercialize tivozanib (f/k/a KRN951), pharmaceutical compositions thereof and associated biomarkers in all territories in the world except for Asia (the KHK Agreement ). Upon entering into the KHK Agreement, the Company made a cash payment in the amount of \$5.0 million. In March 2010, the Company made a \$10.0 million milestone payment to KHK in connection with the dosing of the first patient in the Company's phase 3 clinical trial of tivozanib. In addition, the Company may be required to make up to an aggregate of \$50.0 million in additional milestone payments upon the achievement of specified regulatory milestones. The Company is also required to pay tiered royalty payments on net sales it makes of tivozanib in its territory. The royalty rates under the KHK Agreement range from the low to mid teens as a percentage of the Company's net sales of tivozanib.

The Company also has the right to grant sublicenses under the KHK Agreement, subject to certain restrictions, and, as previously described, on February 16, 2011, the Company entered into the Astellas Agreement. Pursuant to the KHK Agreement, the Company is required to pay KHK 30% of certain amounts the Company receives under the Astellas Agreement in connection with Astellas' development and commercialization activities in Europe and the Royalty Territory, including up-front license fees, milestone payments and royalties the Company may receive from Astellas. The Company is not obligated to make any payments to KHK in respect of research and development funding or equity investments, subject to certain limitations.

The Company recorded \$22.5 million of research and development expense in the six months ended June 30, 2011 associated with a \$22.5 million payment due to KHK related to the up-front license payment received under the Astellas Agreement.

**(5) Prepaid Expenses**

Prepaid expenses and other current assets consisted of the following:

	June 30, 2011	December 31, 2010
	(in thousands)	
Prepaid clinical expenses	\$ 5,886	\$ 2,741
Interest receivable	1,646	1,092
Prepaid insurance	674	311
Prepaid maintenance costs	573	495
Other prepaid expenses and current assets	515	225
	\$ 9,294	\$ 4,864

**(6) Accrued Expenses**

Accrued expenses consisted of the following:

	June 30, 2011	December 31, 2010
	(in thousands)	
Clinical expenses	\$ 6,164	\$ 5,676



Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

Salaries and benefits	2,837	3,696
Accrued interest	248	256
Professional fees	144	204
Other	884	289
	\$ 10,277	\$ 10,121

**Table of Contents****(7) Loans Payable**

On May 15, 2008, the Company entered into a \$21.0 million financing agreement with Hercules Technology Growth Capital Inc., or Hercules Technology Growth, and Comerica Bank, referred to as the prior loan agreement. On May 28, 2010, the Company entered into a new loan and security agreement with Hercules Technology II, L.P. and Hercules Technology III, L.P., affiliates of Hercules Technology Growth, referred to as the new loan agreement, pursuant to which the Company received a loan in the aggregate principal amount of \$25.0 million and repaid the remaining outstanding principal and interest under the prior loan agreement of \$17.4 million. The Company was initially required to repay the aggregate principal balance of the loan that is outstanding under the new loan agreement in 30 equal monthly installments of principal starting on April 1, 2011. However, the new loan agreement provides that such date will be extended under certain circumstances. On April 1, 2011, the Company triggered the first of two possible extensions to the date from which principal payments will be made. The Company is now required to repay the aggregate principal balance of the loan that is outstanding under the new loan agreement in 30 equal monthly installments of principal starting on October 1, 2011. The current portion of loans payable as of June 30, 2011 considers this extension. Per annum interest is payable at the greater of 11.9% and an amount equal to 11.9% plus the prime rate of interest minus 4.75%, provided however, that the per annum interest shall not exceed 15.0%. The Company must make interest payments on the loan each month following the date of borrowing under the new loan agreement. The entire principal balance and all accrued but unpaid interest will be due and payable on March 1, 2014, provided, however, that, as noted above, the repayment commencement date, and therefore the due date for the loan, is subject to extension under certain circumstances specified in the new loan agreement. The loan is secured by a lien on all of the Company's personal property as of, or acquired after, the date of the new loan agreement, except for intellectual property.

The new loan agreement requires a deferred charge of \$1.25 million to be paid in May 2012 related to the termination of the prior loan agreement. This amount is included in current liabilities as other liabilities. The new loan also includes an additional deferred charge of \$1.24 million due upon the maturity of the new loan which has been recorded as a loan discount and is being amortized to interest expense over the term of the new loan agreement using the effective interest rate method. The Company recorded a long-term liability for the full amount of the charge since the payment of such amount is not contingent on any future event. The Company incurred approximately \$193,000 in loan issuance costs related to the new loan agreement paid directly to the lenders, which have been offset against the loan proceeds as a loan discount. As part of the new loan agreement, the Company issued warrants to the lenders on June 2, 2010 to purchase up to 156,641 shares of the Company's common stock at an exercise price equal to \$7.98 per share. These warrants expire seven years from issuance. The Company recorded the relative fair value of the warrants of approximately \$780,000 as equity and as a discount to the related loan outstanding and will amortize the value of the discount to interest expense over the term of the loan using the effective interest method. The relative fair value of the warrant was calculated using the Black-Scholes option-pricing model with the following assumptions: volatility of 64.12%, an expected term equal to the contractual life of the warrant (seven years), a risk-free interest rate of 2.81% and no dividend yield. The resulting effective interest rate including the fair value of the warrant, the new loan issuance costs and the deferred charge approximates 16.1%.

The new loan agreement defines events of default, including the occurrence of an event that results in a material adverse effect upon the Company's business operations, properties, assets or condition (financial or otherwise), its ability to perform its obligations under and in accordance with the terms of the new loan agreement, or upon the ability of the lenders to enforce any of their rights or remedies with respect to such obligations, or upon the collateral under the new loan agreement or upon the liens of the lenders on such collateral or upon the priority of such liens. Hercules Technology Growth Capital also received an option, subject to the Company's written consent, not to be unreasonably withheld, to purchase, either with cash or through conversion of outstanding principal under the loan, up to \$2.0 million of equity of the Company sold in any sale by the Company to third parties of equity securities resulting in at least \$10.0 million in net cash proceeds to the Company, subject to certain exceptions. The Company has evaluated the embedded conversion option, and has concluded that it does not need to be bifurcated and separately accounted for. No amount will be recognized for the conversion feature until such time as the conversion feature is exercised and it can be determined whether a beneficial conversion feature exists. As of June 30, 2011, there have been no events of default under the loan. As of June 30, 2011, the principal balance outstanding was \$25.0 million.

Future minimum payments under the loans payable outstanding as of June 30, 2011 are as follows:

<b>Years Ending December 31:</b>	
2011(6 months remaining)	\$ 3,662
2012	12,860
2013	11,610
2014	4,213
	32,345
Less amount representing interest	(4,858)

Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

Less discount	(1,146)
Less deferred charges	(2,487)
Less current portion	(6,039)
Loans payable, net of current portion and discount	\$ 17,815

**Table of Contents****(8) Stock-based Compensation****Stock Plans**

The Company issued stock options and restricted stock awards during the six months ended June 30, 2011.

A summary of the status of the Company's stock option activity at June 30, 2011 and changes during the six months then ended is presented in the table and narrative below:

	Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual Term	Aggregate Intrinsic Value
Outstanding at December 31, 2010	3,605,718	\$ 6.44		
Granted	696,291	\$ 15.09		
Exercised	(409,160)	\$ 3.31		
Cancelled	(51,158)	\$ 9.43		
Outstanding at June 30, 2011	3,841,691	\$ 8.30	7.02	\$ 47,300,085
Vested or expected to vest at June 30, 2011	3,702,857	\$ 8.09	6.93	\$ 46,345,172
Exercisable at June 30, 2011	2,364,276	\$ 5.44	5.75	\$ 35,876,765

The aggregate intrinsic value in the table above represents the value (the difference between the Company's closing common stock price on the last trading day of the six months ended June 30, 2011 and the exercise price of the options, multiplied by the number of in-the-money options) that would have been received by the option holders had all option holders exercised their options on June 30, 2011. As of June 30, 2011, there was \$9.2 million of total unrecognized stock-based compensation expense related to stock options granted under the Company's 2002 Stock Incentive Plan and 2010 Stock Incentive Plan (the "plans"). The expense is expected to be recognized over a weighted-average period of 2.6 years.

Stock-based awards to employees are required to be measured at fair value. The Company uses the Black-Scholes pricing model in order to calculate the estimated fair value of its stock option grants. This model requires the Company to make assumptions with respect to factors such as volatility, interest rate, dividend yield and term. Since the Company completed its initial public offering in March 2010, it did not have sufficient history as a publicly traded company to evaluate its volatility. As such, the Company has used an average of several peer companies volatilities to determine a reasonable estimate of its volatility. For purposes of identifying similar entities, the Company considered characteristics such as industry, length of trading history, market capitalization and similar product pipelines. The Company utilized a weighted average method of using its own data for the quarters that it has been public, along with data it obtained from its peer companies. Due to the lack of available quarterly data for these peer companies and insufficient history as a public company, the Company elected to use the simplified method for plain vanilla options to estimate the expected term of the stock option grants. Under this approach, the weighted-average expected life is presumed to be the average of the vesting term and the contractual term of the option.

During the three and six months ended June 30, 2011 and 2010, respectively, the assumptions used in the Black-Scholes pricing model for new grants were as follows:

	Three Months Ended June 30,	
	2011	2010
Volatility factor	64.37%	64.12-64.43%
Risk-free interest rate	2.13%	2.11%
Dividend yield		
Expected term (in years)	5.50-6.25	5.50-6.25



**Table of Contents**

	Six Months Ended June 30,	
	2011	2010
Volatility factor	64.37%-65.01%	63.92-64.43%
Risk-free interest rate	2.13%-2.57%	2.11%-2.92%
Dividend yield		
Expected term (in years)	5.50-6.25	5.50-6.25

The restricted stock activity for the three months ended June 30, 2011 is as follows:

	Number of Shares	Weighted-Average Exercise Price
Unvested at December 31, 2010		
Granted	69,000	\$ 14.16
Cancelled		
Expired		
Vested/Released		
Unvested at June 30, 2011	69,000	\$ 14.16

As of June 30, 2011, there was \$0.5 million of total unrecognized stock-based compensation expense related to restricted stock awards granted under the plans. The expense is expected to be recognized over a weighted-average period of 0.9 years.

On February 15, 2011, the Company's Board of Directors adopted, subject to stockholder approval, amendment no. 1 to the Company's 2010 Stock Incentive Plan to increase the amount of options granted to newly elected Board members, and amendment no. 2 to the Company's 2010 Stock Incentive Plan to increase the number of shares of common stock reserved for issuance under the Company's 2010 Stock Incentive Plan by 3,000,000. Pursuant to amendment no. 2, the number of shares of the Company's common stock reserved for issuance under the 2010 Stock Incentive Plan is the sum of (i) 4,875,000 shares of common stock plus (ii) the number of shares of common stock subject to awards granted under the 2002 Stock Incentive Plan which expire, terminate or are otherwise surrendered, cancelled, forfeited or repurchased by the Company at their original issuance price pursuant to a contractual repurchase right, up to a maximum of 5,500,000 shares.

On April 12, 2011, the Company's board of directors approved an amendment no. 3 to the Company's 2010 Stock Incentive Plan which became effective upon its approval, to include the following provisions:

restrictions on repricing, within the meaning of the rules of the NASDAQ Stock Market, any stock option or stock appreciation rights, or SARs, award unless such action is approved by the Company's stockholders;

minimum vesting provisions with respect to certain awards granted under the plan;

a maximum limit on the aggregate number of shares that may be granted as awards other than options; and

revised share counting rules that prohibit the recycling of shares that are tendered or withheld to pay the exercise price of an award or to satisfy tax withholding obligations.

**(9) Income Taxes**

The Company calculates its provision for income taxes on ordinary income based on its projected annual tax rate for the year. As of June 30, 2011, the Company is projecting an ordinary loss for the year ended December 31, 2011 and, since it maintains a full valuation allowance on all of its deferred tax assets, the Company has recorded no income tax provision or benefit in the current quarter and year to date period.

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

As a result of the initial public offering of the Company's common stock in March 2010, the Company underwent a change in ownership for purposes of Internal Revenue Code Section 382. As a result, the Company believes the utilization of federal net operating loss carryforwards and research credit carryforwards as of the date of the initial public offering will be subject to an annual limitation based on the value of the Company immediately before the stock offering. The annual limitation will be increased in the first five years after the change in ownership as a result of the Company's built-in-gains. This limitation is not expected to result in the loss of any of these tax attributes during the carryforward period.

## **Table of Contents**

### **(10) Common Stock**

#### ***Reverse Stock Split***

On February 2, 2010, the Company's Board of Directors, and on February 11, 2010, the Company's stockholders, approved a 1-for-4 reverse stock split of the Company's common stock. The reverse stock split was effected on February 18, 2010. All share and per share amounts in the condensed consolidated financial statements have been retroactively adjusted for all periods presented to give effect to the reverse stock split, including reclassifying an amount equal to the reduction in par value to additional paid-in capital.

#### ***Initial Public Offering***

In March 2010, the Company raised \$81.0 million in gross proceeds from the sale of 9,000,000 shares of its common stock in an initial public offering at \$9.00 per share. The net offering proceeds after deducting approximately \$3.1 million in offering related expenses and underwriters discounts were approximately \$72.2 million. In March 2010, the underwriters of the initial public offering exercised their option to purchase, and in April 2010, the Company closed the sale to such underwriters of, an additional 968,539 shares of common stock at \$9.00 per share resulting in additional net proceeds to the Company of approximately \$8.1 million. All outstanding shares of the Company's convertible preferred stock were converted into 18,979,155 shares of common stock upon the completion of the initial public offering.

In connection with the initial public offering, the Company reclassified its liability related to preferred stock warrants into additional paid-in capital as a result of the conversion of warrants to purchase convertible preferred stock into warrants to purchase common stock.

#### ***Private Placement***

On October 28, 2010, the Company entered into a definitive agreement with respect to the private placement of 4.5 million shares of its unregistered common stock at \$13.50 per share to a group of institutional and accredited investors. The Company completed the private placement on November 3, 2010, resulting in approximately \$56.6 million in net proceeds to the Company.

On May 31, 2011, the Company entered into a definitive agreement with respect to the sale of 438,340 shares of its unregistered common stock at \$17.11 per share to Johnson & Johnson Development Corporation. The Company completed the private placement on May 31, 2011, resulting in approximately \$7.5 million in net proceeds to the Company.

#### ***Follow-on Offering***

In June 2011, the Company raised \$100.6 million in gross proceeds from the sale of 5,750,000 shares of its common stock in a follow-on public offering at \$17.50 per share. In June 2011, the underwriters of the public offering exercised their option to purchase an additional 602,119 shares of common stock at \$17.50 per share resulting in additional gross proceeds to the Company of approximately \$10.5 million. The combined net offering proceeds after deducting approximately \$6.9 million in offering related expenses and underwriters' discounts and commissions were approximately \$104.2 million.



**Table of Contents****Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations.  
Forward-Looking Information**

The following discussion of our financial condition and results of operations should be read with our unaudited condensed consolidated financial statements and notes included in Item 1 of this Quarterly Report on Form 10-Q for the three and six months ended June 30, 2011, as well as the audited consolidated financial statements and notes and Management's Discussion and Analysis of Financial Condition and Results of Operations for the fiscal year ended December 31, 2010, included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2010, filed with the Securities and Exchange Commission, or SEC, on March 11, 2011. This Management's Discussion and Analysis of Financial Condition and Results of Operations contains forward-looking statements within the meaning of the Private Securities Litigation Reform Act of 1995. These forward-looking statements regarding future events and our future results are based on current expectations, estimates, forecasts, and projections and the beliefs and assumptions of our management including, without limitation, our expectations regarding our research, development and commercialization plans and prospects, results of operations, general and administrative expenses, research and development expenses, and the sufficiency of our cash for future operations. Words such as anticipate, target, project, believe, goals, estimate, potential, predict, may, will, expect, might, could, intend, variations of these terms or the negative of those terms and similar expressions are intended to identify these forward-looking statements. Readers are cautioned that these forward-looking statements are predictions and are subject to risks, uncertainties, and assumptions that are difficult to predict. Therefore, actual results may differ materially and adversely from those expressed in any forward-looking statements. Among the important factors that could cause actual results to differ materially from those indicated by our forward-looking statements are those discussed under the heading Risk Factors in Item 1A of Part II and elsewhere in this report.

**Overview**

We are a cancer therapeutics company committed to discovering, developing and commercializing targeted cancer therapies to impact patients' lives. Our product candidates are directed against important mechanisms, or targets, known or believed to be involved in cancer. Tivozanib, our lead product candidate, which we recently partnered with Astellas Pharma Inc., or Astellas, is designed to provide an optimal blockade of the vascular endothelial growth factor, or VEGF, pathway by inhibiting all three VEGF receptors: VEGF receptors 1, 2 and 3. Our clinical trials of tivozanib to date have demonstrated a favorable safety and efficacy profile for tivozanib. We have completed a successful 272-patient phase 2 clinical trial of tivozanib in patients with advanced renal cell cancer, or RCC. In this trial, we measured, among other things, each patient's progression-free survival, which refers to the period of time that began when a patient entered the clinical trial and ended when either the patient died or the patient's cancer had grown by a specified percentage or spread to a new location in the body. Final data from the trial show the overall median progression-free survival of patients in the phase 2 clinical trial was 11.7 months. In a retrospective analysis of the subset of 176 patients in our phase 2 clinical trial who had the clear cell type of RCC and who had undergone prior removal of their affected kidney, referred to as a nephrectomy, both of which are inclusion criteria for our phase 3 clinical trial of tivozanib, the median progression-free survival was 14.8 months. The most common treatment-related side effects seen in the phase 2 clinical trial were hypertension (44.9%) and dysphonia, or hoarseness of voice (21.7%). Severe (grade 3/4) hypertension was observed in 11.8% of patients in the trial. Additionally, the incidence of other side effects in the phase 2 clinical trial, which are commonly associated with other VEGF receptor inhibitors, such as diarrhea, rash, mucositis, stomatitis, asthenia, fatigue, and hand-foot syndrome, was notably low in comparison to clinical trial results of other VEGF receptor inhibitors. Severe (grade 3/4) incidences of these side effects that were considered by the investigator to be possibly related to tivozanib occurred in fewer than two percent of patients (other than asthenia, for which the incidence was 2.6%).

In February 2010, we initiated enrollment in our global, phase 3 clinical trial comparing the efficacy and safety of tivozanib with Nexavar® (sorafenib), an approved therapy, for first-line treatment in RCC, which we refer to as the TIVO-1 study. The TIVO-1 study is being conducted in patients with advanced clear cell RCC who have undergone a prior nephrectomy and who have not received any prior VEGF-targeted therapy. In August 2010, we completed enrollment in the TIVO-1 study with 517 patients. Based upon the current rate of events, we do not anticipate receiving top-line TIVO-1 data until at least the fourth quarter of this year. Nexavar is an oral VEGF receptor inhibitor approved for the treatment of RCC. In its phase 3 clinical trial in patients with advanced clear cell RCC, 94% of whom had undergone a prior nephrectomy, Nexavar demonstrated a median progression-free survival of 5.5 months. Progression-free survival is the primary endpoint in the TIVO-1 study. The TIVO-1 study is designed so that a difference in progression-free survival of three months or more between the treatment arms would be statistically significant. In addition to the TIVO-1 study, we are conducting clinical pharmacology and safety studies including a mass balance study, a food effect study, a thorough QTc study (which is a study to establish that there are no undesired adverse cardiac effects), a study in patients with liver impairment, and drug-drug interaction studies, that will be required in support of a new drug application, or NDA, for tivozanib. In addition, we plan to conduct, or will seek waivers from conducting, additional special population studies and a pediatric study. We have also conducted additional toxicology studies in non-human primates and rodents, which will be included in our registration application.

## Table of Contents

In addition to the TIVO-1 study, we are evaluating tivozanib in multiple clinical trials including: a completed phase 1b clinical trial in combination with Torisel® (temsirolimus), an approved inhibitor of the receptor known as mammalian target of rapamycin, or mTOR, in patients with advanced RCC; a phase 1b clinical trial in combination with the FOLFOX6 chemotherapy regimen in patients with advanced gastrointestinal cancers, including colorectal cancer; a recently completed phase 1b clinical trial in combination with Taxol® (paclitaxel) in patients with metastatic breast cancers; a phase 1b clinical trial in combination with Xeloda® (capecitabine), an oral chemotherapeutic agent, in patients with breast and colorectal cancers; a completed phase 1b clinical trial as a monotherapy in patients with non-small cell lung cancer; and a phase 2 clinical trial designed to evaluate biomarkers of tivozanib in patients with RCC. In addition, a phase 1 investigator sponsored clinical trial was completed in which tivozanib was combined with Afinitor® (everolimus), an approved inhibitor of the mTOR receptor, in patients with advanced gastrointestinal malignancies. We have completed enrollment in the phase 2 portion of this investigator sponsored trial combining tivozanib with Afinitor in patients with refractory metastatic colorectal cancer. We expect that the results of these trials will help to inform our clinical development plans for tivozanib as a monotherapy and in combination with other anti-cancer therapies in multiple cancer indications.

We acquired exclusive rights to develop and commercialize tivozanib worldwide outside of Asia pursuant to a license agreement we entered into with Kirin Brewery Co. Ltd. (now Kyowa Hakko Kirin), or KHK, in 2006. Under the license agreement, we obtained an exclusive license to research, develop, manufacture and commercialize tivozanib, pharmaceutical compositions thereof and associated biomarkers for the diagnosis, prevention and treatment of any and all human diseases and conditions outside of Asia. KHK has retained all rights to tivozanib in Asia. We have obligations to make milestone and royalty payments to KHK. The royalty rates range from the low to mid teens as a percentage of our net sales of tivozanib. As discussed below under the heading Strategic Partnerships, we recently entered into a strategic collaboration with Astellas in which we have agreed to share responsibility, including all profits and losses, with Astellas for continued development and commercialization of tivozanib in North America and Europe. Throughout the rest of the world, outside of North America, Europe and Asia, we granted Astellas an exclusive, royalty-bearing license to develop and commercialize tivozanib. We are required to pay KHK low to mid teen royalties on our net sales in North America, and 30% of certain amounts we receive in connection with Astellas development and commercialization activities of tivozanib outside of North America and Asia, including certain amounts we received or will receive from Astellas as up-front license fees, milestone payments and royalties.

In addition to tivozanib, we have a pipeline of monoclonal antibodies derived from our proprietary Human Response Platform, a novel method of building preclinical models of human cancer, which are intended to more accurately represent cancer biology in patients. Ficlatazumab, our next most advanced product candidate, is an antibody which binds to hepatocyte growth factor, or HGF, thereby blocking its function. Through the use of our Human Response Platform, our scientists have observed that the HGF/c-Met pathway is a significant driver of tumor growth. We have completed a phase 1 clinical trial of ficlatazumab and recently completed enrollment of a phase 2 clinical trial in patients with non-small cell lung cancer.

We have also identified a number of other promising targets for the development of novel cancer therapeutics using our Human Response Platform. We have preclinical antibody discovery programs underway focusing on targets that appear to be important drivers of tumor growth, including our third clinical candidate AV-203, which targets the ErbB3 receptor (partnered with Biogen Idec, Inc., or Biogen Idec), our monoclonal antibody antagonists of the Recepteur d'Origine Nantais (partnered with Centocor Ortho Biotech Inc., or Centocor), as well as programs directed toward the Notch receptors and the Fibroblast Growth Factor receptors.

Our Human Response Platform was designed to overcome many of the limitations of traditional approaches to modeling human cancer. The traditional method of modeling human cancer uses a model referred to as a xenograft. A xenograft model is created by adapting cells from a human tumor to grow in a petri dish, and then injecting these cells in a mouse, where they grow into tumors. However, the resulting tumors differ from the original tumor in important respects, and, accordingly, xenograft models are often poor predictors of the success of cancer drugs in human clinical trials. In our Human Response Platform, we use patented genetic engineering techniques to grow populations of spontaneous tumors in animals containing human-relevant, cancer-causing mutations and tumor variation akin to what is seen in populations of human tumors. Because we believe that these populations of tumors better replicate what is seen in human cancer, we believe that our Human Response Platform provides us with unique insights into cancer biology and mechanisms of drug response and resistance, and represents a significant improvement over traditional approaches. We are utilizing this Human Response Platform alone and with our strategic partners to (i) identify and validate target genes which drive tumor growth, (ii) evaluate drugs which can block the function of these targets and (iii) identify biomarkers, which are indicators of drug response and resistance in patients, in an effort to evaluate which patients are most likely to respond favorably to treatment with such drugs.

## **Table of Contents**

We have devoted substantially all of our resources to our drug discovery efforts comprising research and development, conducting clinical trials for our product candidates, protecting our intellectual property and the general and administrative support of these operations. We have generated no revenue from product sales and, through June 30, 2011, have principally funded our operations through:

\$263.6 million of non-dilutive capital in the form of license fees, milestone payments and research and development funding received from our strategic partners;

\$169.6 million of funding from the sale of convertible preferred stock prior to our initial public offering, including \$77.5 million of equity sales to our strategic partners;

\$89.7 million of gross proceeds from the sale of common stock in connection with the completion of our initial public offering;

\$25.0 million of loan proceeds in connection with our loan agreement with Hercules Technology II, L.P. and Hercules Technology III, L.P.;

\$60.8 million of gross proceeds from the private placement of 4.5 million shares of our unregistered common stock at \$13.50 per share to a group of institutional and accredited investors in November 2010;

\$111.2 million of gross proceeds from the sale of common stock in connection with the follow-on offering of our common stock in June 2011; and

\$15.0 million of gross proceeds in connection with the license agreement with Centocor executed in May 2011, which includes \$7.5 million of gross proceeds from the sale of common stock to Johnson & Johnson Development Corporation, an affiliate of Centocor (recorded at \$8.0 million, the fair market value on the date of issuance), and \$7.5 million of non-dilutive capital in the form of license fees (recorded net of the discount on sale of common stock as \$7.0 million of revenue).

We do not have a history of being profitable and, as of June 30, 2011, we had an accumulated deficit of \$156.9 million. We anticipate that we will continue to incur significant operating costs over the next several years as we advance our plan to expand our discovery, research, development and commercialization activities, including the phase 3 clinical development and planned commercialization of our lead product candidate, tivozanib, and the continued clinical development of our phase 2 product candidate, ficlatuzumab. We will need additional financing to support our operating activities.

## **Strategic Partnerships**

### ***Kyowa Hakko Kirin***

In December 2006, we entered into a license agreement with KHK under which we obtained an exclusive license to research, develop, manufacture and commercialize tivozanib, pharmaceutical compositions thereof and associated biomarkers. Our exclusive license covers all territories in the world, except for Asia. KHK has retained rights to tivozanib in Asia. Under the license agreement, we obtained exclusive rights in our territory under certain KHK patents, patent applications and know-how related to tivozanib, to research, develop, make, have made, use, import, offer for sale, and sell tivozanib for the diagnosis, prevention and treatment of any and all human diseases and conditions.

Upon entering into the license agreement with KHK, we made a one-time cash payment in the amount of \$5.0 million. We also made a \$10.0 million milestone payment to Kyowa Hakko Kirin in March 2010 in connection with the initial dosing of patients in our phase 3 clinical trial of tivozanib. In addition, we may be required to make up to an aggregate of \$50.0 million in additional milestone payments upon the achievement of specified regulatory milestones. We are also required to pay KHK tiered royalty payments on net sales we make of tivozanib in North America. The royalty rates under the agreement range from the low to mid teens as a percentage of our net sales of tivozanib. In connection with

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

the execution of our collaboration agreement with Astellas discussed below, we are required to pay KHK 30% of the license fee received from Astellas as well as certain amounts we may receive from Astellas in connection with Astellas' development and commercialization activities outside of North America and Asia related to tivozanib, other than amounts we receive in respect of research and development funding or equity investments, subject to certain limitations.

In connection with our obligation under the license agreement with KHK to pay a certain percentage of sublicense revenue we receive, we incurred expenses of \$22.5 million for our payment to KHK related to the up-front license payment received under the collaboration agreement with Astellas. The full amount was paid to KHK in April 2011.

### *Astellas Pharma Inc.*

In February 2011, we entered into a collaboration and license agreement with Astellas and certain of its indirect wholly owned subsidiaries in connection with which we and Astellas will develop and commercialize tivozanib for the treatment of a broad range of cancers, including RCC, and breast and colorectal cancers. Under the terms of the collaboration agreement, we and Astellas will share responsibility for continued development and commercialization of tivozanib in the United States, Mexico and Canada, or North

---

**Table of Contents**

America, and in Europe under the joint development plan and joint commercialization plan, respectively. Throughout the rest of the world (which excludes North America, Europe and Asia), which we refer to as the royalty territory, Astellas has an exclusive, royalty-bearing license to develop and commercialize tivozanib. Our plan to commercialize tivozanib in collaboration with Astellas, as described herein, is subject to our and Astellas' receipt of necessary regulatory approvals from the FDA and foreign regulatory authorities based upon favorable results in clinical trials. There can be no assurance that such approvals will be obtained.

Assuming successful approvals of tivozanib by applicable regulatory agencies, we will hold all marketing authorizations in North America, including any new drug application in the United States, and Astellas will hold all marketing authorizations in the rest of the world, other than Asia.

Assuming successful approvals of tivozanib by applicable regulatory agencies, we, as the lead commercialization party in North America, will have lead responsibility for formulating the commercialization strategy for North America under the joint commercialization plan, with each of us and Astellas responsible for conducting fifty percent (50%) of the sales efforts and medical affairs activities in North America. Astellas will have lead responsibility for commercialization activities in Europe under the joint commercialization plan, and we will be responsible for conducting fifty percent (50%) of the medical affairs activities in the major European countries. All costs associated with each party's conduct of development and commercialization activities (including clinical manufacturing and commercial manufacturing costs, if any) in North America (including any regulatory milestones and royalties associated with tivozanib in North America which may become payable by us to KHK under our license agreement with KHK), and any resulting profits or losses, will be shared equally between the parties. All costs associated with each party's conduct of development and commercialization activities (including clinical manufacturing and commercial manufacturing costs, if any) in Europe, and any resulting profits or losses, will be shared equally between the parties. As between the parties, we will remain responsible for complying with our sublicense revenue sharing obligations, if any, to KHK under our license agreement with KHK in connection with the development and commercialization of tivozanib outside of North America.

We are responsible for manufacturing, through our third party manufacturer, all of Astellas' requirements for tivozanib pursuant to a clinical supply agreement which we have entered into with Astellas, and a commercial supply agreement which the parties are currently negotiating.

Each party is obligated to use commercially reasonable efforts to develop and commercialize tivozanib in each of the United States, Mexico and Canada, including the filing of an NDA in the United States to treat patients with RCC, and to develop and commercialize tivozanib in each European country specified in the agreement. Astellas is also obligated to use commercially reasonable efforts to develop and commercialize tivozanib in each country in the royalty territory.

During the term of the agreement, neither party nor its controlled affiliates may commercialize anywhere in North America, Europe or the royalty territory any product that has a specified mechanism of action (as further defined in the collaboration agreement) for any oncology indication, except that Astellas may commercialize specified compounds for hematological cancer. Astellas may also commercialize products (other than tivozanib) in the royalty territory, on a country-by-country basis, upon expiration of the applicable royalty term, and in North America and Europe upon expiration of all valid claims under the licensed patents.

In connection with the agreement, we received an initial cash payment of \$125 million, comprised of a \$75 million license fee and \$50 million in research and development funding, both of which are non-creditable and non-refundable against any amounts due under the collaboration agreement. We retained net proceeds of approximately \$97.6 million of the initial cash payment from Astellas, after payments to KHK and strategic, legal and financial advisors. We are also eligible to receive an aggregate of approximately \$1.3 billion in potential milestone payments, comprised of (i) up to \$575 million in milestone payments upon achievement of specified clinical development and regulatory milestone events, including up to \$90 million in milestone payments in connection with specified regulatory filings, and receipt of marketing approvals, for tivozanib to treat RCC in the United States and Europe, and (ii) up to \$780 million in milestone payments upon the achievement of specified sales events. In addition, if tivozanib is successfully developed and launched in the royalty territory, Astellas will be required to pay to us tiered, double digit royalties on net sales of tivozanib in the royalty territory, if any, subject to offsets under certain circumstances. We are required to pay KHK low to mid teen royalties on our net sales in North America, and 30% of certain amounts we may receive from Astellas in connection with Astellas' development and commercialization activities in Europe and the royalty territory, including up-front license fees, milestone payments and royalties.

Unless terminated earlier in accordance with its terms, the collaboration agreement with Astellas expires (a) with respect to the royalty territory, on a country by-country basis, upon the latest to occur of: (i) the expiration of the last-to-expire valid claim of an AVEO patent or joint patent covering the composition of tivozanib, (ii) the expiration of the last-to-expire valid claim of an AVEO patent or joint patent covering the use of tivozanib, but only for so long as no generic competition exists in such country, and (iii) twelve years from first commercial sale of tivozanib in such country, and (b) with respect to North America and Europe as a whole, upon the expiration of all payment obligations between the parties related to development and commercialization of tivozanib in North America and Europe. After the second anniversary of the effective date of the collaboration agreement, Astellas has the right to terminate the collaboration agreement, in its entirety or solely with respect to the royalty

territory, at any time upon 180 days prior written notice to us. Either party may terminate the collaboration agreement with respect to a specified territory or country as set forth

**Table of Contents**

in the collaboration agreement, if the other party fails to cure a material breach related to such territory or country, as applicable. We may also terminate the collaboration agreement in its entirety upon a patent-related challenge by Astellas, its affiliates or sublicensees, if such patent-related challenge is not withdrawn within 30 days following our notice to Astellas of such termination.

We are accounting for the joint development and commercialization activities in North America and Europe as a joint risk sharing collaboration in accordance with Accounting Standards Codification (ASC) 808 *Collaborative Arrangements*. Accordingly, the joint development and commercialization activities in North America and Europe were separated from the other deliverables included in the agreement with Astellas. In addition, these activities were not deemed to be separate deliverables under the agreement with Astellas, and accordingly, none of the up-front consideration paid by Astellas under the agreement was attributed to the joint development and commercialization in North America and Europe.

Payments from Astellas with respect to Astellas' share of research and development costs incurred by us are recorded as a reduction to expense due to the joint risk sharing provisions of the agreement in North America and Europe. As a result of the cost-sharing provisions in our agreement with Astellas, we reduced research and development expense by \$6.1 million and \$12.3 million during the three and six months ended June 30, 2011, respectively, and general and administrative expense by \$0.2 million and \$0.4 million during the three and six months ended June 30, 2011, respectively. Included in our accounts receivable balance on the condensed consolidated balance sheet at June 30, 2011 is \$12.5 million for amounts due from Astellas pursuant to the cost-sharing provisions.

Activities under the agreement with Astellas outside of the joint development and commercialization activities in North America and Europe were evaluated under ASC 605-25 *Revenue Recognition- Multiple Element Arrangements* to determine if they represented a multiple element revenue arrangement. The agreement with Astellas includes the following deliverables outside of the joint development and commercialization activities in North America and Europe: a co-exclusive license to develop and commercialize tivozanib in North America and Europe, a royalty-bearing license to develop and commercialize tivozanib in the royalty-bearing territory, which includes our obligation to provide access to clinical and regulatory information resulting from the activities in North America and Europe to Astellas for its development and commercialization of tivozanib in the royalty-bearing territory, and our obligation to supply clinical material to Astellas for development of tivozanib in the royalty-bearing territory. All of these deliverables were deemed to have stand-alone value and to meet the criteria to be accounted for as separate units of accounting under ASC Topic 605-25. ASC Topic 605-25 establishes a selling price hierarchy for determining the selling price of a deliverable, which includes: (1) vendor-specific objective evidence if available; (2) third-party evidence if vendor-specific objective evidence is not available; and (3) estimated selling price if neither vendor-specific objective evidence nor third-party evidence is available. We allocated the up-front consideration of \$125 million to the deliverables based on our best estimate of selling price of each deliverable using the relative selling price method as we did not have vendor specific objective evidence or third party evidence for such deliverables. Our best estimate of selling price considered discounted cash flow models, the key assumptions of which included the market opportunity for commercialization of tivozanib in North America and Europe and in the royalty-bearing territory, the development costs and market opportunity for the expansion of tivozanib into other solid tumor types, and the time to commercialization of tivozanib for all potential oncology indications. We allocated \$120.2 million of the up-front consideration from Astellas to the co-exclusive license in North America and Europe and \$4.8 million of the up-front consideration from Astellas to the combined deliverable representing a royalty-bearing license to develop and commercialize tivozanib in the royalty-bearing territory along with our obligation to provide access to clinical and regulatory information resulting from the activities in North America and Europe to Astellas for its use in the royalty-bearing territory. The relative selling price for our obligation to supply clinical material to Astellas for development in the royalty-bearing territory had de minimus value.

We recorded the \$120.2 million relative selling price of the co-exclusive license granted in North America and Europe as collaboration revenue during the three months ended March 31, 2011 upon delivery of the license, and deferred approximately \$4.8 million of revenue representing the relative selling price of the royalty-bearing license to develop and commercialize tivozanib in the royalty-bearing territory along with our obligation to provide access to clinical and regulatory information resulting from the activities in North America and Europe to Astellas for its use in the royalty-bearing territory. We are recording the \$4.8 million ratably over our period of performance through April 2022, the remaining patent life of tivozanib. We recorded approximately \$107,000 and \$161,000 of revenue during the three and six months ended June 30, 2011, respectively, associated with the amortization of the deferred revenue associated with this agreement.

***Centocor Ortho Biotech Inc. (Centocor)***

In May 2011, we entered into an exclusive license agreement, or the Centocor license agreement, with Centocor Ortho Biotech Inc., or Centocor, for the worldwide development and commercialization of our internally-discovered antibodies targeting the RON (Recepteur d' Origine Nantais) receptor, including the grant to Centocor of an exclusive, worldwide license to our proprietary RON-driven tumor models. We also granted Centocor a nonexclusive, non-sublicensable, worldwide license to our proprietary list of human genes intended to predict correlation of response to RON-targeted antibodies, or our RON index. Centocor is responsible for





**Table of Contents**

all clinical development, manufacturing and commercialization activities and costs. Subject to an agreed-upon research plan and budget, Centocor will also fund certain research for a three-year term to be conducted by us, including translational research studies using our proprietary Human Response Platform to identify biomarkers for patients most likely to benefit from treatment with RON targeted antibodies.

In connection with the Centocor license agreement, we received a one-time cash payment in the amount of \$7.5 million and a separate equity investment in the amount of approximately \$7.5 million through the purchase by Johnson & Johnson Development Corporation, an affiliate of Centocor, of 438,340 newly issued shares of our common stock at a purchase price of \$17.11 per share. Milestone payments for the successful development and commercialization of a RON-targeted antibody, if all approvals in multiple indications and all sales milestones are achieved, could total, in the aggregate, \$540 million. Upon commercialization, we are eligible to receive tiered double-digit royalty payments on Centocor's net sales of any RON-targeted antibody, as a percentage of net sales. Centocor's royalty obligations in a particular country begin on the date of first commercial sale of a product in that country, and end on the later of 10 years after the date of first commercial sale of the product in that country or the date of the last to expire of the issued patents covering the product in that country. All milestone payments and royalties will be reduced by a certain percentage if Centocor develops or commercializes a RON-targeted antibody which has incorporated significant, meaningful improvements made after a specified period by Centocor to the antibodies delivered by us. The royalties will also be reduced by a certain percentage on a country-by-country basis upon the entry of a generic competitor.

The Centocor license agreement will remain in effect until the expiration of all of Centocor's royalty obligations to us, determined on a product-by-product and country-by-country basis. Prior to the filing of an investigational new drug application with the FDA or a similar application filed with another regulatory authority outside of the United States (which we refer to as IND submission), Centocor has the right to terminate the Centocor license agreement at will upon 90 days written notice to us. After IND submission, Centocor may terminate the Centocor license agreement at will upon 180 days written notice to us. Either party has the right to terminate the Centocor license agreement in connection with an insolvency event involving the other party or a material breach of the Centocor license agreement by the other party that remains uncured for a specified cure period. In the event that Centocor terminates the Centocor license agreement at will, or if we terminate the Centocor license agreement due to Centocor's material breach or insolvency, worldwide rights to the development, manufacture, and commercialization of RON-targeted antibodies revert back to us.

As noted above, Johnson & Johnson Development Corporation paid \$7.5 million for 438,340 shares of our common stock at a purchase price of \$17.11 per share, which reflected the average of the daily volume weighted average prices for our common stock for the 30 consecutive trading days ending on May 26, 2011. This weighted average sales price of \$17.11 per share resulted in a \$1.22 per share discount from the May 31, 2011 closing price of \$18.33 per share, or a discount of \$534,775 from the fair market value of the common stock on the effective date of the Centocor License Agreement. We determined this transaction was not within the scope of ASC 605-25 and, accordingly, the Company recorded the sale of common stock to Johnson & Johnson Development Corporation at fair value based on the closing price of the Company's stock on May 31, 2011 of \$18.33 per share.

The remaining activities under the Centocor license agreement were evaluated under ASC Topic 605-25 (as amended by ASU 2009-13) to determine if they represented a multiple element revenue arrangement. We determined that the Centocor license agreement included the following deliverables:

Exclusive, sublicensable commercialization and development license related to RON antibodies (the "RON license");

Non-exclusive license to use our RON index (the "RON index license"); and

Our obligation to provide research services.

We determined that each deliverable had stand-alone value upon delivery and therefore represents a separate unit of accounting. Factors considered in this determination included, among other things, the subject of the licenses and the research and development and commercial capabilities of Centocor.

We excluded the fair value of the common stock purchased by Johnson & Johnson Development Corporation from the arrangement consideration to be allocated to the identified deliverables and allocated the remaining \$7.0 million of up-front consideration attributable to the deliverables based on the relative selling price method. We determined the estimated selling price for the RON license and the RON index license based on management's best estimate of selling price as we did not have vendor-specific objective evidence or third-party evidence of selling price for those deliverables. Our best estimate of selling price for the RON license and RON Index license considered discounted cash

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

flow models, the key assumptions of which included the market opportunity for commercialization of a potential product candidate using the RON receptor worldwide, an estimate of costs related to phase 1, 2 and 3 clinical studies with certain multiplication factors related to the probability of success, and the time to commercialization of a potential product candidate.

---

## **Table of Contents**

This analysis used various assumptions that are typical for similarly staged monoclonal antibodies and other reasonable cost assumptions in determining research and development, and sales, general & administrative costs. As the relative selling price of the RON license and RON index license (the delivered items) exceeds the up-front consideration attributable to the deliverables of \$7.0 million, the entire up-front payment was recognized as revenue upon delivery of the licenses during the three months ended June 30, 2011.

We will record revenue related to research and development services as the services are delivered at the contractual rate, which approximates fair value for those services.

We may be entitled to receive future milestone payments totaling \$540 million. We have elected to recognize all milestone payments as revenue once the milestones have been triggered if the milestone is deemed to be substantive. We believe the development, approval and sales milestones that may be received under the Centocor license agreement are consistent with the definition of a milestone included in ASU 2010-17 and, accordingly, we will recognize payments related to the achievement of such milestones, if any, as revenue upon receipt. Factors considered in this determination included scientific and regulatory risks that must be overcome to achieve each milestone, the level of effort and investment required to achieve each milestone, and the monetary value attributed to each milestone.

The adoption of ASU 2009-13 did not materially affect our accounting for the Centocor License Agreement.

### ***OSI Pharmaceuticals***

In September 2007, we entered into a collaboration and license agreement with OSI Pharmaceuticals, Inc., (a wholly-owned subsidiary of Astellas US Holding Inc., a holding company owned by Astellas Pharma Inc.) or OSI. This strategic partnership is primarily focused on the identification and validation of genes and targets involved in the processes of epithelial-mesenchymal transition or mesenchymal-epithelial transition, in cancer. The research program portion of our strategic partnership with OSI, which concluded in June 2011, focused on the development of proprietary target-driven tumor models for use in target validation, drug screening and biomarker identification to support OSI's drug discovery and development activities. In connection with the terms of our agreement, OSI elected to obtain exclusive rights, with the right to grant sublicenses, under certain aspects of our intellectual property, to research, develop, make, sell and import drug products and associated diagnostics directed to 16 targets identified and/or validated under the agreement. OSI has sole responsibility and is required to use commercially reasonable efforts to develop and commercialize drugs and associated diagnostics directed to the targets to which it has obtained rights. In July 2009, we expanded our strategic partnership with OSI and we granted OSI a non-exclusive license to use our proprietary bioinformatics platform, and non-exclusive, perpetual licenses to use bioinformatics data and to use a proprietary gene index related to a specific target pathway. Further, as part of our expanded strategic partnership, we granted OSI an option to receive non-exclusive perpetual rights to certain elements of our Human Response Platform, including the right to obtain certain of our tumor models and tumor archives.

In September 2007, OSI paid us an up-front payment of \$7.5 million, which was recorded in deferred revenue and was being amortized over our period of substantial involvement, which ended in July 2011. OSI also paid us \$2.5 million for the first year of research program funding, which was recorded in deferred revenue and was recognized as revenue over the performance period and, thereafter, made sponsored research payments of \$625,000 per quarter through July 2009. In addition, OSI purchased 1,833,334 shares of our series C convertible preferred stock, at a per share price of \$3.00, resulting in gross proceeds to us of \$5.5 million. We determined that the price paid of \$3.00 per share by OSI represented a premium of \$0.50 over the price per share for shares of our series D convertible preferred stock sold in April 2007; accordingly, we are recognizing the premium of \$917,000 as additional license revenue on a straight-line basis over the period of substantial involvement. In connection with the initial public offering we consummated in March 2010 and the related 1:4 reverse stock split of our common stock, each four shares of outstanding series C convertible preferred stock were converted into one share of common stock.

In July 2009 under the amended agreement, OSI paid us an up-front payment of \$5.0 million, which was recorded in deferred revenue and was amortized over our remaining period of substantial involvement, which ended in July 2011. OSI also agreed to fund research costs through June 30, 2011. In addition, OSI purchased 3,750,000 shares of our series E convertible preferred stock at a per share price of \$4.00, resulting in gross proceeds to us of \$15.0 million. We determined that the price of \$4.00 per share paid by OSI represented a premium of \$1.04 per share over the fair value of the series E convertible preferred stock of \$2.96 as calculated by us in our retrospective stock valuation; accordingly, we recognized the premium of \$3.9 million as additional license revenue on a straight-line basis over the period of substantial involvement, which ended in July 2011. In connection with the initial public offering we consummated in March 2010 and the related 1:4 reverse stock split of our common stock, each four shares of outstanding series E convertible preferred stock were converted into one share of common stock.

In November 2010, OSI exercised its option under the July 2009 expansion of the agreement to license certain elements of our proprietary technology platform, including components of the Human Response Platform for the identification/characterization of



**Table of Contents**

novel epithelial-mesenchymal transition agents and proprietary patient selection biomarkers, in support of OSI's clinical development programs. We did not consider the option granted to OSI in July 2009 as a deliverable as there was significant uncertainty that this option would ultimately be exercised. In connection with the exercise of the option, OSI is obligated to pay us \$25 million in license expansion fees. We received \$12.5 million upon delivery of the notice of option exercise, and we received the remaining \$12.5 million in July 2011 in connection with the successful transfer of the applicable technology. We deferred the initial \$12.5 million payment, and recognized the full \$25 million relating to the option exercise by OSI over the period of substantial involvement, which ended in July 2011.

Under the July 2009 expanded agreement, if all applicable milestones are achieved, payments for the successful achievement of discovery, development and commercialization milestones under the agreement could total, in the aggregate, over \$94.0 million for each target and its associated products. In March 2011, we earned \$1.5 million related to deliverables and research milestones under the agreement. In addition, we are eligible to receive up to \$24.0 million in biomarker related milestones. Upon commercialization of products which were part of the research program under the agreement, we are eligible to receive tiered royalty payments on sales of products by OSI, its affiliates and sublicensees. All milestones earned to date are for selection of targets, delivery of models, delivery of tumor archives or delivery of cell lines. These milestones are not considered to be at risk and substantive, therefore, the milestone payments were deferred and were recognized on a straight-line basis over the remaining estimated period of substantial involvement, which was July 2011.

We believe the application of the provisions of ASU 2009-13 to this arrangement would not change the units of accounting under the arrangement or the manner in which we recognize revenue for the arrangement.

***Biogen Idec***

In March 2009, we entered into an exclusive option and license agreement with Biogen Idec International GmbH, a subsidiary of Biogen Idec Inc., which we collectively refer to herein as Biogen Idec, regarding the development and commercialization of our discovery-stage ErbB3-targeted antibodies for the potential treatment and diagnosis of cancer and other diseases outside of the United States, Canada and Mexico. Under the agreement, we are responsible for developing ErbB3 antibodies through completion of the first phase 2 clinical trial designed in a manner that, if successful, will generate data sufficient to support advancement to a phase 3 clinical trial. Within a specified time period after we complete this phase 2 clinical trial and deliver to Biogen Idec a detailed data package containing the results thereof, Biogen Idec may elect to obtain (1) a co-exclusive (with us), worldwide license, including the right to grant sublicensees, under our relevant intellectual property to develop and manufacture ErbB3 antibody products, and (2) an exclusive license, including the right to grant sublicensees, under our relevant intellectual property, to commercialize ErbB3 antibody products in all countries in the world other than the United States, Canada and Mexico. We retain the exclusive right to commercialize ErbB3 antibody products in the United States, Canada and Mexico.

We account for the Biogen Idec arrangement pursuant to ASC Topic 605-25. The deliverables under the arrangement include an option for a co-exclusive, world-wide license to develop and manufacture ErbB3 antibody products and an option for an exclusive license to commercialize ErbB3 antibody products in all countries in the world other than the United States, Canada and Mexico. We determined that these deliverables did not have standalone value due to the fact that the program was still in preclinical development and required our experience to advance development of the product. As such, we determined that the agreement should be accounted for as one unit of accounting.

Under the terms of the agreement, Biogen Idec paid us an upfront cash payment of \$5.0 million in March 2009, which is being amortized over our period of substantial involvement, defined as the patent life of the development candidate. In addition, Biogen Idec purchased 7,500,000 shares of series E convertible preferred stock at a per share price of \$4.00, resulting in gross proceeds to us of \$30.0 million. We determined that the price of \$4.00 paid by Biogen Idec represented a premium of \$1.09 per share over the fair value of the series E convertible preferred stock of \$2.91 as calculated by us in our retrospective stock valuation; accordingly, we are recognizing the premium of \$8.2 million as revenue on a straight-line basis over the period of substantial involvement. In connection with the initial public offering we consummated in March 2010 and the related 1:4 reverse stock split of our common stock, each four shares of outstanding series E convertible preferred stock were converted into one share of common stock.

In June 2009, we received a \$5.0 million milestone payment for achievement of the first pre-clinical discovery milestone under the agreement. Since the \$5.0 million milestone payment received in June 2009 was a near term milestone and not considered to be substantive and at risk, the revenue is being amortized as additional license revenue over our period of substantial involvement. We also earned a second \$5.0 million milestone payment upon selection of a development candidate in March 2010 and a third \$5.0 million milestone payment based on achieving the GLP toxicology initiation milestone in June 2011. Each of these milestones were considered substantive and at risk and were included in revenue for the quarter ended March 31, 2010 and June 30, 2011, respectively. We could also receive an option exercise fee and regulatory milestone payments of \$50.0 million in the aggregate if Biogen Idec exercises its option to obtain exclusive rights to commercialize ErbB3 antibody products in its territory. We consider these milestone payments to be substantive and at risk so we expect to record revenue upon achievement of these milestones in accordance with ASU 2010-17.



---

## **Table of Contents**

We believe the application of the provisions of ASU 2009-13 to this arrangement would not change the units of accounting under the arrangement or the manner in which we recognize revenue for the arrangement.

### ***Schering-Plough (now Merck)***

In March 2007, we entered into an agreement with Schering-Plough Corporation, or Schering-Plough (now Merck & Co., Inc., or Merck), through its subsidiary Schering Corporation, acting through its Schering-Plough Research Institute division, under which we granted Merck exclusive, worldwide rights to develop and commercialize all of our monoclonal antibody antagonists of hepatocyte growth factor, or HGF, including ficlatuzumab, for therapeutic and prophylactic use in humans and for veterinary use. We also granted Merck an exclusive, worldwide license to related biomarkers for diagnostic use. We also are using our Human Response Platform to conduct translational research to guide the clinical development of ficlatuzumab. Merck was responsible for all costs related to the clinical development of ficlatuzumab and clinical and commercial manufacturing. On September 28, 2010, we received notice from Merck of termination of the collaboration agreement effective as of December 27, 2010, at which point we became responsible for the performance and funding of all future research, development, manufacturing and commercialization activities for ficlatuzumab.

Under the agreement, Merck paid us an up-front payment of \$7.5 million in May 2007, which is being amortized over our period of substantial involvement, which was initially estimated to be through completion of the first phase 2 proof-of-concept trial for ficlatuzumab (which was expected to be the first half of 2012), but has been adjusted to reflect the termination of the agreement effective on December 27, 2010. In addition, Merck purchased 4,000,000 shares of our series D convertible preferred stock, at a per share price of \$2.50, resulting in gross proceeds to us of \$10.0 million. The amount paid for the series D convertible preferred stock represented fair value as it was the same as the amounts paid by unrelated investors in March and April 2007. In connection with the initial public offering which we consummated in March 2010, and the related 1:4 reverse stock split of our common stock, each four shares of outstanding series D convertible preferred stock were converted into one share of common stock.

In June 2010, we earned and received an \$8.5 million milestone payment in connection with the enrollment of patients in our phase 2 clinical trial of ficlatuzumab under the agreement. Since the \$8.5 million milestone payment earned in June 2010 was considered substantive and at risk, it has been included in revenue for the year ended December 31, 2010.

In March 2011, in connection with the transition of responsibility for the ficlatuzumab program from Merck back to us, we made a \$10.2 million payment to Merck for the purchase of a supply of ficlatuzumab to support ongoing clinical studies. We have taken title to all of this inventory as of June 30, 2011 and have expensed \$1.1 million related to this inventory during the three months ended March 31, 2011, and \$9.1 million during the three months ended June 30, 2011, as title passed to us.

## **Financial Overview**

### ***Revenue***

To date, we have not generated any revenue from product sales. All of our revenue to date has been derived from license fees, milestone payments, and research and development payments received from our strategic partners.

In the future, we may generate revenue from a combination of product sales, license fees, milestone payments and research and development payments in connection with certain strategic partnerships, and royalties resulting from the sales of products developed under licenses of our intellectual property. We expect that any revenue we generate will fluctuate from quarter to quarter as a result of the timing and amount of license fees, certain research and development reimbursements, milestone and other payments received under our strategic partnerships, and the amount and timing of payments that we receive upon the sale of our products, to the extent any are successfully commercialized. We do not expect to generate revenue from product sales until 2013 at the earliest. If we or our strategic partners fail to complete the development of our drug candidates in a timely manner or obtain regulatory approval for them, our ability to generate future revenue, and our results of operations and financial position, would be materially adversely affected.

### ***Research and Development Expense***

Research and development expenses consist of expenses incurred in connection with the discovery and development of our product candidates. These expenses consist primarily of:

Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

employee-related expenses, which include salaries and benefits;

expenses incurred under agreements with contract research organizations, investigative sites and consultants that conduct our clinical trials and a substantial portion of our preclinical studies;



**Table of Contents**

the cost of acquiring and manufacturing clinical trial materials;

facilities, depreciation and other allocated expenses, which include direct and allocated expenses for rent and maintenance of facilities and equipment, and depreciation of fixed assets;

license fees for and milestone payments related to in-licensed products and technology;

stock-based compensation expense to employees and non-employees; and

costs associated with non-clinical activities and regulatory approvals.

We expense research and development costs as incurred. Nonrefundable advance payments for goods and services that will be used in future research and development activities are expensed when the activity has been performed or when the goods have been received rather than when the payment is made.

Research and development expenses are net of amounts reimbursed under our agreement with Astellas for Astellas' share of development and commercialization costs incurred by us under the joint development plan.

Conducting a significant amount of research and development is central to our business model. Product candidates in later stages of clinical development generally have higher development costs than those in earlier stages of clinical development, primarily due to the increased size and duration of later stage clinical trials. We plan to increase our research and development expenses for the foreseeable future as we continue development of our most advanced product candidate, tivozanib, and advance the ficlatuzumab program and our earlier-stage research and development projects.

We track external development expenses and personnel expense on a program-by-program basis and allocate common expenses, such as scientific consultants and lab supplies, to each program based on the personnel resources allocated to such program. Facilities, depreciation, stock-based compensation, research and development management and research and development support services are not allocated and are considered overhead. Below is a summary of our research and development expenses for the three and six months ended June 30, 2011 and 2010:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2011	2010	2011	2010
	(in thousands)		(in thousands)	
Tivozanib	\$ 4,554	\$ 17,056	\$ 32,709	\$ 31,942
Ficlatuzumab	13,693	3,094	16,970	5,149
AV-203 program	1,192	647	2,288	1,121
Platform collaborations	573	889	1,349	1,606
Antibody pipeline	1,709	1,473	3,371	3,004
Other research and development	278	344	506	794
Overhead	3,079	2,494	5,902	4,999
Total research and development expenses	\$ 25,078	\$ 25,997	\$ 63,095	\$ 48,615

*Tivozanib*

We have completed a phase 2 clinical trial for tivozanib and in August 2010 completed enrollment of our 517-patient phase 3 clinical trial for tivozanib in advanced RCC. We are also conducting phase 1 clinical trials of tivozanib in various combinations and dosing regimens in advanced RCC and additional solid tumor indications. Future research and development costs for the tivozanib program are not reasonably certain because such costs are dependent on a number of variables, including the cost and design of any additional clinical trials including

additional trials in combination with other drugs, the timing of the regulatory process, and the success of the ongoing phase 3 clinical trial. We recently entered into a collaboration and license agreement with Astellas pursuant to which we and Astellas share responsibility for tivozanib, including expenses for continued development and commercialization of tivozanib, in North America and Europe. Astellas is responsible for continued development and commercialization of tivozanib outside of North America, Europe and Asia. All costs associated with each party's conduct of development and commercialization activities in North America and Europe pursuant to a joint development plan, and any resulting profits or losses, will be shared equally between the parties. We have included \$6.3 million and \$12.7 million in cost reimbursements as a reduction in tivozanib related expenses for the three and six months ended June 30, 2011, respectively. Our current estimate for the cost of the phase 3 clinical trial program, including the cost of the comparator drug, Nexavar, is approximately \$67.0 million, excluding the effect of our cost sharing arrangement with Astellas. In the first quarter of 2010, we paid KHK a \$10.0 million milestone in connection with the initiation of our phase 3 clinical trial of tivozanib. We may also be required to make up to an aggregate of \$50.0 million in milestone payments to KHK upon the achievement of specified regulatory milestones. Further, we are required to pay KHK tiered royalty payments on net sales we make of tivozanib in North America, which range from the low to mid teens as a percentage of net sales. In connection with

**Table of Contents**

the execution of our collaboration agreement with Astellas, we are required to pay KHK 30% of the license fee received from Astellas as well as certain amounts we may receive from Astellas in connection with Astellas' development and commercialization activities outside of North America and Asia related to tivozanib, other than amounts we receive in respect of research and development funding or equity investments, subject to certain limitations. In the first quarter of 2011, we recorded \$22.5 million of expense for amounts owed to KHK related to the up-front license payment received under the collaboration agreement with Astellas. This payment was made to KHK in the second quarter of 2011.

*Ficlatuzumab*

In March 2007, we entered into a license agreement related to ficlatuzumab with Merck (formerly Schering-Plough) pursuant to which Merck was responsible for all expenses relating to development of ficlatuzumab in accordance with an agreed-upon budget. We recorded revenue and expenses on a gross basis under this arrangement. We have completed a phase 1 clinical trial of ficlatuzumab and recently completed enrollment of a phase 2 clinical trial. We earned an \$8.5 million milestone payment from Merck upon initiation of the Phase 2 clinical trial in the second quarter of 2010. On September 28, 2010, we received from Merck a notice of termination of the collaboration agreement effective as of December 27, 2010, at which point we became responsible for the performance and funding of all future research, development, manufacturing and commercialization activities for ficlatuzumab. In connection with the transition of responsibility for the ficlatuzumab program, we recently purchased supply of ficlatuzumab for \$10.2 million to support ongoing clinical trials of ficlatuzumab. We have taken title to all of this material as of June 30, 2011 and, pursuant to the provisions of ASC Topic 730, have recognized this amount as research and development expense during the six months ended June 30, 2011. Due to the unpredictable nature of preclinical and clinical development, we are unable to estimate with any certainty the costs we will incur in the future development of the ficlatuzumab program.

*AV-203: Anti-ErbB3 Antibody Program*

Our AV-203 program is focused on identifying inhibitors of ErbB3. In 2010, we nominated our lead development candidate, AV-203, which is currently in preclinical development. We have granted Biogen Idec an exclusive option to co-develop (with us) and commercialize our ErbB3-targeted antibodies for the potential treatment and diagnosis of cancer and other diseases outside of the United States, Canada and Mexico. Due to the unpredictable nature of preclinical and clinical development and given the early stage of this program, we are unable to estimate with any certainty the costs we will incur in the future development of any candidate identified from this program. Upon the selection of AV-203 as a development candidate in the first quarter of 2010, we earned a \$5.0 million milestone payment from Biogen Idec, and we earned a third \$5.0 million milestone payment in June 2011 based on initiation of a GLP toxicology study.

*Platform Collaborations*

We have performed research services for OSI Pharmaceuticals using our Human Response Platform. The agreement with OSI concluded in July 2011. The related expenses, including personnel and related expenses, are captured as a cost of the agreement with OSI Pharmaceuticals. Expenses incurred under the agreement with OSI Pharmaceuticals are fully supported by the revenue from that agreement.

*Antibody Pipeline*

We expect that the expenses related to our antibody pipeline will continue to increase as we seek to identify additional targets for preclinical research and additional personnel are added to these projects. Future research and development costs for our antibody pipeline are not reasonably certain because such costs are dependent on a number of variables, including the success of preclinical studies on these antibodies and the identification of other potential candidates across multiple oncology indications.

*Other Research and Development*

Other research and development includes expenses related to our Human Response Platform, which is not specifically related to a particular product candidate or a specific strategic partnership, and in 2010 included expenses related to AV-412, a product candidate for which we have decided not to pursue further development. AV-412 was the subject of a license agreement with Mitsubishi Pharma Corporation. We terminated the license agreement with Mitsubishi Pharma effective January 26, 2010. We do not expect to incur further costs for this product candidate.

*Uncertainties of Estimates Related to Research and Development Expenses*

The process of conducting preclinical studies and clinical trials necessary to obtain FDA approval for each of our product candidates is costly and time consuming. The probability of success for each product candidate and clinical trial may be affected by a variety of factors, including, among others, the quality of the product candidate's early clinical data, investment in the program, competition, manufacturing capabilities and commercial viability.



## **Table of Contents**

At this time, we cannot reasonably estimate or know the nature, specific timing and estimated costs of the efforts that will be necessary to complete the remainder of the development of our product candidates, or the period, if any, in which material net cash inflows may commence from our product candidates. This is due to the numerous risks and uncertainties associated with developing drugs, including the uncertainty of:

the progress and results of our clinical trials;

the scope, progress, results and costs of preclinical development, laboratory testing and clinical trials for any other product candidate;

the costs, timing and outcome of regulatory review of our product candidates;

our ability to establish and maintain strategic partnerships, the terms of those strategic partnerships and the success of those strategic partnerships, if any, including the timing and amount of payments that we might receive from strategic partners;

the emergence of competing technologies and products and other adverse market developments; and

the costs of preparing, filing and prosecuting patent applications and maintaining, enforcing and defending intellectual property-related claims.

As a result of the uncertainties discussed above, we are unable to determine the duration and completion costs of current or future clinical stages of our product candidates (except for the estimates we have made for the cost of our phase 3 clinical trial of tivozanib) or when, or to what extent, we will generate revenues from the commercialization and sale of any of our product candidates. Development timelines, probability of success and development costs vary widely. We anticipate that we will make determinations as to which additional programs to pursue and how much funding to direct to each program on an ongoing basis in response to the scientific and clinical success of each product candidate, as well as ongoing assessment of the product candidate's commercial potential. We plan to develop additional product candidates internally which will significantly increase our research and development expenses in future periods. We will need to raise additional capital in the future in order to commercialize tivozanib and to fund the development of ficlatuzumab and our other product candidates.

### ***General and Administrative Expenses***

General and administrative expenses consist principally of salaries and related costs for personnel in executive, finance, business development, marketing, information technology, legal and human resources functions. Other general and administrative expenses include facility costs not otherwise included in research and development expenses, patent filing, prosecution and defense costs and professional fees for legal, consulting, auditing and tax services.

We anticipate that our general and administrative expenses will increase for, among others, the following reasons:

the need to support our research and development activities, which we expect to expand as we continue the development of our product candidates;

we began to incur expenses related to the sales and marketing of our product candidates in anticipation of commercial launch before we receive regulatory approval of a product candidate; and

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

as a result of increased payroll, expanded infrastructure and higher consulting, legal, accounting and investor relations costs, and directors and officers insurance premiums, associated with being a public company.

### ***Interest Income and Interest Expense***

Interest income consists of interest earned on our cash and cash equivalents and marketable securities. The primary objective of our investment policy is capital preservation.

Interest expense consists primarily of interest, amortization of debt discount, and amortization of deferred financing costs associated with our loans payable.

### ***Income Taxes***

We calculate our provision for income taxes on ordinary income based on our projected annual tax rate for the year. As of June 30, 2011, we are projecting an ordinary loss for the year ended December 31, 2011 and since we maintain a full valuation allowance on all of our deferred tax assets, we have recorded no income tax provision or benefit in the current quarter.

### **Critical Accounting Policies and Significant Judgments and Estimates**

Our discussion and analysis of our financial condition and results of operations are based on our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The

**Table of Contents**

preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities, revenues and expenses and the disclosure of contingent assets and liabilities in our financial statements. On an ongoing basis, we evaluate our estimates and judgments, including those related to accrued expenses, stock-based compensation and revenue recognition. We base our estimates on historical experience, known trends and events and various other factors that are believed to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions. Our critical accounting policies are reflected in our Annual Report on Form 10-K for the year ended December 31, 2010 filed with the U.S. Securities and Exchange Commission on March 11, 2011. In connection with the adoption of Accounting Standards Update ( ASU ) No. 2009-13, *Multiple-Deliverable Revenue Arrangements*, which amends ASC Topic 605-25, *Revenue Recognition - Multiple Element Arrangements* and ASU No. 2010-17, *Revenue Recognition - Milestone Method* on January 1, 2011, we have updated our critical accounting policy with respect to revenue recognition as described below. Other than with respect to revenue recognition provided under ASU 2009-13 and ASU 2010-17, there have been no other significant changes to our critical accounting policies since the beginning of this fiscal year.

***Revenue Recognition***

Our revenues are generated primarily through collaborative research, development and commercialization agreements. The terms of these agreements generally contain multiple elements, or deliverables, which may include (i) licenses, or options to obtain licenses, to our technology, (ii) research and development activities to be performed on behalf of the collaborative partner and (iii) in certain cases, services in connection with the manufacturing of pre-clinical and clinical material. Payments to us under these arrangements typically include one or more of the following: non-refundable, up-front license fees; option exercise fees; funding of research and/or development efforts; milestone payments; and royalties on future product sales.

Effective January 1, 2011, we adopted ASU No. 2009-13, *Multiple-Deliverable Revenue Arrangements*, which amends ASC Topic 605-25, *Revenue Recognition - Multiple Element Arrangements*. In addition, effective January 1, 2011, we adopted ASU No. 2010-17, *Revenue Recognition - Milestone Method*.

When evaluating multiple element arrangements, we consider whether the deliverables under the arrangement represent separate units of accounting. This evaluation requires subjective determinations and requires management to make judgments about the individual deliverables and whether such deliverables are separable from the other aspects of the contractual relationship. In determining the units of accounting, management evaluates certain criteria, including whether the deliverables have standalone value, based on the consideration of the relevant facts and circumstances for each arrangement. The consideration received is allocated among the separate units of accounting, and the applicable revenue recognition criteria are applied to each of the separate units.

We typically receive up-front, non-refundable payments when licensing our intellectual property in conjunction with a research and development agreement. When management believes the license to our intellectual property does not have stand-alone value from the other deliverables to be provided in the arrangement, we generally recognize revenue attributed to the license on a straight-line basis over our contractual or estimated performance period, which is typically the term of our research and development obligations. If management cannot reasonably estimate when our performance obligation ends, then revenue is deferred until management can reasonably estimate when the performance obligation ends. When management believes the license to our intellectual property has stand-alone value, we generally recognize revenue attributed to the license upon delivery. The periods over which revenue should be recognized are subject to estimates by management and may change over the course of the research and development agreement. Such a change could have a material impact on the amount of revenue we record in future periods.

Payments or reimbursements resulting from our research and development efforts for those arrangements where such efforts are considered as deliverables are recognized as the services are performed and are presented on a gross basis so long as there is persuasive evidence of an arrangement, the fee is fixed or determinable, and collection of the related receivable is reasonably assured. Amounts received prior to satisfying the above revenue recognition criteria are recorded as deferred revenue in the accompanying balance sheets.

At the inception of each agreement that includes milestone payments, we evaluate whether each milestone is substantive and at risk to both parties on the basis of the contingent nature of the milestone, specifically reviewing factors such as the scientific and other risks that must be overcome to achieve the milestone, as well as the level of effort and investment required. Revenues from milestones, if they are nonrefundable and deemed substantive, are recognized upon successful accomplishment of the milestones. Milestones that are not considered substantive are accounted for as license payments and recognized on a straight-line basis over the remaining period of performance.

**Table of Contents****Results of Operations****Comparison of Three Months Ended June 30, 2011 and 2010**

The following table summarizes the results of our operations for each of the three months ended June 30, 2011 and 2010, together with the changes in those items in dollars and as a percentage:

	Three Months Ended June 30,		Increase/ (decrease)	%
	2011	2010		
	(in thousands)			
Revenue	\$ 26,554	\$ 15,622	\$ 10,932	70%
Operating expenses:				
Research and development	25,078	25,997	(919)	(4)%
General and administrative	6,371	3,835	2,536	66%
Total operating expenses	31,449	29,832	1,617	5%
Income (loss) from operations	(4,895)	(14,210)	9,315	(66)%
Other income (expense), net	11	(582)	593	(102)%
Interest expense	(946)	(725)	(221)	30%
Interest income	99	28	71	254%
Net income (loss)	\$ (5,731)	\$ (15,489)	\$ 9,758	(63)%

The following table sets forth revenue for the three months ended June 30, 2011 and 2010:

Revenue	Three Months Ended June 30,		Increase/ (decrease)	%
	2011	2010		
	(in thousands)			
Strategic Partner:				
OSI Pharmaceuticals	\$ 13,988	\$ 3,186	\$ 10,802	339%
Centocor Ortho Biotech	7,243		7,243	
Merck		12,121	(12,121)	(100)%
Biogen Idec	5,216	227	4,989	2,198%
Astellas	107		107	
Other		88	(88)	(100)%
	\$ 26,554	\$ 15,622	\$ 10,932	70%

**Revenue.** Revenue for the three months ended June 30, 2011 was \$26.6 million compared to \$15.6 million for the three months ended June 30, 2010, an increase of approximately \$10.9 million or 70%. The increase is primarily attributable to an increase of \$10.8 million in revenue from OSI, primarily related to the recognition of previously deferred revenue in connection with OSI's option exercise in November 2010 under our research and license agreement; \$7.0 million in revenue recognized in connection with the up-front license payment from Centocor related to the RON program; \$5.0 million in revenue recognized in connection with the Biogen milestone payment related to achieving GLP toxicology initiation; \$0.3 million in research and development funding from Centocor; and \$0.1 million in revenue recognized in connection with our agreement with Astellas. These increases were partially offset by a decrease of \$12.1 million in revenue earned under the Merck agreements due to the termination of our ficlatuzumab collaboration in December 2010.

**Research and development.** Research and development expenses for the three months ended June 30, 2011 were \$25.1 million compared to \$26.0 million for the three months ended June 30, 2010, a decrease of \$0.9 million or 4%. The decrease is primarily attributable to a net decrease



## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

in clinical trial costs of \$6.4 million resulting primarily from a decrease in costs related to the phase 3 clinical trial of tivozanib due in part to the \$9.1 million purchase of Nexavar (the comparator drug) during the three months ended June 30, 2010, partially offset by an increase in clinical trial costs related to the Phase 2 clinical trial of ficlatuzumab. The decrease is also due to the reimbursement of \$6.1 million of tivozanib development costs pursuant to our agreement with Astellas, and a decrease in lab supplies of \$0.2 million.

**Table of Contents**

These decreases are partially offset by a \$9.5 million increase in contract manufacturing costs primarily related to a \$10.2 million payment to Merck in March 2011 for the purchase of a supply of ficlatuzumab to support ongoing clinical studies for ficlatuzumab, of which \$9.1 million was received and expensed during the three months ended June 30, 2011; a \$1.4 million increase in salaries, benefits and contract labor mainly due to an increase in personnel primarily supporting development activities for tivozanib; a \$0.3 million increase in facility costs due to the expansion to an additional location at 12 Emily Street; a \$0.3 million increase in consulting costs primarily related to the development of tivozanib; and a \$0.2 million increase in stock-based compensation.

**General and administrative.** General and administrative expenses for the three months ended June 30, 2011 were \$6.4 million compared to \$3.8 million for the three months ended June 30, 2010, an increase of \$2.5 million or 66%. The increase is primarily the result of a \$0.9 million increase in salaries and benefits due to an increase in personnel mainly due to an overall increase in hiring; an increase of \$0.5 million in recruiting and relocation costs due to an overall increase in hiring; an increase of \$0.4 million in legal costs primarily related to an increase in patent prosecution costs; an increase of \$0.4 million for pre-commercialization activities for tivozanib; a \$0.2 million increase in stock-based compensation expense; and a \$0.2 million increase in facility costs due to the expansion to an additional location at 12 Emily Street. These increases were partially offset by the reimbursement of \$0.2 million of tivozanib costs under the terms of our agreement with Astellas.

**Other income (expense), net.** Other income (expense), net for the three months ended June 30, 2011 was \$11,000 compared to \$(582,000) for the three months ended June 30, 2010, an increase of \$593,000. The expense for the three months ended June 30, 2010 is primarily due to the loss on the refinancing of our outstanding debt with Hercules Technology Growth and Comerica Bank in May of 2010 (see footnote 7 of the notes to our condensed consolidated financial statements).

**Interest expense.** Interest expense for the three months ended June 30, 2011 was \$0.9 million compared to \$0.7 million for the three months ended June 30, 2010, an increase of \$0.2 million or 30%. The increase in interest expense is due to the refinancing of our loan agreement with Hercules Technology Growth in May 2010, resulting in a higher average loan balance outstanding during the three months ended June 30, 2011 compared to the three months ended June 30, 2010.

**Interest income.** Interest income for the three months ended June 30, 2011 was \$99,000 compared to \$28,000 for the three months ended June 30, 2010, an increase of \$71,000. The increase in interest income is primarily due to an overall higher average cash balance during the three months ended June 30, 2011 compared to the three months ended June 30, 2010.

**Comparison of Six Months Ended June 30, 2011 and 2010**

The following table summarizes the results of our operations for each of the six months ended June 30, 2011 and 2010, together with the changes in those items in dollars and as a percentage:

	Six Months Ended		Increase/ (decrease)	%
	2011	June 30, 2010 (in thousands)		
Revenue	\$ 160,168	\$ 26,503	\$ 133,665	504%
Operating expenses:				
Research and development	63,095	48,615	14,480	30%
General and administrative	15,599	6,588	9,011	137%
<b>Total operating expenses</b>	<b>78,694</b>	<b>55,203</b>	<b>23,491</b>	<b>43%</b>
Income (loss) from operations	81,474	(28,700)	110,174	(384)%
Other income (expense), net	(45)	130	(175)	(135)%
Interest expense	(1,958)	(1,332)	(626)	47%
Interest income	164	35	129	369%
<b>Net income (loss)</b>	<b>\$ 79,635</b>	<b>\$ (29,867)</b>	<b>\$ 109,502</b>	<b>(367)%</b>



**Table of Contents**

The following table sets forth revenue for the six months ended June 30, 2011 and 2010:

Revenue	Six Months Ended June 30,		Increase/ (decrease)	%
	2011	2010		
	(in thousands)			
Strategic Partner:				
Astellas	\$ 120,361		\$ 120,361	
OSI Pharmaceuticals	27,108	\$ 6,188	20,920	338%
Centocor Ortho Biotech	7,243		7,243	
Merck		14,915	(14,915)	(100)%
Biogen Idec	5,432	5,303	129	2%
Other	24	97	(73)	(75)%
	\$ 160,168	\$ 26,503	\$ 133,665	504%

**Revenue.** Revenue for the six months ended June 30, 2011 was \$160.2 million compared to \$26.5 million for the six months ended June 30, 2010, an increase of approximately \$133.7 million or 504%. The increase is primarily attributable to \$120.4 million in revenue recognized in connection with our agreement with Astellas; an increase of \$21.0 million in revenue primarily related to the recognition of previously deferred revenue related to OSI's option exercise in November 2010 under our research and license agreement; \$7.0 million in revenue recognized in connection with the up-front license payment from Centocor related to the RON program; and \$0.3 million in research and development funding from Centocor. These increases were partially offset by a decrease of \$14.9 million in revenue earned under our agreements with Merck due to the termination of our ficlatuzumab collaboration in December 2010.

**Research and development.** Research and development expenses for the six months ended June 30, 2011 were \$63.1 million compared to \$48.6 million for the six months ended June 30, 2010, an increase of \$14.5 million or 30%. The increase is primarily attributable to a net increase in licensing costs of \$12.6 million resulting primarily from a \$22.5 million expense recorded in connection with our obligations to KHK related to the up-front license payment received under our agreement with Astellas during the first quarter of 2011, compared to a \$10.0 million milestone payment to KHK in connection with the initial dosing of patients in our phase 3 clinical trial of tivozanib during the same period last year; a \$10.0 million increase in contract manufacturing primarily related to a \$10.2 million payment to Merck for the purchase of a supply of ficlatuzumab to support ongoing clinical studies; a \$2.6 million increase in salaries, benefits and contract labor mainly due to an increase in personnel primarily supporting development activities for tivozanib; a \$0.7 million increase in consulting costs primarily related to the development of tivozanib; a \$0.4 million increase in stock-based compensation; a \$0.4 million increase in facility costs due to the expansion to an additional location at 12 Emily Street; a \$0.1 million increase in travel costs; and a \$0.1 million increase in lab supplies. These increases were partially offset by the reimbursement of \$12.3 million of tivozanib development costs pursuant to our agreement with Astellas; and a decrease in clinical trial costs of \$0.2 million.

**General and administrative.** General and administrative expenses for the six months ended June 30, 2011 were \$15.6 million compared to \$6.6 million for the six months ended June 30, 2010, an increase of \$9.0 million or 137%. The increase is primarily the result of a \$4.25 million payment to a financial advisor in connection with the consummation of our agreement with Astellas; a \$1.5 million increase in salaries and benefits due to an increase in personnel mainly due to an overall increase in hiring; a \$1.1 million increase in legal costs incurred primarily due to patent prosecution costs and advice related to the collaboration agreement with Astellas; an increase of \$0.7 million for pre-commercialization activities for tivozanib development; an increase of \$0.7 million for recruiting and relocation costs due to an overall increase in hiring; a \$0.3 million increase in stock-based compensation expense; an increase of \$0.2 million for costs related to being a public company; and an increase of \$0.2 million in facility costs due to an increase in personnel and the expansion to an additional location at 12 Emily Street. These increases were partially offset by the reimbursement of \$0.4 million of tivozanib costs pursuant to our agreement with Astellas.

**Other income (expense), net.** Other income (expense), net for the six months ended June 30, 2011 was \$(45,000) compared to \$130,000 for the six months ended June 30, 2010, a decrease of \$175,000. The income for the six months ended June 30, 2010 is largely a result of a decrease in the value of warrants to purchase preferred stock resulting from a decrease in the value of the underlying stock, partially offset by the loss on the refinancing of our outstanding debt with Hercules Technology Growth and Comerica Bank in May 2010; there was no corresponding income for the six months ended June 30, 2011 as the warrants converted to warrants to purchase common stock in connection with our initial public offering in March 2010.

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

**Interest expense.** Interest expense for the six months ended June 30, 2011 was \$2.0 million compared to \$1.3 million for the six months ended June 30, 2010, an increase of \$0.6 million or 47%. The increase in interest expense is due to the refinancing of our loan agreement with Hercules Technology Growth in May 2010, resulting in a higher average loan balance outstanding during the six months ended June 30, 2011 compared to the six months ended June 30, 2010.

**Table of Contents**

**Interest income.** Interest income for the six months ended June 30, 2011 was \$164,000 compared to \$35,000 for the six months ended June 30, 2010, an increase of \$129,000, or 369%. The increase in interest income is primarily due to an overall higher average cash balance during the six months ended June 30, 2011 compared to the six months ended June 30, 2010.

**Liquidity and Capital Resources**

We have funded our operations principally through the sale of equity securities sold in connection with our public offerings, private placements of equity securities, revenue from strategic partnerships, debt financing and interest income. As of June 30, 2011, we have received gross proceeds of \$89.7 million from the sale of common stock in our initial public offering, \$60.8 million from our private placement of shares of our common stock to a group of institutional and accredited investors, \$111.2 from our follow-on offering of shares of our common stock, \$169.6 million from the sale of convertible preferred stock prior to becoming a public company, and \$7.5 million of gross proceeds from the sale of common stock in connection with the agreement with Johnson and Johnson Development. As of June 30, 2011, we had received an aggregate of \$271.6 million in cash from our three agreements with Merck and our agreements with OSI Pharmaceuticals, Biogen Idec, Astellas, Centocor and Eli Lilly, and \$25.0 million in funding from our debt financing with Hercules Technology Growth and certain of its affiliates. As of June 30, 2011, we had cash, cash equivalents and marketable securities of approximately \$296.8 million. Currently, our funds are invested in money market funds, U.S. government agency securities, a foreign government agency security, U.S. treasuries, corporate debt and commercial paper. The following table sets forth the primary sources and uses of cash for each of the periods set forth below:

	<b>Six Months Ended</b>	
	<b>June 30,</b>	
	<b>2011</b>	<b>2010</b>
Net cash provided by (used in) operating activities	\$ 45,497	\$ (28,932)
Net cash used in investing activities	(124,154)	(71,429)
Net cash provided by financing activities	113,879	85,088
	\$ 35,222	\$ (15,273)

**Table of Contents**

For the six months ended June 30, 2011 and 2010, our operating activities provided (used) cash of \$45.5 million, and \$(28.9) million, respectively. The cash provided by operations for the six months ended June 30, 2011 was due primarily to our net income adjusted for non-cash items and offset by an increase in accounts receivable of \$28.4 million primarily due to the reimbursement of development expenses by Astellas, as well as amounts due to us from OSI and Biogen, a decrease in deferred revenue of \$10.6 million related to, in part, the recognition of previously deferred revenue related to OSI's option exercise in November 2010 under our research and license agreement, and a \$4.4 million increase in prepaid expenses primarily due to prepaid clinical expenses. The cash used in operations for the six months ended June 30, 2010 was due primarily to our net loss adjusted for non-cash items as well as a \$4.6 million increase in prepaid expenses primarily associated with an advance payment for purchase of Nexavar, the comparator drug in our phase 3 clinical trial of tivozanib.

For the six months ended June 30, 2011 and 2010, our investing activities used cash of \$124.2 million, and \$71.4 million, respectively. The cash used by investing activities for the six months ended June 30, 2011 and 2010 was primarily the net result of purchases of marketable securities partially offset by maturities and sales, in addition to purchases of property and equipment of \$1.2 million and \$0.4 million, respectively.

For the six months ended June 30, 2011 and 2010, our financing activities provided \$113.9 million and \$85.1 million, respectively. The cash provided by financing activities for the six months ended June 30, 2011 was primarily due to the sale and issuance of 6,352,119 shares of common stock at a price of \$17.50 per share in our follow-on public offering in June 2011 with net proceeds of \$104.2 million, the sale and issuance of 438,340 shares of common stock at a price of \$17.11 per share in connection with the Centocor license agreement, as well as stock option exercises of \$1.7 million. The cash provided by financing activities for the six months ended June 30, 2010 was due to the sale and issuance of 9,000,000 shares of common stock at a price of \$9.00 per share in our initial public offering with net proceeds of \$72.2 million, the exercise of the option to purchase an additional 968,539 shares by the underwriters in the initial public offering resulting in net proceeds of \$8.1 million, stock option exercises of \$0.5 million, and net proceeds of \$7.6 million from the modification of loans payable from our loan agreement entered in to with affiliates of Hercules Technology Growth, offset partially by principal payments on loans payable in the amount of \$3.3 million.

**Credit Facilities.** On May 15, 2008, we entered into a \$21.0 million financing agreement with Hercules Technology Growth and Comerica Bank, referred to as the prior loan agreement. The full amount of the loan was drawn down in 2008. On May 28, 2010, we entered into a new loan and security agreement with Hercules Technology II, L.P. and Hercules Technology III, L.P., affiliates of Hercules Technology Growth, referred to as the new loan agreement, pursuant to which we received a loan in the aggregate principal amount of \$25.0 million. In connection with the new loan agreement, we paid off the remaining outstanding principal and interest of \$17.4 million under the prior loan agreement. We are required to repay the aggregate principal balance of the loan that is outstanding under the new loan agreement in 30 equal monthly installments of principal starting on October 1, 2011, provided, however, that such date will be extended under certain circumstances specified in the new loan agreement. The new loan agreement requires a deferred charge of \$1.25 million to be paid in May 2012 related to the termination of the prior loan agreement. This amount is included in current liabilities as other liabilities. The new loan agreement also includes an obligation to pay an additional deferred charge of \$1.24 million due upon the maturity of the loan which has been recorded as a loan discount and is being amortized to interest expense over the term of the new loan agreement using the effective interest rate method. We recorded a long-term liability for the full amount of the charge since the payment of such amount is not contingent on any future event. Per annum interest is payable at the greater of 11.9% and an amount equal to 11.9% plus the prime rate of interest minus 4.75%, provided however, that the per annum interest shall not exceed 15.0%. We must make interest payments on the loan each month following the date of borrowing under the new loan agreement. The entire principal balance and all accrued but unpaid interest, plus the end of term payment in the amount of approximately \$1.24 million, will be due and payable on March 1, 2014, provided, however, that, as noted above. The repayment commencement date, and therefore the due date for the loan, is subject to extension under certain circumstances specified in the new loan agreement.

The loan is secured by a lien on all of our personal property, as of, or acquired after, the date of the new loan agreement, except for intellectual property. As of June 30, 2011, the principal balance outstanding was \$25.0 million.

In November 2003, we entered into a \$7.5 million financing agreement with General Electric Capital Corporation for an equipment capital expenditure line, which we refer to as the equipment line, and a refinancing line of existing equipment debt, which we refer to as the refinancing line. Borrowings under the equipment line were repayable over 54 months, the first six of which were interest only at fixed interest rates ranging from 8.39% to 10.11%, with a 10% end-of-term balloon payment (guaranteed purchase option). The aggregate principal outstanding under the equipment line and the refinancing line was fully paid in June 2010. There is no remaining ability to borrow under the equipment line and refinancing line with General Electric Capital Corporation.

**Operating Capital Requirements.** Assuming we successfully complete clinical trials and obtain requisite regulatory approvals, we anticipate commercializing our first product in 2013 at the earliest. Therefore, we anticipate that we will continue to incur significant operating costs to complete our clinical trial programs for tivozanib, build commercial capabilities, develop our antibody





## **Table of Contents**

pipeline and expand our corporate infrastructure. We believe that our existing cash and cash equivalents, marketable securities, committed research and development funding and milestone payments that we expect to receive under our existing strategic partnership and license agreements, and payments we believe that we will receive under new strategic partnerships we assume we will enter into under our current projected operating plan, will allow us to fund our operating plan beyond 2012.

If our available cash and cash equivalents are insufficient to satisfy our liquidity requirements, or if we identify additional opportunities to do so, we may seek to sell additional equity or debt securities or obtain a credit facility. The sale of additional equity and debt securities may result in additional dilution to our shareholders. If we raise additional funds through the issuance of debt securities or preferred stock, these securities could have rights senior to those of our common stock and could contain covenants that would restrict our operations. We may require additional capital beyond our currently forecasted amounts. Any such required additional capital may not be available on reasonable terms, if at all. If we were unable to obtain additional financing, we may be required to reduce the scope of, delay or eliminate some or all of our planned research, development and commercialization activities, which could harm our business.

Because of the numerous risks and uncertainties associated with research, development and commercialization of pharmaceutical products, we are unable to estimate the exact amount of our working capital requirements. Our future capital requirements will depend on many factors, including, but not limited to:

the number and characteristics of the product candidates we pursue;

the scope, progress, results and costs of researching and developing our product candidates, and conducting preclinical and clinical trials;

the timing of, and the costs involved in, obtaining regulatory approvals for our product candidates;

the cost of commercialization activities if any of our product candidates are approved for sale, including marketing, sales and distribution costs;

the cost of manufacturing our product candidates and any products we successfully commercialize;

our ability to establish and maintain strategic partnerships, licensing or other arrangements and the financial terms of such agreements;

the costs involved in preparing, filing, prosecuting, maintaining, defending and enforcing patent claims, including litigation costs and the outcome of such litigation; and

the timing, receipt and amount of sales of, or royalties on, our future products, if any.

## **Contractual Obligations and Commitments**

In connection with our obligation under the license agreement with KHK to pay 30% of sublicense revenue we receive, we incurred expenses of \$22.5 million for amounts owed to KHK related to the up-front license payment received under our collaborative agreement with Astellas. The full amount was paid to KHK in April 2011.

We also incurred expenses to financial advisors in connection with our collaborative agreement with Astellas of \$4.25 million. The full amount was paid to these financial advisors in April 2011.

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

On February 28, 2011, we entered into a sublease agreement with Acceleron Pharma, Inc., to sublease 14,214 square feet of office space. The sublease will expire on May 30, 2015. In conjunction with the lease, we entered into a standby letter of credit in the amount of \$97,129 which will expire on May 31, 2012 subject to automatic extensions for periods of one year related to the term of the sublease. The letter of credit has been collateralized by a money market account held by the bank which issued the letter of credit. This money market account is classified as a component of restricted cash on the condensed consolidated balance sheet at June 30, 2011.

There have been no other material changes to our contractual obligations and commitments outside the ordinary course of business from those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2010 filed with the SEC on March 11, 2011.

### **Off-Balance Sheet Arrangements**

We did not have during the periods presented, and we do not currently have, any off-balance sheet arrangements, as defined under SEC rules.

---

**Table of Contents**

**Item 3. Quantitative and Qualitative Disclosures About Market Risk.**

We invest in short-term marketable securities for investment purposes. We are exposed to market risk related to changes in interest rates. As of June 30, 2011 and December 31, 2010, we had cash and cash equivalents and marketable securities of \$296.8 million and \$140.2 million, respectively, consisting of money market funds, U.S. treasuries, U.S. government agency securities, a foreign government agency security, corporate debt and commercial paper. Our primary exposure to market risk is interest rate sensitivity, which is affected by changes in the general level of U.S. interest rates, particularly because our investments are in short-term marketable securities. Our marketable securities are subject to interest rate risk and will fall in value if market interest rates increase. Due to the short-term duration of our investment portfolio and the low risk profile of our investments, an immediate 10% change in interest rates would not have a material effect on the fair market value of our portfolio. We have the ability to hold our marketable securities until maturity, and therefore we would not expect our operating results or cash flows to be affected to any significant degree by the effect of a change in market interest rates on our investments. We do not currently have any auction rate securities.

We contract with contract research organizations and investigational sites globally. We may be subject to fluctuations in foreign currency rates in connection with these agreements. We do not hedge our foreign currency exchange rate risk.

Our long-term debt bears interest at variable rates. In May 2010, we entered into a new loan agreement with affiliates of Hercules Technology Growth pursuant to which we received a loan in the aggregate principal amount of \$25.0 million. Per annum interest is payable at the greater of 11.9% and 11.9% plus the prime rate of interest minus 4.75%, not to exceed 15%. As a result of the 15% maximum per annum interest rate under the new loan agreement, we have limited exposure to changes in interest rates on borrowings under this loan. For every 1% increase in prime over 4.75% on the outstanding debt amount as of June 30, 2011, we would have a decrease in future annual cash flows of approximately \$219,000 over the next twelve month period.

**Item 4. Controls and Procedures.**

Our management, with the participation of our principal executive officer and our principal financial officer, evaluated, as of the end of the period covered by this Quarterly Report on Form 10-Q, the effectiveness of our disclosure controls and procedures. Based on that evaluation of our disclosure controls and procedures as of June 30, 2011, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures as of such date are effective at the reasonable assurance level in ensuring that information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, or the Exchange Act, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports we file or submit under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

There were no changes in our evaluation of internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) that occurred during the six months ended June 30, 2011 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

---

**Table of Contents**

**PART II. OTHER INFORMATION**

**Item 1A. Risk Factors**

Our business is subject to numerous risks. We caution you that the following important factors, among others, could cause our actual results to differ materially from those expressed in forward-looking statements made by us or on our behalf in filings with the SEC, press releases, communications with investors and oral statements. Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q and in any other public statements we make may turn out to be wrong. They can be affected by inaccurate assumptions we might make or by known or unknown risks and uncertainties. Many factors mentioned in the discussion below will be important in determining future results. Consequently, no forward-looking statement can be guaranteed. Actual future results may differ materially from those anticipated in forward-looking statements. We undertake no obligation to update any forward-looking statements, whether as a result of new information, future events or otherwise. You are advised, however, to consult any further disclosure we make in our reports filed with the SEC. These risk factors restate and supersede the risk factors set forth under the heading "Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2010.

**Risks Related to Development, Clinical Testing and Regulatory Approval of Our Drug Candidates**

*We are dependent on the success of our lead drug candidate, tivozanib, which is in phase 3 development.*

To date, we have invested a significant portion of our efforts and financial resources in the research and development of tivozanib. We are currently conducting our phase 3 registration clinical trial for tivozanib, referred to as TIVO-1, as well as a phase 2 clinical trial and phase 1 clinical trials, many of which focus on tivozanib in combination with other known anti-cancer agents.

Our near-term prospects, including our ability to finance our company and to generate revenues, will depend heavily on the successful development and commercialization of tivozanib. All of our other potential product candidates, with the exception of ficlatuzumab, are in the preclinical research stage. The clinical and commercial success of tivozanib will depend on a number of factors, including the following:

successful completion of our phase 3 clinical trial and timely enrollment in, and completion of, our other on-going or planned clinical trials;

our ability to demonstrate to the satisfaction of the U.S. Food and Drug Administration, or FDA, or equivalent foreign regulatory agencies, tivozanib's safety and efficacy through current and future clinical trials, including without limitation TIVO-1;

the prevalence and severity of adverse side effects;

timely receipt of necessary marketing approvals from the FDA and similar foreign regulatory authorities;

achieving and maintaining compliance with all regulatory requirements applicable to tivozanib;

the availability, relative cost, safety and efficacy of alternative and competing treatments;

the effectiveness of our marketing, sales and distribution strategies and operations, and those of Astellas, our strategic collaboration partner for development and commercialization of tivozanib;

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

the ability of our third-party manufacturers to manufacture clinical trial and commercial supplies of tivozanib and to develop, validate and maintain a commercially viable manufacturing process that is compliant with current good manufacturing practices, or cGMP;

our ability, and the ability of Astellas, to successfully obtain third party reimbursement and generate commercial demand that result in sales of tivozanib, assuming applicable regulatory approvals are obtained;

our ability to avoid third party patent interference or patent infringement claims;

acceptance of tivozanib as safe and effective by patients, the medical community and third-party payors; and

a continued acceptable safety profile of the product following approval.

Many of these factors are beyond our control. Accordingly, we cannot assure you that we, or our strategic partner, will ever be able to generate revenues through the sale of tivozanib. If we, or our strategic partner, are not successful in commercializing tivozanib, or are significantly delayed in doing so, our business will be materially harmed and the price of our common stock could substantially decline.

**Table of Contents**

***Positive results in our phase 2 clinical trial of tivozanib may not be predictive of the results in our phase 3 clinical trial. If the results of our phase 3 clinical trial are not positive, or are not sufficient for approval of tivozanib, our business will be adversely affected.***

Positive results in early clinical trials of a drug candidate may not be replicated in later clinical trials. A number of companies in the pharmaceutical and biotechnology industries have suffered significant setbacks in late-stage clinical trials even after achieving promising results in earlier-stage development. Although the results of our phase 2 clinical trial of tivozanib for the treatment of advanced RCC were positive, we cannot assure you that the phase 3 clinical trial for the treatment of advanced RCC will achieve positive results. A number of factors could contribute to a lack of positive results in our phase 3 clinical trial of tivozanib.

For example, in our phase 2 clinical trial, we compared tivozanib to treatment with placebo. In our phase 3 clinical trial, the primary endpoint is a comparison of progression-free survival of patients treated with tivozanib to the progression-free survival of patients treated with Nexavar. Nexavar is a VEGF receptor inhibitor which has been approved by the FDA and the European Medicines Agency, or the EMA, for the treatment of advanced RCC, as well as the treatment of hepatocellular carcinoma. Based on our discussions with the FDA and the EMA, we set the number of patients to be enrolled in the clinical trial at a number we expect will be sufficient to demonstrate that a difference in progression-free survival of three months or more between the treatment arms would be statistically significant. The FDA has advised us that the results of the phase 3 clinical trial will need to show not only that patients treated with tivozanib have a statistically significant improvement in progression-free survival as compared to patients treated with Nexavar, but also that the improvement in progression-free survival of patients treated with tivozanib is clinically meaningful in the context of the safety of the drug. It is not clear how much of an improvement in progression-free survival will be required in order for it to be deemed clinically meaningful in the context of the safety of the drug. The FDA and other regulatory authorities will have substantial discretion in evaluating the results of our phase 3 clinical trial, including with respect to what constitutes a clinically meaningful improvement in progression-free survival. Overall survival is a secondary endpoint in our phase 3 clinical trial. Based on our discussions with the FDA, we do not expect the FDA to require that we show a statistically significant improvement in overall survival in patients treated with tivozanib in order to obtain approval by the FDA; however, if the overall survival data are not positive, it may influence how the FDA and other regulatory authorities interpret other data from our phase 3 clinical trial. We did not gather data on overall survival in our phase 2 clinical trial of tivozanib.

We cannot be certain as to what type and how many clinical trials the FDA, or equivalent foreign regulatory agencies, will require us to conduct before we may successfully gain approval to market tivozanib. Prior to approving a new drug, the FDA generally requires that the efficacy of the drug be demonstrated in two adequate and well-controlled clinical trials. In some situations, the FDA approves drugs on the basis of a single well-controlled clinical trial. Based on our discussions with the FDA and the EMA, we believe we will be required to conduct only a single phase 3 clinical trial of tivozanib in advanced RCC. All of the VEGF inhibitor drugs approved by the FDA and the EMA to date in advanced RCC, including Votrient, which was approved by the FDA in October 2009, have been approved on the basis of a single phase 3 clinical trial. However, if the FDA or EMA determines that our phase 3 clinical trial results are not statistically significant and do not demonstrate a clinically meaningful benefit and an acceptable safety profile, or if the FDA or EMA requires us to conduct additional phase 3 clinical trials of tivozanib in order to gain approval, we will incur significant additional development costs, commercialization of tivozanib would be prevented or delayed and our business would be adversely affected.

***If we do not obtain regulatory approval for tivozanib, ficlatuzumab or any other product candidates, our business will be adversely affected.***

Tivozanib, ficlatuzumab and any other product candidate we seek to develop will be subject to extensive governmental regulations relating to, among other things, development, clinical trials, manufacturing and commercialization. In order to obtain regulatory approval for the commercial sale of any product candidate, we must demonstrate through extensive preclinical studies and clinical trials that the product candidate is safe and effective for use in each target indication, and that our production process yields a consistent and stable product. This process can take many years to complete, requiring the expenditure of substantial resources with highly uncertain results. We or our strategic partners may never obtain regulatory approval for tivozanib, ficlatuzumab or any other product candidate we may develop.

We have completed a phase 2 clinical trial of our lead product candidate, tivozanib, and are currently conducting a phase 3 clinical trial of tivozanib for the treatment of advanced RCC. We are also conducting phase 1b clinical trials of tivozanib in various combinations and dosing regimens in RCC and additional solid tumor indications, including breast cancer and colorectal cancer. In addition to tivozanib, we have a pipeline of monoclonal antibodies derived from our Human Response Platform, a novel method of building preclinical models of human cancer, which are intended to more accurately represent cancer biology in patients. Our first product candidate derived from our Human Response Platform, ficlatuzumab, has entered a phase 2 clinical trial for non-small cell lung cancer. The results to date from preclinical studies, our phase 1 and phase 2 clinical trials of tivozanib and our phase 1 clinical trials of ficlatuzumab may not be predictive of results in preclinical studies and clinical trials currently in process or that we may initiate in the future. A failure of one or more preclinical or clinical trials can occur at any stage of testing. Moreover, there can be no assurance that we will demonstrate the required safety and efficacy to obtain regulatory approvals for any of our product candidates.



---

**Table of Contents**

Even though tivozanib has been generally well-tolerated in the limited number of patients who have been treated with it, there is no guarantee that unacceptable side effects or other risks will not occur with the exposure of a larger number of patients. If tivozanib, ficlatuzumab or any other product candidate is not shown to be safe and effective in humans through clinical trials, we or our strategic partners will not be able to obtain regulatory approval for such product candidate, and the resulting delays in developing other product candidates and conducting related preclinical studies and clinical trials, as well as the potential need for additional financing, would have a material adverse effect on our business, financial condition and results of operations.

***If we are not successful in discovering, developing and commercializing additional product candidates, our ability to expand our business and achieve our strategic objectives would be impaired.***

Although a substantial amount of our efforts will focus on the continued clinical testing and potential approval of tivozanib as well as the continued development of ficlatuzumab, a key element of our strategy is to discover, develop and commercialize a portfolio of antibody-based products. We are seeking to do so through our internal research programs and intend to explore strategic partnerships for the development of new products. All of our other potential product candidates remain in the discovery and preclinical study stages. Research programs to identify product candidates require substantial technical, financial and human resources, whether or not any product candidates are ultimately identified. Our research programs may initially show promise in identifying potential product candidates, yet fail to yield product candidates for clinical development for many reasons, including the following:

the research methodology used may not be successful in identifying potential product candidates;

competitors may develop alternatives that render our product candidates obsolete;

a product candidate may on further study be shown to have harmful side effects or other characteristics that indicate it is unlikely to be effective or otherwise does not meet applicable regulatory criteria;

a product candidate may not be capable of being produced in commercial quantities at an acceptable cost, or at all; and

a product candidate may not be accepted as safe and effective by patients, the medical community or third-party payors.

***Any failure or delay in completing clinical trials for our product candidates may prevent us from obtaining regulatory approval or commercializing product candidates on a timely basis, or at all, which would require us to incur additional costs and delay receipt of any product revenue.***

We cannot predict whether we will encounter problems with any of our ongoing or planned clinical trials that will cause us or regulatory authorities to delay, suspend or terminate those clinical trials. The completion of clinical trials for product candidates may be delayed or halted for many reasons, including:

delays or failure in reaching agreement on acceptable clinical trial contracts or clinical trial protocols with prospective sites;

failure of our third-party contractors or our investigators to comply with regulatory requirements or otherwise meet their contractual obligations in a timely manner;

delays or failure in obtaining the necessary approvals from regulators or institutional review boards in order to commence a clinical trial at a prospective trial site, or their suspension or termination of a clinical trial once commenced;



## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

our inability to manufacture or obtain from third parties materials sufficient to complete our preclinical studies and clinical trials;

delays in patient enrollment, and variability in the number and types of patients available for clinical trials, or high drop-out rates of patients in our clinical trials;

difficulty in maintaining contact with patients after treatment, resulting in incomplete data;

poor effectiveness of our product candidates during clinical trials;

safety issues, including serious adverse events associated with our product candidates;

governmental or regulatory delays and changes in regulatory requirements, policy and guidelines; or

varying interpretations of data by the FDA and similar foreign regulatory agencies.

Clinical trials often require the enrollment of large numbers of patients, and suitable patients may be difficult to identify and recruit. Our ability to enroll sufficient numbers of patients in our clinical trials depends on many factors, including the size of the patient population, the nature of the protocol, the proximity of patients to clinical sites, the eligibility criteria for the trial, competing clinical trials and the availability of approved effective drugs. In addition, patients may withdraw from a clinical trial for a variety of

**Table of Contents**

reasons. If we fail to enroll and maintain the number of patients for which the clinical trial was designed, the statistical power of that clinical trial may be reduced which would make it harder to demonstrate that the product candidate being tested in such clinical trial is safe and effective. Additionally, we may not be able to enroll a sufficient number of qualified patients in a timely or cost-effective manner.

We, the FDA, other applicable regulatory authorities or institutional review boards may suspend or terminate clinical trials of a product candidate at any time if we or they believe the patients participating in such clinical trials are being exposed to unacceptable health risks or for other reasons.

Significant clinical trial delays could allow our competitors to obtain marketing approval before we do or shorten the patent protection period during which we may have the exclusive right to commercialize our product candidates. Our product development costs also will increase if we experience delays in completing clinical trials. In addition, it is impossible to predict whether legislative changes will be enacted, or whether FDA regulations, guidance or interpretations will be changed, or what the impact of such changes, if any, may be. If we experience any such problems, we may not have the financial resources to continue development of the product candidate that is affected or the development of any of our other product candidates.

---

## **Table of Contents**

*Even if we receive regulatory approval for any of our product candidates, we will be subject to ongoing FDA requirements and continued regulatory review, which may result in significant additional expense. Additionally, our product candidates, if approved, could be subject to labeling and other restrictions and market withdrawal and we may be subject to penalties if we fail to comply with regulatory requirements or experience unanticipated problems with our products.*

Any regulatory approvals that we or our strategic partners receive for our product candidates may also be subject to limitations on the approved indicated uses for which the product may be marketed or to the conditions of approval, or contain requirements for potentially costly post-marketing testing, including phase 4 clinical trials, and surveillance to monitor the safety and efficacy of the product candidate. In addition, if the FDA approves any of our product candidates, the manufacturing processes, labeling, packaging, distribution, adverse event reporting, storage, advertising, promotion and recordkeeping for the product will be subject to extensive and ongoing regulatory requirements. These requirements include submissions of safety and other post-marketing information and reports, registration, as well as continued compliance with cGMP and good clinical practices, or GCP, for any clinical trials that we conduct post-approval. Later discovery of previously unknown problems with a product, including adverse events of unanticipated severity or frequency, or with our third-party manufacturers or manufacturing processes, or failure to comply with regulatory requirements, may result in, among other things:

restrictions on the marketing or manufacturing of the product, withdrawal of the product from the market, or voluntary or mandatory product recalls;

fines, warning letters or holds on clinical trials;

refusal by the FDA to approve pending applications or supplements to approved applications filed by us or our strategic partners, or suspension or revocation of product license approvals;

product seizure or detention, or refusal to permit the import or export of products; and

injunctions or the imposition of civil or criminal penalties.

The FDA's policies may change and additional government regulations may be enacted that could prevent, limit or delay regulatory approval of our product candidates. We cannot predict the likelihood, nature or extent of government regulation that may arise from future legislation or administrative action, either in the United States or abroad. If we are slow or unable to adapt to changes in existing requirements or the adoption of new requirements or policies, or if we are not able to maintain regulatory compliance, we may lose any marketing approval that we may have obtained and we may not achieve or sustain profitability, which would adversely affect our business.

***Failure to obtain regulatory approval in jurisdictions outside the United States will prevent us from marketing our products abroad.***

We intend to market our products, if approved, in international markets, which will require separate regulatory approvals and compliance with numerous and varying regulatory requirements. The approval procedures vary among countries and may involve requirements for additional testing, and the time required to obtain approval may differ from that required to obtain FDA approval. In addition, in many countries outside the United States, a product candidate must be approved for reimbursement before it can be approved for sale in that country. In some cases, the price that we intend to charge for our product is also subject to approval. Approval by the FDA does not ensure approval by regulatory authorities in other countries or jurisdictions, and approval by one foreign regulatory authority does not ensure approval by regulatory authorities in other foreign countries or jurisdictions or by the FDA. The foreign regulatory approval process may include all of the risks associated with obtaining FDA approval. We may not obtain foreign regulatory approvals on a timely basis, if at all. We and our strategic partners may not be able to file for regulatory approvals and may not receive necessary approvals to commercialize our products in any market.

### **Risks Related to Our Financial Position and Capital Requirements**

***We anticipate that we will continue to incur significant operating costs for the foreseeable future. We may never achieve or sustain profitability, which would depress the market price of our common stock.***

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

Although we had net income for the three months ended March 31, 2011 and the six months ended June 30, 2011, we have a history of incurring net losses. We have incurred net losses in all prior periods. As of June 30, 2011, we had an accumulated deficit of \$156.9 million. We do not know whether or when we will achieve or sustain profitability. To date, we have not commercialized any products or generated any revenues from the sale of products. Our losses have resulted principally from costs incurred in our discovery and development activities. We anticipate that we will continue to incur significant operating costs over the next several years as we execute our plan to expand our discovery, research, development and commercialization activities, including planned development activities and commercialization of our lead product candidate, tivozanib, and the continued clinical development of our phase 2 product candidate, ficlatuzumab, to which we recently regained rights from Merck, and for which we are now responsible for the performance and funding of all future research, development, manufacturing and commercialization activities.

## **Table of Contents**

If we do not successfully develop and obtain regulatory approval for our existing and future pipeline product candidates and effectively manufacture, market and sell any product candidates that are approved, we may never generate product sales, and even if we do generate product sales, we may never achieve or sustain profitability on a quarterly or annual basis. Our failure to become and remain profitable would depress the market price of our common stock and could impair our ability to raise capital, expand our business, diversify our product offerings or continue our operations.

*We will require substantial additional financing to achieve our goals, and a failure to obtain this necessary capital when needed could force us to delay, limit, reduce or terminate our product development or commercialization efforts.*

Since our inception, most of our resources have been dedicated to the discovery, preclinical and clinical development of our product candidates. In particular, we are currently conducting a phase 3 and phase 2 clinical trial of tivozanib, with which we share expenses with Astellas, and a phase 2 clinical trial of ficlatuzumab, which will require substantial funds to complete. We believe that we will continue to expend substantial resources for the foreseeable future developing tivozanib, ficlatuzumab and other new and existing antibody product candidates. These expenditures will include costs associated with research and development, acquiring new technologies, conducting preclinical and clinical trials, obtaining regulatory approvals and manufacturing products, as well as marketing and selling any products approved for sale. In addition, other unanticipated costs may arise. Because the outcome of our planned and anticipated clinical trials is highly uncertain, we cannot reasonably estimate the actual amounts necessary to successfully complete the development and commercialization of our product candidates.

We believe that our existing cash and cash equivalents, marketable securities, committed research and development funding and milestone payments that we expect to receive under our existing strategic partnership and license agreements, and payments we believe that we will receive under new strategic partnerships we assume we will enter into under our current projected operating plan, will allow us to fund our operating plan beyond 2012. However, our operating plan may change as a result of many factors currently unknown to us, and we may need to seek additional funds sooner than planned, through public or private equity or debt financings or other sources, such as strategic partnerships. In addition, we may seek additional capital due to favorable market conditions or strategic considerations even if we believe we have sufficient funds for our current or future operating plans.

Our future capital requirements depend on many factors, including:

the number and characteristics of the product candidates we pursue;

the scope, progress, results and costs of researching and developing our product candidates, and conducting preclinical and clinical trials;

the timing of, and the costs involved in, obtaining regulatory approvals for our product candidates;

the cost of commercialization activities if any of our product candidates are approved for sale, including marketing, sales and distribution costs;

the cost of manufacturing our product candidates and any products we successfully commercialize;

our ability to establish and maintain strategic partnerships, licensing or other arrangements and the financial terms of such agreements;

the costs involved in preparing, filing, prosecuting, maintaining, defending and enforcing patent claims, including litigation costs and the outcome of such litigation; and

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

the timing, receipt and amount of sales of, or royalties on, our future products, if any.

Additional funds may not be available when we need them, on terms that are acceptable to us, or at all. If adequate funds are not available to us on a timely basis, we may be required to:

delay, limit, reduce or terminate preclinical studies, clinical trials or other development activities for one or more of our product candidates;

delay, limit, reduce or terminate our research and development activities; or

delay, limit, reduce or terminate our establishment of sales and marketing capabilities or other activities that may be necessary to commercialize our product candidates.

***Raising additional capital may cause dilution to our existing stockholders, restrict our operations or require us to relinquish rights to our technologies or product candidates.***

---

## **Table of Contents**

We may seek additional capital through a combination of private and public equity offerings, debt financings, strategic partnerships and alliances and licensing arrangements. To the extent that we raise additional capital through the sale of equity or convertible debt securities, stockholders will be diluted, and the terms may include liquidation or other preferences that adversely affect stockholders' rights. Debt financing, if available, may involve agreements that include covenants limiting or restricting our ability to take certain actions, such as incurring debt, making capital expenditures or declaring dividends. If we raise additional funds through strategic partnerships and alliances and licensing arrangements with third parties, we may have to relinquish valuable rights to our technologies or product candidates, or grant licenses on terms that are not favorable to us. If we are unable to raise additional funds through equity or debt financing when needed, we may be required to delay, limit, reduce or terminate our product development or commercialization efforts or grant rights to develop and market product candidates that we would otherwise prefer to develop and market ourselves.

### ***A substantial portion of our future revenues may be dependent upon our strategic partnership agreements.***

Our success will depend in significant part on our ability to attract and maintain strategic partners and strategic relationships to support the development and commercialization of our products. We currently expect that a substantial portion of our future revenues may be dependent upon our strategic partnerships with Astellas, OSI Pharmaceuticals, Inc., or OSI, Biogen Idec and Centocor Ortho Biotech Inc., or Centocor. Under each of these strategic partnerships, our strategic partners have significant development and commercialization responsibilities with respect to anticipated therapeutics to be developed and sold. If these strategic partners were to terminate their agreements with us, fail to meet their obligations or otherwise decrease their level of efforts, allocation of resources or other commitments under these agreements, our future revenues could be negatively impacted and the development and commercialization of our product candidates would be interrupted. In addition, if some or any of the development, regulatory and commercial milestones are not achieved or if certain net sales thresholds are not achieved, as set forth in the respective agreements, we will not fully realize the expected economic benefits of the agreements. Further, the achievement of certain of the milestones under these strategic partnership agreements will depend on factors that are outside of our control and most are not expected to be achieved for several years, if at all. Any failure to successfully maintain our strategic partnership agreements could materially and adversely affect our ability to generate revenues.

For a discussion of additional risks that we face with respect to our strategic partnership agreements, see [If any of our current strategic partners fails to perform its obligations or terminates its agreement with us, the development and commercialization of the product candidates under such agreement could be delayed or terminated and our business could be substantially harmed beginning on page 55.](#)

### ***Fluctuations in our quarterly operating losses could adversely affect the price of our common stock.***

Our quarterly operating losses may fluctuate significantly. Some of the factors that may cause our operating losses to fluctuate on a period-to-period basis include:

the status of our preclinical and clinical development programs;

the level of expenses incurred in connection with our preclinical and clinical development programs;

any intellectual property infringement lawsuit or other litigation in which we may become involved;

the implementation or termination of collaboration, licensing, manufacturing or other material agreements with third parties, and non-recurring revenue or expenses under any such agreement; and

compliance with regulatory requirements.

Period-to-period comparisons of our historical and future financial results may not be meaningful, and investors should not rely on them as an indication of future performance. Our fluctuating losses may fail to meet the expectations of securities analysts or investors. Our failure to meet these expectations may cause the price of our common stock to decline.

***Unstable market and economic conditions may have serious adverse consequences on our business, financial condition and stock price.***

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

As widely reported, global credit and financial markets have been experiencing extreme disruptions over the past several years, including severely diminished liquidity and credit availability, declines in consumer confidence, declines in economic growth, increases in unemployment rates, and uncertainty about economic stability. There can be no assurance that further deterioration in credit and financial markets and confidence in economic conditions will not occur. Our general business strategy may be adversely affected by the current adverse economic conditions and volatile business environment and continued unpredictable and unstable market conditions. If the current equity and credit markets deteriorate further, or do not improve, it may make any necessary debt or equity financing more difficult, more costly, and more dilutive. Failure to secure any necessary financing in a timely manner and on favorable terms could have a material adverse effect on our growth strategy, financial performance and stock price and could require



---

## **Table of Contents**

us to delay or abandon clinical development plans. In addition, there is a risk that one or more of our current service providers, manufacturers and other partners may not survive these difficult economic times, which could directly affect our ability to attain our operating goals on schedule and on budget.

At June 30, 2011, we had \$296.8 million of cash, cash equivalents and marketable securities consisting of money market funds, U.S. treasuries, U.S. government agency securities, a foreign government agency security, corporate debt and commercial paper. As of the date of this report, we are not aware of any downgrades, material losses, or other significant deterioration in the fair value of our cash equivalents or marketable securities. However, no assurance can be given that further deterioration in conditions of the global credit and financial markets would not negatively impact our current portfolio of cash equivalents or marketable securities or our ability to meet our financing objectives. Further dislocations in the credit market may adversely impact the value and/or liquidity of marketable securities owned by us.

There is a possibility that our stock price may decline, due in part to the volatility of the stock market and general economic downturn.

### **Risks Related to Our Business and Industry**

*We face substantial competition, which may result in others discovering, developing or commercializing products before, or more successfully, than we do.*

Our future success depends on our ability to demonstrate and maintain a competitive advantage with respect to the design, development and commercialization of product candidates. Our objective is to design, develop and commercialize new products with superior efficacy, convenience, tolerability and safety. We expect any product candidate that we commercialize with our strategic partners or on our own will compete with existing, market-leading products. For example, we anticipate that tivozanib, if approved for the treatment of advanced RCC, would compete with angiogenesis inhibitors and mTOR inhibitors that are currently approved for the treatment of advanced RCC, such as Avastin, marketed by Roche Laboratories, Inc., Nexavar, marketed by Onyx Pharmaceuticals, Inc. and Bayer HealthCare AG, Sutent, marketed by Pfizer Inc., Votrient, marketed by GlaxoSmithKline plc, Torisel, marketed by Pfizer, Inc. and Afinitor, marketed by Novartis Pharmaceuticals Corporation, and other therapies in development such as axitinib, which is under development by Pfizer.

Many of our potential competitors have substantially greater financial, technical and personnel resources than we have. In addition, many of these competitors have significantly greater commercial infrastructures than we have. We will not be able to compete successfully unless we successfully:

design and develop products that are superior to other products in the market;

attract qualified scientific, medical, sales and marketing and commercial personnel;

obtain patent and/or other proprietary protection for our processes and product candidates;

obtain favorable reimbursement, formulary and guideline status;

obtain required regulatory approvals; and

collaborate with others in the design, development and commercialization of new products.

Established competitors may invest heavily to quickly discover and develop novel compounds that could make our product candidates obsolete. In addition, any new product that competes with an approved product must demonstrate compelling advantages in efficacy, convenience, tolerability and safety in order to overcome price competition and to be commercially successful. If we are not able to compete effectively against our current and future competitors, our business will not grow and our financial condition and operations will suffer.

*We may not achieve research, development and commercialization goals in the time frames that we publicly estimate, which could have an adverse impact on our business and could cause our stock price to decline.*

We set goals for, and make public statements regarding, the timing of certain accomplishments, such as the commencement and completion of preclinical studies, initiation and completion of clinical trials, and other developments and milestones under our research and development programs. The actual timing of these events can vary significantly due to a number of factors including without limitation delays or failures in our and our current and potential future collaborators' preclinical studies or clinical trials, the amount of time, effort and resources committed to our programs by us and our current and potential future collaborators and the uncertainties inherent in the regulatory approval process. As a result, there can be no assurance that our or our preclinical studies and clinical trials will advance or be completed in the time frames we expect, that we or our current and potential future collaborators will make regulatory submissions or receive regulatory approvals as planned or that we or our current and potential future collaborators will be able to adhere to our current schedule for the achievement of key milestones under any of our programs. If we or any collaborators fail to achieve one or more of these milestones as planned, our business could be materially adversely affected and the price of our common stock could decline.

## **Table of Contents**

***Because we have a short operating history, there is a limited amount of information about us upon which you can evaluate our business and prospects.***

Our operations began in October 2001 and we have only a limited operating history upon which you can evaluate our business and prospects. In addition, as an early stage company, we have limited experience and have not yet demonstrated an ability to successfully overcome many of the risks and uncertainties frequently encountered by companies in new and rapidly evolving fields, particularly in the biopharmaceutical area. For example, to execute our business plan, we will need to successfully:

execute product development activities;

obtain required regulatory approvals for the development and commercialization of our product candidates;

build and maintain a strong intellectual property portfolio;

build and maintain robust sales, distribution and marketing capabilities;

obtain reimbursement and gain market acceptance for our products;

develop and maintain successful strategic relationships and partnerships; and

manage our spending as costs and expenses increase due to clinical trials, regulatory approvals and commercialization.

If we are unsuccessful in accomplishing these objectives, we may not be able to develop product candidates, raise capital, expand our business or continue our operations.

***If we fail to attract and keep senior management and key scientific personnel, we may be unable to successfully develop our product candidates, conduct our clinical trials and commercialize our product candidates.***

Our success depends in part on our continued ability to attract, retain and motivate highly qualified management, clinical and scientific personnel. We are highly dependent upon our senior management, particularly Tuan Ha-Ngoc, our President and Chief Executive Officer, Elan Ezickson, our Executive Vice President and Chief Business Officer, David Johnston, our Chief Financial Officer, William Slichenmyer, our Chief Medical Officer, Michael Bailey, our Chief Commercial Officer, and Jenő Gyuris, our Senior Vice President, Head of Research, as well as other senior scientists on our management team. Although none of these individuals has informed us to date that he intends to retire or resign in the near future, the loss of services of any of these individuals or one or more of our other members of senior management could delay or prevent the successful development of our product pipeline, completion of our planned clinical trials or the commercialization of our product candidates. We do not carry key person insurance covering any members of our senior management. Although we have entered into an employment agreement and a severance and change in control agreement with Tuan Ha-Ngoc, and severance and change in control agreements with each of Elan Ezickson, David Johnston, William Slichenmyer, Michael Bailey and Jenő Gyuris, these agreements do not provide for a fixed term of service.

Although we have not historically experienced unique difficulties attracting and retaining qualified employees, we could experience such problems in the future. For example, competition for qualified personnel in the biotechnology and pharmaceuticals field is intense. We will need to hire additional personnel as we expand our clinical development and commercial activities. We may not be able to attract and retain quality personnel on acceptable terms.

***Our employees may engage in misconduct or other improper activities, including noncompliance with regulatory standards and requirements and insider trading.***

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

We are exposed to the risk of employee fraud or other misconduct. Misconduct by employees could include intentional failures to comply with FDA regulations, to provide accurate information to the FDA, to comply with manufacturing standards we have established, to comply with federal and state health-care fraud and abuse laws and regulations, to report financial information or data accurately or to disclose unauthorized activities to us. In particular, sales, marketing and business arrangements in the healthcare industry are subject to extensive laws and regulations intended to prevent fraud, kickbacks, self-dealing and other abusive practices. These laws and regulations may restrict or prohibit a wide range of pricing, discounting, marketing and promotion, sales commission, customer incentive programs and other business arrangements. Employee misconduct could also involve the improper use of information obtained in the course of clinical trials, which could result in regulatory sanctions and serious harm to our reputation. We have adopted a Code of Business Conduct and Ethics, but it is not always possible to identify and deter employee misconduct, and the precautions we take to detect and prevent this activity may not be effective in controlling unknown or unmanaged risks or losses or in protecting us from governmental investigations or other actions or lawsuits stemming from a failure to be in compliance with such laws or regulations. If any such actions are instituted against us, and we are not successful in defending ourselves or asserting our rights, those actions could have a significant impact on our business, including the imposition of significant fines or other sanctions.

## **Table of Contents**

In addition, during the course of our operations, our directors, executives and employees may have access to material, nonpublic information regarding our business, our results of operations or potential transactions we are considering. Despite the adoption of an Insider Trading Policy, we may not be able to prevent a director, executive or employee from trading in our common stock on the basis of, or while having access to, material, nonpublic information. If a director, executive or employee was to be investigated, or an action was to be brought against a director, executive or employee for insider trading, it could have a negative impact on our reputation and our stock price. Such a claim, with or without merit, could also result in substantial expenditures of time and money, and divert attention of our management team from other tasks important to the success of our business.

### ***We may encounter difficulties in managing our growth and expanding our operations successfully.***

As we seek to advance our product candidates through clinical trials, we will need to expand our development, regulatory, manufacturing, marketing and sales capabilities or contract with third parties to provide these capabilities for us. As our operations expand, we expect that we will need to manage additional relationships with various strategic partners, suppliers and other third parties. Future growth will impose significant added responsibilities on members of management. Our future financial performance and our ability to commercialize our product candidates and to compete effectively will depend, in part, on our ability to manage any future growth effectively. To that end, we must be able to manage our development efforts and clinical trials effectively and hire, train and integrate additional management, administrative and sales and marketing personnel. We may not be able to accomplish these tasks, and our failure to accomplish any of them could prevent us from successfully growing our company.

### ***If product liability lawsuits are brought against us, we may incur substantial liabilities and may be required to limit commercialization of our product candidates.***

We face an inherent risk of product liability as a result of the clinical testing of our product candidates and will face an even greater risk if we commercialize any products. For example, we may be sued if any product we develop allegedly causes injury or is found to be otherwise unsuitable during product testing, manufacturing, marketing or sale. Any such product liability claims may include allegations of defects in manufacturing, defects in design, a failure to warn of dangers inherent in the product, negligence, strict liability, and a breach of warranties. Claims could also be asserted under state consumer protection acts. If we cannot successfully defend ourselves against product liability claims, we may incur substantial liabilities or be required to limit commercialization of our product candidates. Even successful defense would require significant financial and management resources. Regardless of the merits or eventual outcome, liability claims may result in:

decreased demand for our product candidates or products that we may develop;

injury to our reputation;

withdrawal of clinical trial participants;

costs to defend the related litigation;

diversion of management's time and our resources;

substantial monetary awards to trial participants or patients;

product recalls, withdrawals or labeling, marketing or promotional restrictions;

loss of revenue;

the inability to commercialize our product candidates; and

a decline in our stock price.

Our inability to obtain and retain sufficient product liability insurance at an acceptable cost to protect against potential product liability claims could prevent or inhibit the commercialization of products we develop. We currently carry product liability insurance covering our clinical studies in the amount of \$10 million in the aggregate. Although we maintain such insurance, any claim that may be brought against us could result in a court judgment or settlement in an amount that is not covered, in whole or in part, by our insurance or that is in excess of the limits of our insurance coverage. Our insurance policies also have various exclusions, and we may be subject to a product liability claim for which we have no coverage. We will have to pay any amounts awarded by a court or negotiated in a settlement that exceed our coverage limitations or that are not covered by our insurance, and we may not have, or be able to obtain, sufficient capital to pay such amounts.

***We may incur significant costs complying with environmental laws and regulations, and failure to comply with these laws and regulations could expose us to significant liabilities.***

We use hazardous chemicals and radioactive and biological materials in certain aspects of our business and are subject to a variety of federal, state and local laws and regulations governing the use, generation, manufacture, distribution, storage, handling, treatment and disposal of these materials. Although we believe our safety procedures for handling and disposing of these materials and waste products comply with these laws and regulations, we cannot eliminate the risk of accidental injury or contamination from the

## **Table of Contents**

use, manufacture, distribution, storage, handling, treatment or disposal of hazardous materials. In the event of contamination or injury, or failure to comply with environmental, occupational health and safety and export control laws and regulations, we could be held liable for any resulting damages and any such liability could exceed our assets and resources. We do not maintain insurance for any environmental liability or toxic tort claims that may be asserted against us.

### **Risks Related to Commercialization of Our Product Candidates**

*We have limited sales, marketing, reimbursement or distribution experience and we will have to invest significant resources to develop those capabilities.*

We have limited sales, marketing, reimbursement or distribution experience. To develop internal sales, reimbursement, distribution and marketing capabilities, we will have to invest significant amounts of financial and management resources, some of which will be committed prior to any confirmation that tivozanib will be approved. For product candidates such as tivozanib, where we will have lead commercialization responsibility in North America under our strategic alliance with Astellas, we could face a number of additional risks in developing our commercial infrastructure, including:

we may not be able to attract and build an effective marketing or sales force;

the cost of establishing a marketing or sales force may not be justifiable in light of the revenues generated by any particular product; and

our direct sales and marketing efforts may not be successful.

Furthermore, we have granted Astellas the rights to commercialize tivozanib in Europe and other areas of the world outside of Asia and, where appropriate, we may elect in the future to utilize strategic partners or contract sales forces to assist in the commercialization of ficlatuzumab, AV-203 and future products, if approved. We may have limited or no control over the sales, marketing and distribution activities of these third parties. Our future revenues may depend heavily on the success of the efforts of these third parties.

*Our commercial success depends upon attaining significant market acceptance of our product candidates, if approved, including tivozanib and ficlatuzumab, among physicians, patients, health care payors and, in the cancer market, acceptance by the major operators of cancer clinics.*

Even if tivozanib, ficlatuzumab or any other product candidate that we may develop or acquire in the future obtains regulatory approval, the product may not gain market acceptance among physicians, health care payors, patients and the medical community. Market acceptance of any products for which we receive approval depends on a number of factors, including:

the efficacy and safety of the product candidate, as demonstrated in clinical trials;

the clinical indications for which the drug is approved;

acceptance by physicians, major operators of cancer clinics, health care payors, physician networks and patients of the drug as a safe and effective treatment;

with respect to tivozanib, the results obtained in our phase 3 clinical trial for the treatment of advanced clear cell RCC and the extent to which the results demonstrate that treatment with tivozanib represents a clinically meaningful improvement in care as compared to other available VEGF inhibitors;

the potential and perceived advantages over alternative treatments, including, with respect to tivozanib, advantages over Avastin, Nexavar, Sutent, Votrient or other emerging therapies;

the cost of treatment in relation to alternative treatments;

the availability of adequate reimbursement and pricing by third parties and government authorities;

the continued projected growth of oncology drug markets;

relative convenience and ease of administration;

the prevalence and severity of adverse side effects; and

the effectiveness of our sales and marketing efforts.

If our approved drugs fail to achieve market acceptance, we would not be able to generate significant revenue.

*Reimbursement may be limited or unavailable in certain market segments for our product candidates, which could make it difficult for us to sell our products profitably.*



---

**Table of Contents**

Market acceptance and sales of our product candidates will depend significantly on the availability of adequate coverage and reimbursement from third-party payors for any of our product candidates and may be affected by existing and future health care reform measures. Government authorities and third-party payors, such as private health insurers and health maintenance organizations, decide which drugs they will pay for and establish reimbursement levels. Reimbursement by a third-party payor may depend upon a number of factors, including the third-party payor's determination that use of a product is:

a covered benefit under its health plan;

safe, effective and medically necessary;

appropriate for the specific patient;

cost-effective; and

neither experimental nor investigational.

Obtaining coverage and reimbursement approval for a product from a government or other third party payor is a time consuming and costly process that could require us to provide supporting scientific, clinical and cost-effectiveness data for the use of our products to the payor. We may not be able to provide data sufficient to gain acceptance with respect to coverage and reimbursement. We cannot be sure that coverage or adequate reimbursement will be available for any of our product candidates. Also, we cannot be sure that reimbursement amounts will not reduce the demand for, or the price of, our products. If reimbursement is not available or is available only to limited levels, we may not be able to commercialize certain of our products.

In both the United States and certain foreign jurisdictions, there have been a number of legislative and regulatory changes to the health care system that could impact our ability to sell our products profitably. In particular, the Medicare Modernization Act of 2003 revised the payment methodology for many products under Medicare. This has resulted in lower rates of reimbursement. There have been numerous other federal and state initiatives designed to reduce payment for pharmaceuticals.

As a result of legislative proposals and the trend towards managed health care in the United States, third-party payors are increasingly attempting to contain health care costs by limiting both coverage and the level of reimbursement of new drugs. They may also refuse to provide any coverage of approved products for medical indications other than those for which the FDA has granted market approvals. As a result, significant uncertainty exists as to whether and how much third-party payors will reimburse patients for their use of newly approved drugs, which in turn will put pressure on the pricing of drugs. We expect to experience pricing pressures in connection with the sale of any products we may develop or commercialize due to the trend toward managed health care, the increasing influence of health maintenance organizations, additional legislative proposals, as well as country, regional, or local healthcare budget limitations. Any products that we may develop or commercialize may not be considered cost-effective, and coverage and reimbursement may not be available or sufficient to allow us to sell our products on a profitable basis.

***Foreign governments may impose price controls, which may adversely affect our future profitability.***

We and our strategic partners intend to seek approval to market our future products in both the United States and in foreign jurisdictions. If approval is obtained in one or more foreign jurisdictions, we and our strategic partners will be subject to rules and regulations in those jurisdictions relating to our product. In some foreign countries, particularly in countries in the European Union, the pricing of prescription pharmaceuticals and biologics is subject to governmental control. In these countries, pricing negotiations with governmental authorities can take considerable time after the receipt of marketing approval for a product candidate. If reimbursement of our future products is unavailable or limited in scope or amount, or if pricing is set at unsatisfactory levels, we may be unable to achieve or sustain profitability.

***Healthcare reform measures could hinder or prevent our product candidates' commercial success.***

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

The U.S. government and other governments have shown significant interest in pursuing healthcare reform. Any government-adopted reform measures could adversely impact the pricing of healthcare products and services in the U.S. or internationally and the amount of reimbursement available from governmental agencies or other third party payors. The continuing efforts of the U.S. and foreign governments, insurance companies, managed care organizations and other payors of health care services to contain or reduce health care costs may adversely affect our ability to set prices which we believe are fair for any products we may develop and commercialize, and our ability to generate revenues and achieve and maintain profitability.

New laws, regulations and judicial decisions, or new interpretations of existing laws, regulations and decisions, that relate to healthcare availability, methods of delivery or payment for products and services, or sales, marketing or pricing, may limit our potential revenue, and we may need to revise our research and development programs. The pricing and reimbursement environment may change in the future and become more challenging due to several reasons, including policies advanced by the U.S. government, new healthcare legislation or fiscal challenges faced by government health administration authorities. Specifically, in both the U.S. and some foreign jurisdictions, there have been a number of legislative and regulatory proposals and initiatives to change the health

---

## **Table of Contents**

care system in ways that could affect our ability to sell any products we may develop and commercialize profitably. Some of these proposed and implemented reforms could result in reduced reimbursement rates for our potential products, which would adversely affect our business strategy, operations and financial results. For example, in March 2010, President Obama signed into law a legislative overhaul of the U.S. healthcare system, known as the Patient Protection and Affordable Care Act of 2010, as amended by the Healthcare and Education Affordability Reconciliation Act of 2010, or the PPACA, which may have far reaching consequences for life science companies like us. As a result of this new legislation, substantial changes could be made to the current system for paying for healthcare in the United States, including changes made in order to extend medical benefits to those who currently lack insurance coverage. Extending coverage to a large population could substantially change the structure of the health insurance system and the methodology for reimbursing medical services, drugs and devices. These structural changes could entail modifications to the existing system of private payors and government programs, such as Medicare and Medicaid, creation of a government-sponsored healthcare insurance source, or some combination of both, as well as other changes. Restructuring the coverage of medical care in the United States could impact the reimbursement for prescribed drugs, biopharmaceuticals, medical devices, or our product candidates. If reimbursement for our approved product candidates, if any, is substantially less than we expect in the future, or rebate obligations associated with them are substantially increased, our business could be materially and adversely impacted.

Further federal and state proposals and healthcare reforms could limit the prices that can be charged for the product candidates that we develop and may further limit our commercial opportunity. Our results of operations could be materially adversely affected by the PPACA, by Medicare prescription drug coverage legislation, by the possible effect of such current or future legislation on amounts that private insurers will pay and by other health care reforms that may be enacted or adopted in the future.

### **Risks Related to Our Dependence on Third Parties**

*If any of our current strategic partners fails to perform its obligations or terminates its agreement with us, the development and commercialization of the product candidates under such agreement could be delayed or terminated and our business could be substantially harmed.*

We currently have strategic partnerships in place relating to certain of our product candidates and technologies as follows:

We have entered into a strategic partnership with Astellas in connection with which we and Astellas have agreed to develop and commercialize tivozanib in North America and Europe and have exclusively licensed to Astellas rights to develop and commercialize tivozanib in the rest of the world other than Asia.

We have entered into an exclusive license agreement with Centocor for the worldwide development and commercialization of our internally-discovered antibodies targeting the RON receptor (Recepteur d Origine Nantais).

We have entered into a strategic partnership with OSI, under which we licensed rights to OSI to research, develop, manufacture and commercialize products related to targets involved in the processes of epithelial-mesenchymal transition or mesenchymal-epithelial transition in cancer.

We have entered into an exclusive option and license agreement with Biogen Idec regarding the development and commercialization of our ErbB3-targeted antibodies for the potential treatment and diagnosis of cancer and other diseases outside of the United States, Canada and Mexico.

## Table of Contents

These strategic partnerships may not be scientifically or commercially successful due to a number of important factors, including the following:

Each of our strategic partners has significant discretion in determining the efforts and resources that it will apply to their strategic partnership with us. The timing and amount of any cash payments, related royalties and milestones that we may receive under such strategic partnerships will depend on, among other things, the efforts, allocation of resources and successful development and commercialization of our product candidates by our strategic partners under their respective agreements. For instance, under our collaboration with Astellas, we must agree on all development and commercialization plans and strategies for North America and Europe before initiating such activities. If we cannot agree with Astellas with respect to specific development or commercialization initiatives, the program may be delayed or unsuccessful.

Our strategic partners may change the focus of their development and commercialization efforts or pursue higher-priority programs.

Our strategic partners may, under specified circumstances, terminate their strategic partnership with us on short notice and for circumstances outside of our control, which could make it difficult for us to attract new strategic partners or adversely affect how we are perceived in the scientific and financial communities. For example, Astellas can terminate its agreement with us after February 2013 with six months notice and can terminate the entire agreement with us in connection with a material breach of the agreement by us that remains uncured for a specified cure period. OSI can terminate its agreement with us, with respect to any or all collaboration targets and all associated products, upon written notice to us and can terminate the entire agreement with us in connection with a material breach of the agreement by us that remains uncured for a specified cure period. Biogen Idec may not elect to exercise its option to develop and commercialize products relating to our ErbB3 program and, after exercise of its option, may terminate its agreement with us for convenience with respect to any product(s) by providing us with three months prior written notice, or due to a material breach of the agreement by us that is not cured within a short time period or if all of our assets are acquired by, or we merge with, another entity, and the other entity is independently developing or commercializing a product containing an ErbB3 antibody and fails to divest the ErbB3 product within a specified time period. Centocor has the right to terminate its license agreement with us upon 90 days written notice to us prior to the filing of an investigational new drug application or, thereafter, upon 180 days written notice to us.

Our strategic partnership agreements with OSI, Biogen Idec and Centocor permit our strategic partners wide discretion in deciding which product candidates to advance through the clinical trial process. For example, under our strategic partnership with OSI, it is possible for the strategic partner to reject product candidates at any point in the research, development and clinical trial process, without triggering a termination of the strategic partnership agreement. In the event of any such decision, our business and prospects may be adversely affected due to our inability to progress such candidates ourselves.

OSI or Biogen Idec may develop and commercialize, either alone or with others, products that are similar to or competitive with the product candidates that are the subject of their strategic partnerships with us.

Our strategic partners may enter into one or more transactions with third parties, including a merger, consolidation, reorganization, sale of a substantial amount of its assets, sale of a substantial amount of its stock or change in control, which could divert the attention of a strategic partner's management and adversely affect a strategic partner's ability to retain and motivate key personnel who are important to the continued development of the programs under the applicable strategic partnership with us. In addition, the third-party in such a transaction with our strategic partner could determine to reprioritize the strategic partner's development programs such that the strategic partner ceases to diligently pursue the development of our programs and/or cause the respective strategic partnership with us to terminate.

Certain of our strategic partners may have the first right to maintain or defend our intellectual property rights and, although we may have the right to assume the maintenance and defense of our intellectual property rights if our strategic partners do not, our ability to do so may be compromised by our strategic partners' acts or omissions.

Our strategic partners may utilize our intellectual property rights in such a way as to invite litigation that could jeopardize or invalidate our intellectual property rights or expose us to potential liability.

Our strategic partners may not comply with all applicable regulatory requirements, or fail to report safety data in accordance with all applicable regulatory requirements.

If Astellas, OSI or Centocor breaches or terminates its arrangement with us, or if Biogen Idec does not elect to exercise its option to participate in development of our ErbB3 antibody candidate, the development and commercialization of the affected product candidate could be delayed, curtailed or terminated because we may not have sufficient financial resources or capabilities to continue development and commercialization of the product candidate on our own.

---

## **Table of Contents**

Our strategic partners may not have sufficient resources necessary to carry the product candidate through clinical development or may not obtain the necessary regulatory approvals.

If one or more of our strategic partners fails to develop or effectively commercialize product candidates for any of the foregoing reasons, we may not be able to replace the strategic partner with another partner to develop and commercialize a product candidate under the terms of the strategic partnership. We may also be unable to obtain, on terms acceptable to us, a license from such strategic partner to any of its intellectual property that may be necessary or useful for us to continue to develop and commercialize a product candidate. Any of these events could have a material adverse effect on our business, results of operations and our ability to achieve future profitability, and could cause our stock price to decline.

***We may not be successful in establishing and maintaining additional strategic partnerships, which could adversely affect our ability to develop and commercialize products.***

In addition to our current strategic partnerships, a part of our strategy is to enter into additional strategic partnerships in the future, including alliances with major biotechnology or pharmaceutical companies. We face significant competition in seeking appropriate strategic partners and the negotiation process is time-consuming and complex. Moreover, we may not be successful in our efforts to establish a strategic partnership or other alternative arrangements for any future product candidates and programs because our research and development pipeline may be insufficient, our product candidates and programs may be deemed to be at too early of a stage of development for collaborative effort and/or third parties may not view our product candidates and programs as having the requisite potential to demonstrate safety and efficacy. Even if we are successful in our efforts to establish new strategic partnerships, the terms that we agree upon may not be favorable to us and we may not be able to maintain such strategic partnerships if, for example, development or approval of a product candidate is delayed or sales of an approved product are disappointing. Any delay in entering into new strategic partnership agreements related to our product candidates could delay the development and commercialization of our product candidates and reduce their competitiveness even if they reach the market.

Moreover, if we fail to establish and maintain additional strategic partnerships related to our product candidates:

the development of certain of our current or future product candidates may be terminated or delayed;

our cash expenditures related to development of certain of our current or future product candidates would increase significantly and we may need to seek additional financing;

we may be required to hire additional employees or otherwise develop expertise, such as sales and marketing expertise, for which we have not budgeted; and

we will bear all of the risk related to the development of any such product candidates.

In addition, if we fail to establish and maintain additional strategic partnerships involving our Human Response Platform, we would not realize its potential as a means of identifying and validating targets for new cancer therapies in collaboration with strategic partners or of identifying biomarkers to aid in the development of our strategic partners' drug candidates.

***We rely on third-party manufacturers to produce our preclinical and clinical drug supplies and we intend to rely on third parties to produce commercial supplies of any approved product candidates. Any failure by a third-party manufacturer to produce supplies for us may delay or impair our ability to complete our clinical trials or commercialize our product candidates.***

We have relied upon a small number of third-party manufacturers for the manufacture of our product candidates for preclinical and clinical testing purposes and intend to continue to do so in the future. For instance, we rely on one supplier for the drug substance for tivozanib. Currently, a separate contract manufacturer manufactures, packages and distributes the drug product for clinical supplies of tivozanib. While we believe that our existing supplier of drug substance and our existing supplier of drug product, or an alternative supplier, would be capable of producing drug substance and drug product, as the case may be, in commercial quantities, we will need to fully validate their ability to produce drug substance and drug product on a commercial scale and establish contractual relationships with them to secure supply on a commercial basis. If we are unable to validate our third-party manufacturing sources' ability to supply on a commercial basis and fail to establish commercially reasonable terms for commercial supply, we may not be able to successfully produce and market tivozanib or would be delayed in

doing so.

In connection with the transition of responsibility for the ficlatuzumab program from Merck, we have purchased a supply of ficlatuzumab from Merck which we expect will support clinical trials through at least phase 2. As of December 27, 2010, the effective date of the termination of our collaboration with Merck, we became responsible for manufacturing future batches of ficlatuzumab for additional clinical trials or for commercial use. If the amounts of ficlatuzumab purchased from Merck are insufficient to complete the ongoing phase 1 and phase 2 clinical trials, or if we are unsuccessful in implementing the manufacturing technology transferred to us from Merck, or if we are unsuccessful in engaging a third party to manufacture ficlatuzumab on terms acceptable to us, future clinical trials and any commercial production of ficlatuzumab could be adversely affected.

---

**Table of Contents**

As with tivozanib and ficlatuzumab, we also expect to rely upon third parties to produce materials required for the clinical and commercial production of any other product candidates. If we are unable to arrange for third-party manufacturing sources, or to do so on commercially reasonable terms, we may not be able to complete development of such other product candidates or market them.

Reliance on third-party manufacturers entails risks to which we would not be subject if we manufactured product candidates ourselves, including reliance on the third party for regulatory compliance and quality assurance, the possibility of breach of the manufacturing agreement by the third party because of factors beyond our control (including a failure to synthesize and manufacture our product candidates in accordance with our product specifications), failure of the third party to accept orders for supply of drug substance and the possibility of termination or nonrenewal of the agreement by the third party, based on its own business priorities, at a time that is costly or damaging to us. In addition, the FDA and other regulatory authorities require that our product candidates be manufactured according to cGMP and similar foreign standards. Any failure by our third-party manufacturers to comply with cGMP or failure to scale up manufacturing processes, including any failure to deliver sufficient quantities of product candidates in a timely manner, could lead to a delay in, or failure to obtain, regulatory approval of any of our product candidates. In addition, such failure could be the basis for action by the FDA to withdraw approvals for product candidates previously granted to us and for other regulatory action, including recall or seizure, fines, imposition of operating restrictions, total or partial suspension of production or injunctions.

We rely on our manufacturers to purchase from third-party suppliers the materials necessary to produce our product candidates for our clinical studies. There are a small number of suppliers for certain capital equipment and raw materials that we use to manufacture our drugs. Such suppliers may not sell these raw materials to our manufacturers at the times we need them or on commercially reasonable terms. We do not have any control over the process or timing of the acquisition of these raw materials by our manufacturers. Moreover, we currently do not have any agreements for the commercial production of these raw materials. Although we generally do not begin a clinical trial unless we believe we have a sufficient supply of a product candidate to complete the clinical trial, any significant delay in the supply of a product candidate or the raw material components thereof for an ongoing clinical trial due to the need to replace a third-party manufacturer could considerably delay completion of our clinical studies, product testing and potential regulatory approval of our product candidates. If our manufacturers or we are unable to purchase these raw materials after regulatory approval has been obtained for our product candidates, the commercial launch of our product candidates would be delayed or there would be a shortage in supply, which would impair our ability to generate revenues from the sale of our product candidates.

Because of the complex nature of many of our early stage compounds and product candidates, our manufacturers may not be able to manufacture such compounds and product candidates at a cost or in quantities or in a timely manner necessary to develop and commercialize related products. If we successfully commercialize any of our drugs, we may be required to establish or access large-scale commercial manufacturing capabilities. In addition, as our drug development pipeline increases and matures, we will have a greater need for clinical trial and commercial manufacturing capacity. We do not own or operate manufacturing facilities for the production of clinical or commercial quantities of our product candidates and we currently have no plans to build our own clinical or commercial scale manufacturing capabilities. To meet our projected needs for commercial manufacturing, third parties with whom we currently work will need to increase their scale of production or we will need to secure alternate suppliers.

***We rely on third parties to conduct preclinical and clinical trials for our product candidates, and if they do not properly and successfully perform their obligations to us, we may not be able to obtain regulatory approvals for our product candidates.***

We design the clinical trials for our product candidates, but we rely on contract research organizations and other third parties to assist us in managing, monitoring and otherwise carrying out many of these trials. We compete with larger companies for the resources of these third parties.

Although we rely on these third parties to conduct many of our clinical trials, we are responsible for ensuring that each of our clinical trials is conducted in accordance with its general investigational plan and protocol. Moreover, the FDA and foreign regulatory agencies require us to comply with regulations and standards, commonly referred to as good clinical practices, for designing, conducting, monitoring, recording, analyzing, and reporting the results of clinical trials to assure that the data and results are credible and accurate and that the rights, integrity and confidentiality of trial participants are protected. Our reliance on third parties that we do not control does not relieve us of these responsibilities and requirements.

The third parties on whom we rely generally may terminate their engagements with us at any time. If we are required to enter into alternative arrangements because of any such termination the introduction of our product candidates to market could be delayed.

If these third parties do not successfully carry out their duties under their agreements with us, if the quality or accuracy of the data they obtain is compromised due to their failure to adhere to our clinical trial protocols or regulatory requirements, or if they otherwise fail to comply with clinical trial protocols or meet expected deadlines, our clinical trials may not meet regulatory requirements. If our clinical trials do not meet



## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

regulatory requirements or if these third parties need to be replaced, our preclinical development activities or clinical trials may be extended, delayed, suspended or terminated. If any of these events occur, we may not be able to obtain regulatory approval of our product candidates and our reputation could be harmed.

---

**Table of Contents****Risks Related to Our Intellectual Property Rights*****We could be unsuccessful in obtaining adequate patent protection for one or more of our product candidates.***

We cannot be certain that patents will be issued or granted with respect to applications that are currently pending, or that issued or granted patents will not later be found to be invalid and/or unenforceable. The patent position of biotechnology and pharmaceutical companies is generally uncertain because it involves complex legal and factual considerations. The standards applied by the United States Patent and Trademark Office and foreign patent offices in granting patents are not always applied uniformly or predictably. For example, there is no uniform worldwide policy regarding patentable subject matter or the scope of claims allowable in biotechnology and pharmaceutical patents. Consequently, patents may not issue from our pending patent applications. As such, we do not know the degree of future protection that we will have on our proprietary products and technology. The scope of patent protection that the U.S. Patent and Trademark Office will grant with respect to the antibodies in our antibody product pipeline is uncertain. It is possible that the U.S. Patent and Trademark Office will not allow broad antibody claims that cover closely related antibodies as well as the specific antibody. Upon receipt of FDA approval, competitors would be free to market antibodies almost identical to ours, thereby decreasing our market share.

***Issued patents covering one or more of our products could be found invalid or unenforceable if challenged in court.***

If we or one of our corporate partners were to initiate legal proceedings against a third party to enforce a patent covering one of our products, the defendant could counterclaim that our patent is invalid and/or unenforceable. In patent litigation in the United States, defendant counterclaims alleging invalidity and/or unenforceability are commonplace. Grounds for a validity challenge could be an alleged failure to meet any of several statutory requirements, for example, lack of novelty, obviousness or non-enablement. Grounds for an unenforceability assertion could be an allegation that someone connected with prosecution of the patent withheld relevant information from the U.S. Patent and Trademark Office, or made a misleading statement, during prosecution. Although we have conducted due diligence on patents we have exclusively in-licensed, and we believe that we have conducted our patent prosecution in accordance with the duty of candor and in good faith, the outcome following legal assertions of invalidity and unenforceability during patent litigation is unpredictable. With respect to the validity question, for example, we cannot be certain that there is no invalidating prior art, of which we and the patent examiner were unaware during prosecution. If a defendant were to prevail on a legal assertion of invalidity and/or unenforceability, we would lose at least part, and perhaps all, of the patent protection on one of our products or certain aspects of our Human Response Platform. Such a loss of patent protection could have a material adverse impact on our business.

***Claims that our platform technologies, our products or the sale or use of our products infringe the patent rights of third parties could result in costly litigation or could require substantial time and money to resolve, even if litigation is avoided.***

We cannot guarantee that our platform technologies, our products, or the use of our products, do not infringe third party patents. Third parties might allege that we are infringing their patent rights or that we have misappropriated their trade secrets. Such third parties might resort to litigation against us. The basis of such litigation could be existing patents or patents that issue in the future.

It is also possible that we failed to identify relevant third party patents or applications. For example, applications filed before November 29, 2000 and certain applications filed after that date that will not be filed outside the United States remain confidential until patents issue. Patent applications in the United States and elsewhere are published approximately 18 months after the earliest filing, which is referred to as the priority date. Therefore, patent applications covering our products or platform technology could have been filed by others without our knowledge. Additionally, pending patent applications which have been published can, subject to certain limitations, be later amended in a manner that could cover our platform technologies, our products or the use of our products.

With regard to tivozanib, we are aware of a third party United States patent, and corresponding foreign counterparts, that contain broad claims related to use of an organic compound, that, among other things, inhibits the tyrosine phosphorylation of a VEGF receptor caused by VEGF binding to such VEGF receptor. Additionally, tivozanib falls within the scope of certain pending patent applications that have broad generic disclosure and disclosure of certain compounds possessing structural similarities to tivozanib. Although we believe it is unlikely that such applications will lead to issued claims that would cover tivozanib and still be valid in view of the prior art, patent prosecution is inherently unpredictable. We are also aware of third party United States patents that contain broad claims related to the use of a tyrosine kinase inhibitor in combination with a DNA damaging agent such as chemotherapy or radiation and we have received written notice from the owners of such patents indicating that they believe we may need a license from them in order to avoid infringing their patents. With regard to ficlatuzumab, we are aware of two separate families of United States patents, United States patent applications and foreign counterparts, with each of the two families being owned by a different third party, that contain broad claims related to anti-HGF antibodies having certain binding properties and their use. We are also aware of a



---

**Table of Contents**

United States patent that contains claims related to a method of treating a tumor by administering an agent that blocks the ability of HGF to promote angiogenesis in the tumor. With regard to AV-203, we are aware of a third party United States patent that contains broad claims relating to anti-ErbB3 antibodies. Based on our analyses, if any of the above third party patents were asserted against us, we do not believe our proposed products or activities would be found to infringe any valid claim of these patents. If we were to challenge the validity of any issued United States patent in court, we would need to overcome a statutory presumption of validity that attaches to every United States patent. This means that in order to prevail, we would have to present clear and convincing evidence as to the invalidity of the patent's claims. There is no assurance that a court would find in our favor on questions of infringement or validity.

In order to avoid or settle potential claims with respect to any of the patent rights described above or any other patent rights of third parties, we may choose or be required to seek a license from a third party and be required to pay license fees or royalties or both. These licenses may not be available on acceptable terms, or at all. Even if we or our strategic partners were able to obtain a license, the rights may be nonexclusive, which could result in our competitors gaining access to the same intellectual property. Ultimately, we could be prevented from commercializing a product, or be forced to cease some aspect of our business operations, if, as a result of actual or threatened patent infringement claims, we are unable to enter into licenses on acceptable terms. This could harm our business significantly.

Defending against claims of patent infringement or misappropriation of trade secrets could be costly and time consuming, regardless of the outcome. Thus, even if we were to ultimately prevail, or to settle at an early stage, such litigation could burden us with substantial unanticipated costs. In addition, litigation or threatened litigation could result in significant demands on the time and attention of our management team, distracting them from the pursuit of other company business.

***Unfavorable outcomes in intellectual property litigation could limit our research and development activities and/or our ability to commercialize certain products.***

If third parties successfully assert intellectual property rights against us, we might be barred from using aspects of our technology platform, or barred from developing and commercializing related products. Prohibitions against using specified technologies, or prohibitions against commercializing specified products, could be imposed by a court or by a settlement agreement between us and a plaintiff. In addition, if we are unsuccessful in defending against allegations of patent infringement or misappropriation of trade secrets, we may be forced to pay substantial damage awards to the plaintiff. There is inevitable uncertainty in any litigation, including intellectual property litigation. There can be no assurance that we would prevail in any intellectual property litigation, even if the case against us is weak or flawed. If litigation leads to an outcome unfavorable to us, we may be required to obtain a license from the patent owner in order to continue our research and development programs or to market our product(s). It is possible that the necessary license will not be available to us on commercially acceptable terms, or at all. This could limit our research and development activities, our ability to commercialize specified products, or both.

Most of our competitors are larger than we are and have substantially greater resources. They are, therefore, likely to be able to sustain the costs of complex patent litigation longer than we could. In addition, the uncertainties associated with litigation could have a material adverse effect on our ability to raise the funds necessary to continue our clinical trials, continue our internal research programs, in-license needed technology, or enter into strategic partnerships that would help us bring our product candidates to market.

In addition, any future patent litigation, interference or other administrative proceedings will result in additional expense and distraction of our personnel. An adverse outcome in such litigation or proceedings may expose us or our strategic partners to loss of our proprietary position, expose us to significant liabilities, or require us to seek licenses that may not be available on commercially acceptable terms, if at all.

***Intellectual property litigation may lead to unfavorable publicity that harms our reputation and causes the market price of our common stock to decline.***

During the course of any patent litigation, there could be public announcements of the results of hearings, rulings on motions, and other interim proceedings in the litigation. If securities analysts or investors regard these announcements as negative, the perceived value of our products, programs, or intellectual property could be diminished. Accordingly, the market price of our common stock may decline.

***Tivozanib and certain aspects of our platform technology are protected by patents exclusively licensed from other companies. If the licensors terminate the licenses or fail to maintain or enforce the underlying patents, our competitive position and our market share in the markets for any of our approved products will be harmed.***

We are a party to several license agreements under which certain aspects of our business depend on patents and/or patent applications owned by other companies or institutions. In particular, we hold exclusive licenses from Kyowa Hakko Kirin for



---

**Table of Contents**

tivozanib and the Dana-Farber Cancer Institute for our MaSS screen, which is a method of using our models to screen for, and identify, novel targets for new cancer drugs. We are likely to enter into additional license agreements as part of the development of our business in the future. Our licensors may not successfully prosecute certain patent applications under which we are licensed and on which our business depends. Even if patents issue from these applications, our licensors may fail to maintain these patents, may decide not to pursue litigation against third party infringers, may fail to prove infringement, or may fail to defend against counterclaims of patent invalidity or unenforceability. In addition, in spite of our best efforts, our licensors might conclude that we have materially breached our license agreements and might therefore terminate the license agreements, thereby removing our ability to obtain regulatory approval and to market products covered by these license agreements. If these in-licenses are terminated, or if the underlying patents fail to provide the intended market exclusivity, competitors would have the freedom to seek regulatory approval of, and to market, products identical to ours. This could have a material adverse effect on our competitive business position and our business prospects.

***We could be unsuccessful in obtaining patent protection on one or more components of our technology platform.***

We believe that an important factor in our competitive position relative to other companies in the field of targeted oncology therapeutics is our proprietary Human Response Platform. This platform is useful for identifying new targets for drug discovery, confirming that newly-identified drug targets actually play a role in cancer, testing new compounds for effectiveness as drugs, and identifying traits useful for predicting which patients will respond to which drugs. We own issued U.S. patents covering our chimeric model technology and directed complementation technology. We have exclusively in-licensed certain patent rights covering a method of using our inducible cancer models to identify new targets for cancer drugs. However, patent protection on other aspects of our technology platform, such as our reconstituted human breast tumor model, is still pending. There is no guarantee that any of such pending patent applications, in the United States or elsewhere, will result in issued patents, and, even if patents eventually issue, there is no certainty that the claims in the eventual patents will have adequate scope to preserve our competitive position. Third parties might invent alternative technologies that would substitute for our technology platform while being outside the scope of the patents covering our platform technology. By successfully designing around our patented technology, third parties could substantially weaken our competitive position in oncology research and development.

***Confidentiality agreements with employees and third parties may not prevent unauthorized disclosure of trade secrets and other proprietary information.***

In addition to patents, we rely on trade secrets, technical know-how, and proprietary information concerning our business strategy in order to protect our competitive position in the field of oncology. In the course of our research, development and business activities, we often rely on confidentiality agreements to protect our proprietary information. Such confidentiality agreements are used, for example, when we talk to vendors of laboratory or clinical development services or potential strategic partners. In addition, each of our employees is required to sign a confidentiality agreement upon joining our company. We take steps to protect our proprietary information, and we seek to carefully draft our confidentiality agreements to protect our proprietary interests. Nevertheless, there can be no guarantee that an employee or an outside party will not make an unauthorized disclosure of our proprietary confidential information. This might happen intentionally or inadvertently. It is possible that a competitor will make use of such information, and that our competitive position will be compromised, in spite of any legal action we might take against persons making such unauthorized disclosures.

Trade secrets are difficult to protect. Although we use reasonable efforts to protect our trade secrets, our employees, consultants, contractors, or outside scientific collaborators might intentionally or inadvertently disclose our trade secret information to competitors. Enforcing a claim that a third party illegally obtained and is using any of our trade secrets is expensive and time consuming, and the outcome is unpredictable. In addition, courts outside the United States sometimes are less willing than U.S. courts to protect trade secrets. Moreover, our competitors may independently develop equivalent knowledge, methods and know-how.

Our research and development strategic partners may have rights to publish data and other information to which we have rights. In addition, we sometimes engage individuals or entities to conduct research relevant to our business. The ability of these individuals or entities to publish or otherwise publicly disclose data and other information generated during the course of their research is subject to certain contractual limitations. These contractual provisions may be insufficient or inadequate to protect our confidential information. If we do not apply for patent protection prior to such publication, or if we cannot otherwise maintain the confidentiality of our proprietary technology and other confidential information, then our ability to obtain patent protection or to protect our trade secret information may be jeopardized.

## **Table of Contents**

*Intellectual property rights do not necessarily address all potential threats to our competitive advantage.*

The degree of future protection afforded by our intellectual property rights is uncertain because intellectual property rights have limitations, and may not adequately protect our business, or permit us to maintain our competitive advantage. The following examples are illustrative:

Others may be able to make compounds that are similar to our product candidates but that are not covered by the claims of the patents that we own or have exclusively licensed.

We or our licensors or strategic partners might not have been the first to make the inventions covered by the issued patent or pending patent application that we own or have exclusively licensed.

We or our licensors or strategic partners might not have been the first to file patent applications covering certain of our inventions.

Others may independently develop similar or alternative technologies or duplicate any of our technologies without infringing our intellectual property rights.

It is possible that our pending patent applications will not lead to issued patents.

Issued patents that we own or have exclusively licensed may not provide us with any competitive advantages, or may be held invalid or unenforceable, as a result of legal challenges by our competitors.

Our competitors might conduct research and development activities in countries where we do not have patent rights and then use the information learned from such activities to develop competitive products for sale in our major commercial markets.

We may not develop additional proprietary technologies that are patentable.

The patents of others may have an adverse effect on our business.

*Changes in U.S. patent law could diminish the value of patents in general, thereby impairing our ability to protect our products.*

As is the case with other biopharmaceutical companies, our success is heavily dependent on intellectual property, particularly patents. Obtaining and enforcing patents in the biopharma industry involve both technological complexity and legal complexity. Therefore, obtaining and enforcing biopharma patents is costly, time-consuming and inherently uncertain. In addition, Congress may pass patent reform legislation. The Supreme Court has ruled on several patent cases in recent years, either narrowing the scope of patent protection available in specified circumstances or weakening the rights of patent owners in specified situations. In addition to increasing uncertainty with regard to our ability to obtain patents in the future, this combination of events has created uncertainty with respect to the value of patents, once obtained. Depending on decisions by the U.S. Congress, the federal courts, and the U.S. Patent and Trademark Office, the laws and regulations governing patents could change in unpredictable ways that would weaken our ability to obtain new patents or to enforce our existing patents and patents that we might obtain in the future.

## **Risks Related to Ownership of Our Common Stock**

*The market price of our common stock has been, and may continue to be, highly volatile, and could fall below the price you paid.*

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

The trading price of our common stock has been, and is likely to continue to be, highly volatile and could be subject to wide fluctuations in price in response to various factors, many of which are beyond our control, including:

new products, product candidates or new uses for existing products introduced or announced by our strategic partners, or our competitors, including Roche's Avastin, Pfizer's Sutent, Onyx's Nexavar, GSK's Votrient and the timing of these introductions or announcements;

actual or anticipated results from and any delays in our clinical trials, including our phase 3 clinical trial of tivozanib, as well as results of regulatory reviews relating to the approval of our product candidates;

the results of our efforts to discover, develop, acquire or in-license additional product candidates or products;

disputes or other developments relating to proprietary rights, including patents, litigation matters and our ability to obtain patent protection for our technologies;

announcements by us or our competitors of significant acquisitions, strategic partnerships, joint ventures and capital commitments;

additions or departures of key scientific or management personnel;

conditions or trends in the biotechnology and biopharmaceutical industries;

actual or anticipated changes in earnings estimates, development timelines or recommendations by securities analysts;



---

**Table of Contents**

general economic and market conditions and other factors that may be unrelated to our operating performance or the operating performance of our competitors, including changes in market valuations of similar companies; and

sales of common stock by us or our stockholders in the future, as well as the overall trading volume of our common stock.

In addition, the stock market in general and the market for biotechnology and biopharmaceutical companies in particular have experienced extreme price and volume fluctuations that have often been unrelated or disproportionate to the operating performance of those companies. These broad market and industry factors may seriously harm the market price of our common stock, regardless of our operating performance. In the past, following periods of volatility in the market, securities class-action litigation has often been instituted against companies. Such litigation, if instituted against us, could result in substantial costs and diversion of management's attention and resources, which could materially and adversely affect our business and financial condition.

***Our executive officers, directors, entities affiliated with such executive officers and directors, and certain other significant stockholders own a significant percentage of our stock and may be able to exercise significant influence over matters subject to stockholder approval.***

To our knowledge, as of June 30, 2011, our executive officers, directors, entities affiliated with such executive officers and directors, and certain other significant stockholders, owned approximately 37% of our common stock, including shares subject to outstanding options and warrants that are exercisable within 60 days after June 30, 2011. These stockholders, acting together or individually, may be able to exert influence over our management and affairs and over matters requiring stockholder approval, including the election of our board of directors and approval of significant corporate transactions. This concentration of ownership could have the effect of delaying or preventing a change in control of our company or otherwise discouraging a potential acquirer from attempting to obtain control of us, which in turn could have a material and adverse effect on the fair market value of our common stock.

***Future sales of shares of our common stock, including shares issued upon the exercise of currently outstanding options and warrants, could negatively affect our stock price.***

A substantial portion of our outstanding common stock can be traded without restriction at any time. Some of these shares are currently restricted as a result of securities laws, but will be able to be sold, subject to any applicable volume limitations under federal securities laws with respect to affiliate sales, in the near future. As such, sales of a substantial number of shares of our common stock in the public market could occur at any time. These sales, or the perception in the market that the holders of a large number of shares intend to sell such shares, could reduce the market price of our common stock. In addition, we have a significant number of shares that are subject to outstanding options and warrants. The exercise of these options and warrants and the subsequent sale of the underlying common stock could cause a further decline in our stock price. These sales also might make it difficult for us to sell equity securities in the future at a time and at a price that we deem appropriate.

***Provisions in our certificate of incorporation, our by-laws or Delaware law might discourage, delay or prevent a change in control of our company or changes in our management and, therefore, depress the trading price of our common stock.***

Provisions of our certificate of incorporation, our by-laws or Delaware law may have the effect of deterring unsolicited takeovers or delaying or preventing a change in control of our company or changes in our management, including transactions in which our stockholders might otherwise receive a premium for their shares over then current market prices. In addition, these provisions may limit the ability of stockholders to approve transactions that they may deem to be in their best interest. These provisions include:

advance notice requirements for stockholder proposals and nominations;

the inability of stockholders to act by written consent or to call special meetings;

the ability of our board of directors to make, alter or repeal our by-laws; and

## Edgar Filing: AVEO PHARMACEUTICALS INC - Form 10-Q

the ability of our board of directors to designate the terms of and issue new series of preferred stock without stockholder approval, which could be used to institute a rights plan, or a poison pill, that would work to dilute the stock ownership of a potential hostile acquirer, likely preventing acquisitions that have not been approved by our board of directors.

In addition, Section 203 of the Delaware General Corporation Law prohibits a publicly-held Delaware corporation from engaging in a business combination with an interested stockholder, generally a person which together with its affiliates owns, or within the last three years has owned, 15% of our voting stock, for a period of three years after the date of the transaction in which the person became an interested stockholder, unless the business combination is approved in a prescribed manner.

---

## **Table of Contents**

The existence of the foregoing provisions and anti-takeover measures could limit the price that investors might be willing to pay in the future for shares of our common stock. They could also deter potential acquirers of our company, thereby reducing the likelihood that a stockholder could receive a premium for shares of our common stock held by a stockholder in an acquisition.

*Our business could be negatively affected as a result of the actions of activist shareholders.*

Proxy contests have been waged against many companies in the biopharmaceutical industry over the last few years. If faced with a proxy contest, we may not be able to successfully respond to the contest, which would be disruptive to our business. Even if we are successful, our business could be adversely affected by a proxy contest because:

responding to proxy contests and other actions by activist shareholders may be costly and time-consuming, and may disrupt our operations and divert the attention of management and our employees;

perceived uncertainties as to the potential outcome of any proxy contest may result in our inability to consummate potential acquisitions, collaborations or in-licensing opportunities and may make it more difficult to attract and retain qualified personnel and business partners; and

if individuals that have a specific agenda different from that of our management or other members of our board of directors are elected to our board as a result of any proxy contest, such an election may adversely affect our ability to effectively and timely implement our strategic plan and create additional value for our stockholders.

*We have limited experience complying with public company obligations.*

We face increased legal, accounting, administrative and other costs and expenses as a public company. Compliance with the Sarbanes-Oxley Act of 2002, the federal securities laws, as well as other rules of the SEC and NASDAQ, will result in significant initial cost to us as well as ongoing increases in our legal, audit and financial compliance costs.

*Failure to achieve and maintain effective internal controls in accordance with Section 404 of the Sarbanes-Oxley Act could have a material adverse effect on our ability to produce accurate financial statements and on our stock price.*

Section 404 of the Sarbanes-Oxley Act of 2002 requires us, on an annual basis, to review and evaluate our internal controls, and requires our independent registered public accounting firm to attest to the effectiveness of our internal controls. Both we and our independent registered public accounting firm will begin attesting to the effectiveness of our internal controls over financial reporting in connection with the filing of our Annual Report on Form 10-K for the year ending December 31, 2011 with the SEC. To achieve compliance with Section 404 within the prescribed period, we are engaged in a process to document and evaluate our internal control over financial reporting, which is both costly and challenging. In this regard, we will need to dedicate internal resources, engage outside consultants and adopt a detailed work plan to (a) assess and document the adequacy of internal control over financial reporting, (b) take steps to improve control processes where appropriate, (c) validate through testing that controls are functioning as documented, and (d) implement a continuous reporting and improvement process for internal control over financial reporting. Despite our efforts, we can provide no assurance as to our, or our independent registered public accounting firm's, conclusions with respect to the effectiveness of our internal control over financial reporting under Section 404. There is a risk that neither we nor our independent registered public accounting firm will be able to conclude within the prescribed timeframe that our internal control over financial reporting is effective as required by Section 404. This could result in an adverse reaction in the financial markets due to a loss of confidence in the reliability of our financial statements.

*We do not expect to pay any cash dividends for the foreseeable future.*

You should not rely on an investment in our common stock to provide dividend income. We do not anticipate that we will pay any cash dividends to holders of our common stock in the foreseeable future. Instead, we plan to retain any earnings to maintain and expand our existing operations. In addition, our ability to pay cash dividends is currently prohibited by the terms of our debt financing arrangements, and any future debt financing arrangement may contain terms prohibiting or limiting the amount of dividends that may be declared or paid on our common stock. Accordingly, investors must rely on sales of their common stock after price appreciation, which may never occur, as the only way to realize any return on their investment. As a result, investors seeking cash dividends should not purchase our common stock.

*Our management has broad discretion over the use of the cash available for our operations and working capital requirements and might not spend available cash in ways that increase the value of your investment.*

Our management has broad discretion on where and how to use our cash and you will be relying on the judgment of our management regarding the application of our available cash to fund our operations. Our management might not apply our cash in ways that increase the value of your investment. We expect to use a substantial portion of our cash to fund the phase 3 clinical trial of tivozanib, our lead product candidate, with the balance, if any, to be used for working capital and other general corporate purposes,

**Table of Contents**

which may in the future include investments in, or acquisitions of, complementary businesses, joint ventures, partnerships, services or technologies. Our management might not be able to yield a significant return, if any, on any investment of this cash. You will not have the opportunity to influence our decisions on how to use our cash reserves.

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

*Use of Proceeds from Registered Securities*

Our initial public offering of common stock was effected through Registration Statements on Form S-1 (File Nos. 333-163778 and 333-165412), that were declared effective by the SEC on March 11, 2010. As of June 30, 2011, we estimate that we have used approximately \$81.6 million of the net proceeds from the initial public offering to fund the clinical development of tivozanib and for working capital, capital expenditures and other general corporate purposes. We have invested the unused proceeds from the offering in short-term interest-bearing, investment grade securities. There has been no material change in our planned use of proceeds from the initial public offering from that described in the final prospectus filed with the SEC on March 12, 2010.

**Item 5. Other Information.**

At our Annual Meeting of Stockholders held on June 1, 2011, our stockholders recommended, in a non-binding, advisory vote, that future advisory votes on the compensation of our named executive officers be held every year. After taking into consideration the foregoing recommendation from our shareholders, our board of directors has determined that we intend to hold future advisory votes on the compensation of our named executive officers every year.

**Item 6. Exhibits.**

The exhibits listed in the Exhibit Index are incorporated herein by reference.

**Table of Contents**

**SIGNATURES**

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

**AVEO PHARMACEUTICALS, INC.**

Date: August 9, 2011

By: */s/* DAVID B. JOHNSTON  
**David B. Johnston**

**Chief Financial Officer and principal financial and accounting  
officer**

**Table of Contents****EXHIBIT INDEX**

<b>Exhibit</b>	<b>Description</b>
10.1+	Research and License Agreement, dated May 31, 2011, by and between the Company and Centocor Ortho Biotech Inc.
10.2	Common Stock Purchase Agreement, dated May 31, 2011, by and between the Company and Johnson & Johnson Development Corporation.
10.3	Registration Rights Agreement, dated May 31, 2011, by and between the Company and Johnson & Johnson Development Corporation.
31.1	Certification of principal executive officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended.
31.2	Certification of principal financial officer pursuant to Rule 13a-14(a)/15d-14(a) of the Securities Exchange Act of 1934, as amended.
32.1	Certification of principal executive officer pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
32.2	Certification of principal financial officer pursuant to 18 U.S.C. §1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.
101.INS	XBRL Instance Document*
101.SCH	XBRL Taxonomy Extension Schema Document*
101.CAL	XBRL Taxonomy Calculation Linkbase Document*
101.DEF	XBRL Taxonomy Extension Definition Linkbase Document*
101.LAB	XBRL Taxonomy Label Linkbase Document*
101.PRE	XBRL Taxonomy Presentation Linkbase Document*

+ Confidential treatment has been requested as to certain portions, which portions have been omitted and separately filed with the Securities and Exchange Commission

\* submitted electronically herewith

In accordance with Rule 406T of Regulation S-T, the XBRL related information in Exhibit 101 to this Quarterly Report on Form 10-Q is deemed not filed or part of a registration statement or prospectus for purposes of sections 11 or 12 of the Securities Act, is deemed not filed for purposes of section 18 of the Exchange Act, and otherwise is not subject to liability under these sections.