ARENA PHARMACEUTICALS INC
Form 10-Q
August 08, 2017

UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended June 30, 2017

or

TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the transition period from to

Commission File Number: 000-31161

ARENA PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

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

858.453.7200

(Registrant's telephone number, including area code)

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

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

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

Large accelerated filer		Accelerated filer
Non-accelerated filer	(Do not check if a small reporting company)	Small reporting company
Emerging growth company		

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

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

The number of shares of common stock outstanding as of the close of business on August 4, 2017:

Class	Number of Shares Outstanding
Common Stock, $0.0001 par value	39,220,245

ARENA PHARMACEUTICALS, INC.

INDEX

TRADEMARKS AND CERTAIN TERMS

Arena Pharmaceuticals ® and Arena ® are registered service marks of Arena. Any other brand names or trademarks appearing in this Quarterly Report on Form 10-Q are the property of their respective holders.

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

PART I. FINANCIAL INFORMATION

Item 1. Financial Statements.

ARENA PHARMACEUTICALS, INC.

Condensed Consolidated Balance Sheets

(In thousands)

(Unaudited)

	June 30, 2017	December 31, 2016
Assets		
Current assets:		
Cash and cash equivalents	$ 130,763	$ 90,712
Accounts receivable	2,404	20,162
Inventory	7,058	6,708
Prepaid expenses and other current assets	3,373	2,307
Total current assets	143,598	119,889
Land, property and equipment, net	40,997	43,828
Intangibles, net	1,880	2,357
Other non-current assets	2,890	2,936
Total assets	$ 189,365	$ 169,010
Liabilities and Equity		
Current liabilities:		
Accounts payable and other accrued liabilities	$ 5,816	$ 12,116
Accrued clinical and preclinical study fees	4,097	3,883
Payable to Eisai	—	9,074
Current portion of deferred revenues	30,975	35,288
Current portion of lease financing obligations	3,810	3,518
Total current liabilities	44,698	63,879
Other long-term liabilities	904	821
Deferred revenues, less current portion	1,467	2,167
Lease financing obligations, less current portion	59,773	61,748
Commitments and contingencies		
Equity:		
Common stock	3	2
Additional paid-in capital	1,527,306	1,441,737
Accumulated other comprehensive loss	(385)	(3,099)
Accumulated deficit	(1,444,149)	(1,398,736)
Total equity attributable to stockholders of Arena	82,775	39,904
Equity attributable to noncontrolling interest in consolidated variable interest entity	(252)	491
Total equity	82,523	40,395
Total liabilities and equity	$ 189,365	$ 169,010

See accompanying notes to unaudited condensed consolidated financial statements.

ARENA PHARMACEUTICALS, INC.

Condensed Consolidated Statements of Operations and Comprehensive Loss

(In thousands, except per share data)

(Unaudited)

	Three months ended June 30, 2017	Three months ended June 30, 2016	Six months ended June 30, 2017	Six months ended June 30, 2016
Revenues:				
Net product sales	$2,059	$4,263	$4,770	$7,781
Other Eisai collaboration revenue	1,781	1,975	3,316	5,201
Other collaboration revenue	1,898	2,249	3,558	4,329
Toll manufacturing	754	1,025	1,472	2,048
Total revenues	6,492	9,512	13,116	19,359
Operating Costs and Expenses:				
Cost of product sales	1,497	851	4,029	3,279
Cost of toll manufacturing	1,074	1,758	1,993	2,946
Research and development	17,922	18,546	33,433	37,048
General and administrative	7,236	8,465	15,400	15,389
Restructuring charges	—	6,115	—	6,115
Total operating costs and expenses	27,729	35,735	54,855	64,777
Loss from operations	(21,237)	(26,223)	(41,739)	(45,418)
Interest and Other Income (Expense):				
Interest income	16	105	50	193
Interest expense	(1,538)	(1,619)	(3,108)	(3,298)
Other	(857)	554	(1,316)	(208)
Total interest and other expense, net	(2,379)	(960)	(4,374)	(3,313)
Net loss	(23,616)	(27,183)	(46,113)	(48,731)
Less net loss attributable to noncontrolling interest in consolidated variable interest entity	299	—	743	—
Net loss attributable to stockholders of Arena	$(23,317)	$(27,183)	$(45,370)	$(48,731)
Net loss attributable to stockholders of Arena per share:				
Basic	$(0.77)	$(1.12)	$(1.66)	$(2.01)
Diluted	$(0.77)	$(1.12)	$(1.66)	$(2.01)
Shares used in calculating net loss attributable to stockholders of Arena per share:				
Basic	30,229	24,308	27,371	24,298
Diluted	30,229	24,308	27,371	24,298
Comprehensive Loss:				
Net loss	$(23,616)	$(27,183)	$(46,113)	$(48,731)

Foreign currency translation gain (loss)	1,910	(1,239)	2,714	1,352
Comprehensive loss	(21,706)	(28,422)	(43,399)	(47,379)
Less comprehensive loss attributable to noncontrolling interest in consolidated variable interest entity	299	—	743	—
Comprehensive loss attributable to stockholders of Arena	$(21,407)	$(28,422)	$(42,656)	$(47,379)

See accompanying notes to unaudited condensed consolidated financial statements.

ARENA PHARMACEUTICALS, INC.

Condensed Consolidated Statements of Cash Flows

(In thousands)

(Unaudited)

	Six Months Ended June 30,	
	June 30, 2017	2016
Operating Activities:		
Net loss	$(46,113)	$(48,731)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	3,033	4,709
Amortization of intangibles	607	104
Share-based compensation	3,968	7,080
Amortization of prepaid financing costs	68	68
Gain on disposal of property and equipment	(393)	(161)
Changes in operating assets and liabilities:		
Accounts receivable	18,954	1,665
Inventory	76	545
Prepaid expenses and other assets	(990)	(720)
Payables and accrued liabilities	(15,709)	5,516
Deferred revenues	(5,658)	(4,206)
Other long-term liabilities	(28)	365
Net cash used in operating activities	(42,185)	(33,766)
Investing Activities:		
Purchases of property and equipment	(90)	(377)
Proceeds from sale of property and equipment	—	161
Other non-current assets	90	—
Net cash used in investing activities	—	(216)
Financing Activities:		
Principal payments on lease financing obligations	(1,684)	(1,421)
Proceeds from issuance of common stock, net	81,496	230
Net cash provided by (used in) financing activities	79,812	(1,191)
Effect of exchange rate changes on cash	2,424	975
Net increase (decrease) in cash and cash equivalents	40,051	(34,198)
Cash and cash equivalents at beginning of period	90,712	156,184
Cash and cash equivalents at end of period	$130,763	$121,986

See accompanying notes to unaudited condensed consolidated financial statements.

3

ARENA PHARMACEUTICALS, INC.

Notes to Unaudited Condensed Consolidated Financial Statements

1. Basis of Presentation

The accompanying unaudited condensed consolidated financial statements of Arena Pharmaceuticals, Inc. should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2016, as filed with the Securities and Exchange Commission, or SEC, from which we derived our condensed consolidated balance sheet as of December 31, 2016. The accompanying condensed consolidated financial statements have been prepared in accordance with US generally accepted accounting principles, or GAAP, for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, since they are interim statements, the accompanying condensed consolidated financial statements do not include all of the information and notes required by GAAP for complete financial statements. The accompanying condensed consolidated financial statements reflect all adjustments, consisting of normal recurring adjustments, that are, in the opinion of our management, necessary to a fair statement of the results for the interim periods presented. Interim results are not necessarily indicative of results for a full year.

The accompanying consolidated financial statements include the balances and activity of our wholly owned subsidiaries and Beacon Discovery, Inc., or Beacon, a variable interest entity in which we have the controlling financial interest (see Note 12). The equity attributable to the noncontrolling interest in Beacon is presented as a separate component from the equity attributable to stockholders of Arena in the equity section of the condensed consolidated balance sheets. The results of operations and comprehensive loss attributable to the noncontrolling interest in Beacon are presented as separate components from the results of operations and comprehensive loss attributable to the stockholders of Arena in the condensed consolidated statements of operations and comprehensive loss.

On June 14, 2017, we filed a certificate of amendment to our certificate of incorporation with the Secretary of State of the state of Delaware to effect a one-for-ten reverse stock split of our issued and outstanding common stock. The accompanying condensed consolidated financial statements and notes thereto give retrospective effect to the reverse stock split for all periods presented. All issued and outstanding common stock, options exercisable for common stock, restricted stock units, performance restricted stock units, and per share amounts contained in the condensed consolidated financial statements have been retroactively adjusted to reflect this reverse stock split for all periods presented. Concurrent with the reverse stock split we effected a reduction in the number of authorized shares of common stock from 367,500,000 shares to 73,500,000 shares.

Liquidity.

As of June 30, 2017, we had cash and cash equivalents of approximately $130.8 million. In July 2017, we raised approximately $162.0 million of proceeds from sales of our common stock (see Note 7). We believe our cash and cash equivalents will be sufficient to fund our operations for at least the next 12 months.

It will require substantial cash to achieve our objectives of discovering, developing and commercializing drugs, and this process typically takes many years and potentially hundreds of millions of dollars for an individual drug. We may not have adequate available cash, or assets that could be readily turned into cash, to meet these objectives in the long term. We will need to obtain significant funds under our existing collaborations, under new collaboration, licensing or other commercial agreements for one or more of our drug candidates and programs or patent portfolios, or from other potential sources of liquidity, which may include the sale of equity, issuance of debt or other transactions.

Recent Accounting Pronouncements

Revenue Recognition.

In May 2014, the Financial Accounting Standards Board, or FASB, issued Accounting Standards Update, or ASU, No. 2014-09, Revenue from Contracts with Customers. ASU No. 2014-09 supersedes most current revenue recognition guidance and establishes a comprehensive revenue recognition model with a broad principle that would require an entity to recognize revenue to depict the transfer of promised goods or services to customers in an amount that reflects the consideration to which the entity expects to be entitled in exchange for those goods or services. To achieve this principle, an entity identifies the contract with a customer, identifies the separate performance obligations in the contract, determines the transaction price, allocates the transaction price to the separate performance obligations and recognizes revenue when each separate performance obligation is satisfied. FASB has subsequently issued additional ASUs to clarify certain elements of the new revenue recognition guidance.

The new guidance allows for two methods of adoption: (a) “full retrospective” adoption, meaning the standard is applied to all periods presented, or (b) “modified retrospective” adoption, meaning the cumulative effect of applying the new guidance is recognized as an adjustment to the opening retained earnings balance for the year of implementation. We plan to adopt the new revenue standard effective January 1, 2018, on a modified retrospective method with the cumulative effect of the change reflected in retained earnings as of January 1, 2018.

We have continued to monitor FASB activity to assess certain interpretative issues and the associated implementation of the new standard. We are in the process of reviewing our revenue arrangements, which we expect to include product sales, manufacturing support payments, royalty payments, other collaboration payments and toll manufacturing, and are not yet able to estimate the anticipated impact to our consolidated financial statements from the implementation of the new standard as we continue to interpret the principles of the new standard.

Other.

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

In February 2016, the FASB issued ASU No. 2016-02, Leases. ASU No. 2016-02 amends the accounting guidance for leases. The amendments contain principles that will require lessees to recognize most leases on the balance sheet by recording a right-of-use asset and a lease liability, unless the lease is a short-term lease that has an accounting lease term of 12 months or less. The amendments also contain other changes to the current lease guidance that may result in changes to how entities determine which contractual arrangements qualify as a lease, the accounting for executory costs (such as property taxes and insurance), as well as which lease origination costs will be capitalizable. The new standard also requires expanded quantitative and qualitative disclosures. ASU No. 2016-02 is effective for annual reporting periods, and interim periods within those periods, beginning after December 15, 2018, with early adoption permitted. ASU No. 2016-02 requires the use of the modified retrospective transition method, whereby the new guidance will be applied at the beginning of the earliest period presented in the financial statements of the period of adoption. We are currently evaluating the impact of ASU No. 2016-02 on our consolidated financial statements.

In May 2017, the FASB issued ASU No. 2017-09, Scope of Modification Accounting. ASU No. 2016-02 clarifies which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting. This guidance is to be applied prospectively to awards modified on or after the adoption date and is effective for fiscal years, and interim periods within those years, beginning after December 15, 2017, with early adoption permitted. We do not anticipate that the adoption of ASU 2017-09 will have a material impact on our consolidated financial statements unless there are significant changes to our outstanding share based payment awards at which time we would assess the impact of the standard.

Use of Estimates.

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

2. Fair Value Disclosures

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

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

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

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

Level 3 - Significant unobservable inputs based on our assumptions.

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

	Fair Value Measurements at June 30, 2017			
	Balance	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds[1]	$6,419	$ 6,419	$ —	$ —

	Fair Value Measurements at December 31, 2016			
	Balance	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Money market funds[1]	$46,371	$ 46,371	$ —	$ —

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

3. Inventory

Inventory consisted of the following, in thousands:

	June 30, 2017	December 31, 2016
Raw materials	$ 2,913	$ 2,553
Work in process	3,361	3,943
Finished goods	784	212
Total inventory	$ 7,058	$ 6,708

4. Land, Property and Equipment

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

	June 30, 2017	December 31, 2016
Cost	$ 103,892	$ 108,356
Less accumulated depreciation and amortization	(62,895)	(64,528)
Land, property and equipment, net	$ 40,997	$ 43,828

5. Accounts Payable and Other Accrued Liabilities

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

	June 30,	December 31,