

UNITED STATES  
SECURITIES AND EXCHANGE COMMISSION  
Washington, D.C. 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 September 30, 2017

OR

Transition report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934  
For transition period from \_\_\_\_\_ to \_\_\_\_\_

Commission File Number: 000-19756



**PDL BIOPHARMA, INC.**

(Exact name of registrant as specified in its charter)

Delaware  
(State or other jurisdiction of incorporation or organization)

94-3023969  
(I.R.S. Employer Identification No.)

932 Southwood Boulevard  
Incline Village, Nevada 89451  
(Address of principal executive offices and Zip Code)

(775) 832-8500  
(Registrant's telephone number, including area code)

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

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

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

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

If an emerging growth company, indicated 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

As of November 7, 2017, there were 154,338,793 shares of the registrant's Common Stock outstanding.

**PDL BIOPHARMA, INC.**  
**2017 Form 10-Q**  
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**We own or have rights to certain trademarks, trade names, copyrights and other intellectual property used in our business, including PDL BioPharma and the PDL logo, each of which is considered a trademark. All other company names, product names, trade names and trademarks included in this Quarterly Report on Form 10-Q are trademarks, registered trademarks or trade names of their respective owners.**

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

**PDL BIOPHARMA, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF INCOME**  
(Unaudited)  
(In thousands, except per share amounts)

|  | Three Months Ended<br>September 30, |                  | Nine Months Ended<br>September 30, |                  |
|--|-------------------------------------|------------------|------------------------------------|------------------|
|  | 2017                                | 2016             | 2017                               | 2016             |
| <b>Revenues</b>  |                                     |                  |                                    |                  |
| Royalties from Queen et al. patents                                      | \$ 1,443                            | \$ 14,958        | \$ 31,884                          | \$ 150,645       |
| Royalty rights - change in fair value                                    | 35,353                              | 16,085           | 132,224                            | (11,872)         |
| Interest revenue   | 6,051                               | 8,594            | 16,968                             | 24,901           |
| Product revenue, net   | 20,067                              | 14,128           | 51,477                             | 14,128           |
| License and other  | (165)                               | (127)            | 19,471                             | 7                |
| <b>Total revenues</b>  | <b>62,749</b>                       | <b>53,638</b>    | <b>252,024</b>                     | <b>177,809</b>   |
| <b>Operating expenses</b>  |                                     |                  |                                    |                  |
| Cost of product revenue (excluding intangible asset amortization)        | 5,565                               | —                | 12,632                             | —                |
| Amortization of intangible assets  | 6,275                               | 6,014            | 18,438                             | 6,014            |
| General and administrative   | 11,989                              | 10,396           | 35,853                             | 27,193           |
| Sales and marketing  | 4,994                               | 11               | 11,194                             | 11               |
| Research and development   | 605                                 | 1,933            | 6,652                              | 1,933            |
| Change in fair value of anniversary payment and contingent consideration | 700                                 | 2,083            | 3,349                              | 2,083            |
| Acquisition-related costs  | —                                   | 546              | —                                  | 3,505            |
| <b>Total operating expenses</b>  | <b>30,128</b>                       | <b>20,983</b>    | <b>88,118</b>                      | <b>40,739</b>    |
| <b>Operating income</b>  | <b>32,621</b>                       | <b>32,655</b>    | <b>163,906</b>                     | <b>137,070</b>   |
| <b>Non-operating expense, net</b>  |                                     |                  |                                    |                  |
| Interest and other income, net   | 238                                 | 162              | 726                                | 404              |
| Interest expense   | (5,096)                             | (4,513)          | (15,082)                           | (13,524)         |
| Gain (loss) on bargain purchase  | (2,276)                             | —                | 3,995                              | —                |
| <b>Total non-operating expense, net</b>                                  | <b>(7,134)</b>                      | <b>(4,351)</b>   | <b>(10,361)</b>                    | <b>(13,120)</b>  |
| <b>Income before income taxes</b>  | <b>25,487</b>                       | <b>28,304</b>    | <b>153,545</b>                     | <b>123,950</b>   |
| Income tax expense   | 4,755                               | 14,400           | 65,180                             | 50,011           |
| <b>Net income</b>  | <b>20,732</b>                       | <b>13,904</b>    | <b>88,365</b>                      | <b>73,939</b>    |
| Less: Net income/(loss) attributable to noncontrolling interests         | —                                   | (3)              | (47)                               | (3)              |
| <b>Net income attributable to PDL's shareholders</b>                     | <b>\$ 20,732</b>                    | <b>\$ 13,907</b> | <b>\$ 88,412</b>                   | <b>\$ 73,942</b> |
| <b>Net income per share</b>  |                                     |                  |                                    |                  |
| Basic  | \$ 0.14                             | \$ 0.08          | \$ 0.56                            | \$ 0.45          |
| Diluted  | \$ 0.14                             | \$ 0.08          | \$ 0.56                            | \$ 0.45          |
| <b>Weighted average shares outstanding</b>                               |                                     |                  |                                    |                  |
| Basic  | 151,146                             | 163,856          | 156,802                            | 163,771          |
| Diluted  | 152,317                             | 164,285          | 157,529                            | 164,075          |
| <b>Cash dividends declared per common share</b>                          | <b>\$ —</b>                         | <b>\$ —</b>      | <b>\$ —</b>                        | <b>\$ 0.10</b>   |

See accompanying notes.

**PDL BIOPHARMA, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME**  
(Unaudited)  
(In thousands)

|  | Three Months Ended |                  | Nine Months Ended |                  |
|--|--------------------|------------------|-------------------|------------------|
|  | September 30,      |                  | September 30,     |                  |
|  | 2017               | 2016             | 2017              | 2016             |
| <b>Net income</b>  | \$ 20,732          | \$ 13,904        | \$ 88,365         | \$ 73,939        |
| <b>Other comprehensive income (loss), net of tax</b>   |                    |                  |                   |                  |
| Change in unrealized gains on investments in available-for-sale securities:  |                    |                  |                   |                  |
| Change in fair value of investments in available-for-sale securities, net of tax   | 648                | —                | 648               | 122              |
| Adjustment for net (gains) losses realized and included in net income, net of tax  | —                  | —                | —                 | (557)            |
| Total change in unrealized gains on investments in available-for-sale securities, net of tax <sup>(a)</sup>              | 648                | —                | 648               | (435)            |
| Change in unrealized gains (losses) on cash flow hedges:   |                    |                  |                   |                  |
| Adjustment to royalties from Queen et al. patents for net (gains) losses realized and included in net income, net of tax | —                  | —                | —                 | (1,821)          |
| Total change in unrealized losses on cash flow hedges, net of tax <sup>(b)</sup>   | —                  | —                | —                 | (1,821)          |
| Total other comprehensive income/(loss), net of tax  | 648                | —                | 648               | (2,256)          |
| <b>Comprehensive income</b>  | 21,380             | 13,904           | 89,013            | 71,683           |
| Less: Comprehensive income/(loss) attributable to noncontrolling interests   | —                  | (3)              | (47)              | (3)              |
| <b>Comprehensive income attributable to PDL's shareholders</b>   | <u>\$ 21,380</u>   | <u>\$ 13,907</u> | <u>\$ 89,060</u>  | <u>\$ 71,686</u> |

<sup>(a)</sup> Net of tax of \$349 and zero for the three months ended September 30, 2017 and 2016, respectively, and \$349 and (\$234) for the nine months ended September 30, 2017 and 2016, respectively.

<sup>(b)</sup> Net of tax of zero and zero for the three months ended September 30, 2017 and 2016, respectively, and zero and (\$981) for the nine months ended September 30, 2017 and 2016, respectively.

See accompanying notes.

**PDL BIOPHARMA, INC.**  
**CONDENSED CONSOLIDATED BALANCE SHEETS**  
(In thousands, except per share amounts)

|  | <b>September 30,</b><br><b>2017</b> | <b>December 31,</b><br><b>2016</b> |
|--|-------------------------------------|------------------------------------|
|  | (unaudited)                         | (Note 1)                           |
| <b>Assets</b>  |                                     |                                    |
| Current assets:  |                                     |                                    |
| Cash and cash equivalents  | \$ 510,085                          | \$ 147,154                         |
| Short-term investments   | 6,409                               | 19,987                             |
| Accounts receivable, net   | 17,465                              | 40,120                             |
| Notes receivable   | 57,545                              | 111,182                            |
| Investments-other  | —                                   | 75,000                             |
| Inventories  | 12,216                              | 2,884                              |
| Prepaid and other current assets   | 9,510                               | 1,704                              |
| <b>Total current assets</b>  | <b>613,230</b>                      | <b>398,031</b>                     |
| Property and equipment, net  | 8,130                               | 38                                 |
| Escrow receivable  | 1,400                               | —                                  |
| Royalty rights - at fair value   | 351,969                             | 402,318                            |
| Notes and other receivables, long-term   | 13,091                              | 159,768                            |
| Long-term deferred tax assets  | 6,186                               | 19,257                             |
| Intangible assets, net   | 222,074                             | 228,542                            |
| Other assets   | 7,758                               | 7,433                              |
| <b>Total assets</b>  | <b>\$ 1,223,838</b>                 | <b>\$ 1,215,387</b>                |
| <b>Liabilities and Stockholders' Equity</b>  |                                     |                                    |
| Current liabilities:   |                                     |                                    |
| Accounts payable   | \$ 10,448                           | \$ 7,016                           |
| Accrued liabilities  | 51,607                              | 30,575                             |
| Accrued income taxes   | 7,155                               | 4,723                              |
| Anniversary payment  | —                                   | 88,001                             |
| Convertible notes payable  | 124,922                             | —                                  |
| <b>Total current liabilities</b>   | <b>194,132</b>                      | <b>130,315</b>                     |
| Convertible notes payable  | 115,716                             | 232,443                            |
| Contingent consideration   | 45,000                              | 42,650                             |
| Other long-term liabilities  | 46,008                              | 54,556                             |
| <b>Total liabilities</b>   | <b>400,856</b>                      | <b>459,964</b>                     |
| Commitments and contingencies (Note 11)  |                                     |                                    |
| Stockholders' equity:  |                                     |                                    |
| Preferred stock, par value \$0.01 per share, 10,000 shares authorized; no shares issued and outstanding  | —                                   | —                                  |
| Common stock, par value \$0.01 per share, 350,000 shares authorized; 154,339 and 165,538 shares issued and outstanding at September 30, 2017 and December 31, 2016, respectively | 1,543                               | 1,655                              |
| Additional paid-in capital   | (102,591)                           | (107,628)                          |
| Accumulated other comprehensive income   | 648                                 | —                                  |
| Retained earnings  | 923,382                             | 857,116                            |
| <b>Total PDL's stockholders' equity</b>  | <b>822,982</b>                      | <b>751,143</b>                     |
| Noncontrolling interests   | —                                   | 4,280                              |
| <b>Total stockholders' equity</b>  | <b>822,982</b>                      | <b>755,423</b>                     |
| <b>Total liabilities and stockholders' equity</b>  | <b>\$ 1,223,838</b>                 | <b>\$ 1,215,387</b>                |

See accompanying notes.

**PDL BIOPHARMA, INC.**  
**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**  
(Unaudited)  
(In thousands)

|   | Nine Months Ended September 30, |           |
|---|---------------------------------|-----------|
|   | 2017                            | 2016      |
| <b>Cash flows from operating activities</b>                                       |                                 |           |
| Net income  | \$ 88,365                       | \$ 73,939 |
| Adjustments to reconcile net income to net cash provided by operating activities: |                                 |           |
| Amortization of convertible notes and term loan offering costs                    | 8,195                           | 6,067     |
| Amortization of intangible assets   | 18,438                          | 6,014     |
| Change in fair value of royalty rights - at fair value                            | (132,224)                       | 11,872    |
| Change in fair value of derivative asset  | 29                              | 875       |
| Change in fair value of anniversary payment and contingent consideration          | 3,349                           | 2,083     |
| Other amortization, depreciation and accretion of embedded derivative             | 1,478                           | 16        |
| Gain on sale of available-for-sale securities                                     | (108)                           | (881)     |
| Escrow receivable   | (1,400)                         | —         |
| Bargain purchase gain   | (3,995)                         | —         |
| Inventory obsolescence  | 30                              | —         |
| Bad debt allowance  | 22                              | —         |
| Stock-based compensation expense  | 3,014                           | 2,649     |
| Deferred income taxes   | 28,970                          | (6,013)   |
| Changes in assets and liabilities, net of affects of business acquired:           |                                 |           |
| Accounts receivable   | 19,454                          | (26,035)  |
| Receivables from licensees and other  | 5,111                           | (5,757)   |
| Prepaid and other current assets  | (4,166)                         | (470)     |
| Accrued interest on notes receivable  | 1,577                           | (2,745)   |
| Inventories   | (2,285)                         | (1,593)   |
| Other assets  | 347                             | 30        |
| Accounts payable  | 1,395                           | 6,740     |
| Accrued liabilities   | 18,980                          | 10,769    |
| Accrued income taxes  | 2,432                           | 2,421     |
| Other long-term liabilities   | 1,055                           | 6,084     |
| Net cash provided by operating activities   | 58,063                          | 86,065    |
| <b>Cash flows from investing activities</b>                                       |                                 |           |
| Purchase consideration paid in advance  | —                               | (109,938) |
| Purchase of investments   | (23,213)                        | (7,985)   |
| Purchase of investments-other   | —                               | (75,000)  |
| Maturities of investments-other   | 75,000                          | —         |
| Proceeds from sales of available-for-sale securities                              | 37,895                          | 1,680     |
| Proceeds from the sale of notes receivables                                       | 144,829                         | —         |
| Purchase of royalty rights - at fair value  | —                               | (59,500)  |
| Proceeds from royalty rights - at fair value                                      | 74,404                          | 47,240    |
| Sale of royalty rights - at fair value  | 108,169                         | —         |
| Purchase of notes receivable  | —                               | (8,000)   |
| Proceeds from sales of assets held for sale                                       | 8,142                           | 54,653    |
| Purchase of property and equipment  | (1,160)                         | —         |
| Net cash provided by / (used in) investing activities                             | 424,066                         | (156,850) |
| <b>Cash flows from financing activities</b>                                       |                                 |           |
| Payment of debt issuance costs  | —                               | (325)     |
| Repayment of term loan  | —                               | (25,000)  |
| Cash received from noncontrolling interest holder                                 | —                               | 250       |
| Payment of anniversary payment  | (87,007)                        | —         |
| Cash paid for purchase of noncontrolling interest                                 | (2,170)                         | —         |
| Cash dividends paid   | (21)                            | (16,433)  |
| Repurchase and retirement of common stock   | (30,000)                        | —         |
| Net cash used in financing activities   | (119,198)                       | (41,508)  |
| Net increase (decrease) in cash and cash equivalents                              | 362,931                         | (112,293) |

|  |                   |                   |
|--|-------------------|-------------------|
| Cash and cash equivalents at beginning of the period | <u>147,154</u>    | <u>218,883</u>    |
| Cash and cash equivalents at end of period           | <u>\$ 510,085</u> | <u>\$ 106,590</u> |

|  | <b>Nine Months Ended September 30,</b> |             |
|--|--|-------------|
|  | <b>2017</b>                            | <b>2016</b> |
| <b>Supplemental cash flow information</b>                                      |  |             |
| Cash paid for income taxes   | \$ 35,120                              | \$ 50,000   |
| Cash paid for interest   | \$ 7,224                               | \$ 9,930    |
| <b>Supplemental schedule of non-cash investing and financing activities</b>    |  |             |
| Warrants received for notes receivable   | \$ —                                   | \$ 2,342    |
| Asset held for sale reclassified from notes receivable to other assets         | \$ 10,000                              | \$ —        |
| Extinguishment of notes receivable   | \$ 43,909                              | \$ —        |
| Accrued Anniversary Payment associated with the acquisition of a business      | \$ —                                   | \$ 87,007   |
| Accrued contingent consideration associated with the acquisition of a business | \$ —                                   | \$ 47,360   |

See accompanying notes.



**PDL BIOPHARMA, INC.**  
**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**  
**September 30, 2017**  
**(Unaudited)**

**1. Summary of Significant Accounting Policies**

***Basis of Presentation***

The accompanying unaudited Condensed Consolidated Financial Statements of PDL Biopharma, Inc. and its subsidiaries (collectively, the “Company” or “PDL”) have been prepared in accordance with Generally Accepted Accounting Principles (United States) (“GAAP”) for interim financial information. The financial statements include all adjustments (consisting only of normal recurring adjustments), that management of the Company believes are necessary for a fair presentation of the periods presented. These interim financial results are not necessarily indicative of results expected for the full fiscal year or for any subsequent interim period.

The accompanying unaudited Condensed Consolidated Financial Statements and related financial information should be read in conjunction with the Company’s audited Consolidated Financial Statements and the related notes thereto for the year ended December 31, 2016, included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2016, filed with the Securities and Exchange Commission (“SEC”) on March 1, 2017. The Condensed Consolidated Balance Sheet at December 31, 2016, has been derived from the audited Consolidated Financial Statements at that date, but does not include all disclosures required by GAAP.

During the quarter ended September 30, 2017, the Company corrected errors in its deferred tax assets and equity accounts, which decreased deferred tax assets by \$20.4 million, decreased retained earnings by \$29.9 million and increased additional paid-in capital by \$9.5 million. The Company concluded that these errors are not material to the previously issued financial statements.

***Significant Accounting Policies***

There have been no material changes to the significant accounting policies discussed in the Company’s Annual Report on Form 10-K for the fiscal year ended December 31, 2016, that are of significance, or potential significance to the Company.

***Adopted Accounting Pronouncements***

In March 2016, the Financial Accounting Standards Board (“FASB”) issued Accounting Standards Update (“ASU”) No. 2016-09, *Improvements to Employee Share-Based Payment Accounting*, intended to improve the accounting for share-based payment transactions as part of its simplification initiative. The ASU requires entities to record all excess tax benefits and tax deficiencies as an income tax benefit or expense in the statement of income. The recognition of excess tax benefits and deficiencies and changes to diluted earnings per share are to be applied prospectively. For tax benefits that were not previously recognized because the related tax deduction had not reduced taxes payable, the Company recorded a \$7.7 million cumulative-effect adjustment in retained earnings as of the beginning of 2017, the year of adoption. The Company applied the presentation changes for excess tax benefits from financing activities to operating activities in the statement of cash flows using a prospective transition method. The guidance allows for an election to recognize forfeitures as they occur rather than on an estimated basis. The Company will continue to account for forfeitures on an estimated basis. During the nine months ended September 30, 2017, there were \$0.2 million excess tax benefits recognized in the Consolidated Statement of Income and classified as an operating activity in the Condensed Consolidated Statement of Cash Flows.

In January 2017, the FASB issued ASU No. 2017-01, *Clarifying the Definition of a Business*, included in ASC 805, *Business Combinations*, which revises the definition of a business. The revised definition clarifies that outputs must be the result of inputs and substantive processes that provide goods or services to customers, other revenue, or investment income. The guidance will be effective for the Company’s annual and interim reporting periods beginning January 1, 2018, and early adoption is permitted. The Company adopted the new definition of a business during the first quarter of 2017, and it did not have a material impact on its business practices, financial condition, results of operations, or disclosures.

***Recently Issued Accounting Pronouncements Not Yet Adopted***

In May 2014, the FASB issued ASU No. 2014-09, *Revenue from Contracts with Customers*. The new standard can be applied either retrospectively to each prior reporting period presented (i.e., full retrospective adoption) or with the cumulative effect of

initially applying the update recognized at the date of the initial application (i.e., modified retrospective adoption) along with additional disclosures. Revenue from financial instruments which are valued under Subtopic 825 will not be subject to the application of ASU 2014-09. As a result, the Company believes that Royalty Rights - At Fair Value are financial instruments within the scope of Subtopic 825 and will be specifically exempted from applying the new revenue standard.

This new standard will replace most of the existing revenue recognition guidance in GAAP when it becomes effective. The new standard, as amended, becomes effective for the Company in the first quarter of fiscal year 2018. The Company currently anticipates adopting this standard using the full retrospective method to restate each prior period presented.

The new revenue standard is principle based and interpretation of those principles may vary from company to company based on their unique circumstances. It is possible that interpretation, industry practice, and guidance may evolve as companies and the accounting profession work to implement this new standard. The Company is still in the process of evaluating the effect of the new standard on the Company's historical financial statements and disclosures. While the Company has not completed its evaluation, the Company currently believes that the impact to revenue and expense recognized will not be material to any of the years presented. As the Company completes its evaluation of this new standard, new information may arise that could change the Company's current understanding of the impact to revenue and expense recognized.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, which seeks to increase transparency and comparability among organizations by, among other things, recognizing lease assets and lease liabilities on the balance sheet for leases classified as operating leases under previous GAAP and disclosing key information about leasing arrangements. ASU No. 2016-02 becomes effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years, with early adoption permitted. The Company is currently evaluating the provisions of ASU No. 2016-02 and assessing the impact, if any, it may have on the Company's Condensed Consolidated Financial Statements.

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments*. The new guidance amends the impairment model to utilize an expected loss methodology in place of the currently used incurred loss methodology, which will result in more timely recognition of losses. ASU No. 2016-13 has an effective date of the fiscal years beginning December 15, 2019, including interim periods within those fiscal years. The Company is currently evaluating ASU 2016-13 and assessing the impact, if any, it may have to the Company's consolidated results of operations, financial position and cash flows.

In August 2016, the FASB issued ASU No. 2016-15, *Classification of Certain Cash Receipts and Cash Payments*. The new standard provides for specific guidance how certain transactions are classified in the statement of cash flows. ASU 2016-15 is effective for fiscal years, and interim periods with those years, beginning after December 15, 2017. Early adoption is permitted. The Company is currently evaluating ASU 2016-15 and assessing the impact, if any, it may have to the Company's Condensed Consolidated Statement of Cash Flows.

In October 2016, the FASB issued ASU No. 2016-16, *Intra-Entity Transfers of Assets Other Than Inventory*, which requires companies to account for the income tax effects of intercompany sales and transfers of assets other than inventory in the period in which the transfer occurs. The new standard is effective for public business entities for annual periods beginning after December 15, 2017 (i.e. 2018 for a calendar-year entity). Early adoption is permitted for all entities as of the beginning of an annual period. The guidance is to be applied using a modified retrospective approach with a cumulative catch-up adjustment to opening retained earnings in the period of adoption. The Company is currently analyzing the impact of ASU No. 2016-16 on the Company's Condensed Consolidated Financial Statements.

In November 2016, the FASB issued ASU No. 2016-18, *Restricted Cash*, which requires entities to show the changes in total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. As a result, entities will no longer present transfers between cash and cash equivalents and restricted cash in the statement of cash flows. When cash, cash equivalents, restricted cash and restricted cash equivalents are presented in more than one line item on the balance sheet, the new guidance requires a reconciliation of the totals in the statement of cash flows to the related captions on the balance sheet. The reconciliation can either be presented either on the face of the statement of cash flows or in the notes to the financial statements. The new standard is effective for public business entities for fiscal years beginning after December 15, 2017 and interim periods therein and is to be applied retrospectively. Early adoption is permitted. The Company is currently analyzing the impact of ASU No. 2016-18 on the Company's Condensed Consolidated Financial Statements.

## 2. Net Income per Share

| <b>Net Income per Basic and Diluted Share:</b>   | <b>Three Months Ended</b> |             | <b>Nine Months Ended</b> |             |
|--|---------------------------|-------------|--------------------------|-------------|
|  | <b>September 30,</b>      |             | <b>September 30,</b>     |             |
|  | <b>2017</b>               | <b>2016</b> | <b>2017</b>              | <b>2016</b> |
| <i>(in thousands except per share amounts)</i>   |                           |             |                          |             |
| <b>Numerator</b>   |                           |             |                          |             |
| Income attributable to PDL's shareholders used to compute net income per basic and diluted share             | \$ 20,732                 | \$ 13,907   | \$ 88,412                | \$ 73,942   |
| <b>Denominator</b>   |                           |             |                          |             |
| Total weighted average shares used to compute net income attributable to PDL's shareholders, per basic share | 151,146                   | 163,856     | 156,802                  | 163,771     |
| Restricted stock outstanding   | 1,171                     | 429         | 727                      | 304         |
| Shares used to compute net income attributable to PDL's shareholders, per diluted share                      | 152,317                   | 164,285     | 157,529                  | 164,075     |
| <b>Net income attributable to PDL's shareholders per share - basic</b>                                       | \$ 0.14                   | \$ 0.08     | \$ 0.56                  | \$ 0.45     |
| <b>Net income attributable to PDL's shareholders per share - diluted</b>                                     | \$ 0.14                   | \$ 0.08     | \$ 0.56                  | \$ 0.45     |

The Company computes net income per diluted share using the sum of the weighted-average number of common and common equivalent shares outstanding. Common equivalent shares used in the computation of net income per diluted share include shares that may be issued pursuant to outstanding stock options and restricted stock awards, the 4.0% Convertible Senior Notes due February 1, 2018 (the "February 2018 Notes") and the 2.75% Convertible Senior Notes due December 1, 2021 (the "December 2021 Notes"), in each case, on a weighted average basis for the period that the notes were outstanding, including the effect of adding back interest expense and the underlying shares using the if converted method.

### *February 2018 Notes Purchased Call Option and Warrant Potential Dilution*

The Company excluded from its calculation of net income per diluted share 12.2 million and 23.8 million shares for the three and nine months ended September 30, 2017 and 2016, respectively, for warrants issued in February 2014, because the exercise price of the warrants exceeded the volume-weighted average share price ("VWAP") of the Company's common stock and conversion of the underlying February 2018 Notes is not assumed, therefore no stock would be issuable upon conversion; however, these securities could be dilutive in future periods. The purchased call options issued in February 2014 will always be anti-dilutive; therefore 13.8 million and 26.9 million shares were excluded from the calculation of net income per diluted share for the three and nine months ended September 30, 2017 and 2016, respectively, and were excluded from the calculation of net income per diluted share. For information related to the conversion rates on the Company's convertible debt, see Note 12.

### *December 2021 Notes Capped Call Potential Dilution*

In November 2016, the Company issued \$150.0 million in aggregate principal of the December 2021 Notes, which provide in certain situations for the conversion of the outstanding principal amount of the December 2021 Notes into shares of the Company's common stock at a predefined conversion rate. For additional information on the conversion rates on the Company's convertible debt, see Note 12. In conjunction with the issuance of the December 2021 Notes, the Company entered into a capped call transaction with a hedge counterparty. The capped call transaction is expected generally to reduce the potential dilution, and/or offset, to an extent, the cash payments the Company may choose to make in excess of the principal amount, upon conversion of the December 2021 Notes. The Company has excluded the capped call transaction from the diluted EPS computation as such securities would have an antidilutive effect and those securities should be considered separately rather than in the aggregate in determining whether their effect on diluted EPS would be dilutive or antidilutive. For additional information regarding the capped call transaction related to the Company's December 2021 Notes, see Note 12.

### *Anti-Dilutive Effect of Restricted Stock Awards and Stock Options*

For the three months ended September 30, 2017 and 2016, the Company excluded approximately 1.8 million and 1.2 million shares underlying restricted stock awards, respectively, and for the nine months ended September 30, 2017 and 2016, the

Company excluded approximately 1.9 million and 1.1 million shares underlying restricted stock awards, respectively, calculated on a weighted average basis, from its net income per diluted share calculations because their effect was anti-dilutive.

For the three months ended September 30, 2017 and 2016, the Company excluded approximately 126,000 and zero shares underlying outstanding stock options, respectively, and for the nine months ended September 30, 2017 and 2016, the Company excluded approximately 59,000 and zero shares underlying outstanding stock options, respectively, calculated on a weighted average basis, its our net income per diluted share calculations because their effect was anti-dilutive.

### 3. Fair Value Measurements

The fair value of the Company's financial instruments are estimates of the amounts that would be received if the Company were to sell an asset or pay to transfer a liability in an orderly transaction between market participants at the measurement date or exit price. The assets and liabilities are categorized and disclosed in one of the following three categories:

Level 1 – based on quoted market prices in active markets for identical assets and liabilities;

Level 2 – based on quoted market prices for similar assets and liabilities, using observable market-based inputs or unobservable market-based inputs corroborated by market data; and

Level 3 – based on unobservable inputs using management's best estimate and assumptions when inputs are unavailable.

The following tables present the fair value of the Company's financial instruments measured at fair value on a recurring basis by level within the valuation hierarchy.

|                                | September 30, 2017 |          |            |            | December 31, 2016 |           |            |            |
|--------------------------------|--------------------|----------|------------|------------|-------------------|-----------|------------|------------|
|                                | Level 1            | Level 2  | Level 3    | Total      | Level 1           | Level 2   | Level 3    | Total      |
| <i>(In thousands)</i>          |                    |          |            |            |                   |           |            |            |
| Financial assets:              |                    |          |            |            |                   |           |            |            |
| Money market funds             | \$ 14,705          | \$ —     | \$ —       | \$ 14,705  | \$ 4              | \$ —      | \$ —       | \$ 4       |
| Certificates of deposit        | —                  | —        | —          | —          | —                 | 75,000    | —          | 75,000     |
| Commercial paper               | —                  | 2,060    | —          | 2,060      | —                 | 19,987    | —          | 19,987     |
| Corporate securities           | 4,349              | —        | —          | 4,349      | —                 | —         | —          | —          |
| Warrants                       | —                  | 49       | —          | 49         | —                 | 78        | —          | 78         |
| Royalty rights - at fair value | —                  | —        | 351,969    | 351,969    | —                 | —         | 402,318    | 402,318    |
| Total                          | \$ 19,054          | \$ 2,109 | \$ 351,969 | \$ 373,132 | \$ 4              | \$ 95,065 | \$ 402,318 | \$ 497,387 |
| Financial liabilities:         |                    |          |            |            |                   |           |            |            |
| Anniversary payment            | \$ —               | \$ —     | \$ —       | \$ —       | \$ —              | \$ —      | \$ 88,001  | \$ 88,001  |
| Contingent consideration       | —                  | —        | 45,000     | 45,000     | —                 | —         | 42,650     | 42,650     |
| Total                          | \$ —               | \$ —     | \$ 45,000  | \$ 45,000  | \$ —              | \$ —      | \$ 130,651 | \$ 130,651 |

As of December 31, 2016, the Company held \$75.0 million in a short-term certificate of deposit, which was designated as cash collateral for the letter of credit issued with respect to the first anniversary payment under the Noden Purchase Agreement (as defined in Note 18 below). On July 3, 2017, the first anniversary payment of \$89.0 million was paid pursuant to the Noden Purchase Agreement and on July 31, 2017, the certificate of deposit matured. There have been no transfers between levels during the three or nine-month periods ended September 30, 2017 and December 31, 2016. The Company recognizes transfers between levels on the date of the event or change in circumstances that caused the transfer.

#### *Certificates of Deposit*

The fair value of the certificates of deposit is determined using quoted market prices for similar instruments and non-binding market prices that are corroborated by observable market data.

### ***Commercial Paper***

Commercial paper securities consist primarily of U.S. corporate debt holdings. The fair value of commercial paper securities is estimated using recently executed transactions or market quoted prices, where observable. Independent pricing sources are also used for valuation.

### ***Corporate Securities***

Corporate securities consist primarily of U.S. corporate security holdings. The fair value of corporate securities is estimated using market quoted prices.

### ***Warrants***

Warrants consist primarily of purchased call options to buy U.S. corporate equity holdings and derivative assets acquired as part of note receivable investments. The fair value of the warrants is estimated using recently quoted market prices or estimated fair value of the underlying equity security and the Black-Scholes option pricing model.

### ***Royalty Rights - At Fair Value***

#### ***Depomed Royalty Agreement***

On October 18, 2013, the Company entered into the Royalty Purchase and Sale Agreement (the "Depomed Royalty Agreement") with Depomed, Inc. and Depo DR Sub, LLC (together, "Depomed"), whereby the Company acquired the rights to receive royalties and milestones payable on sales of Type 2 diabetes products licensed by Depomed in exchange for a \$240.5 million cash payment. Total consideration was \$241.3 million, which was comprised of the \$240.5 million cash payment to Depomed and \$0.8 million in transaction costs.

The rights acquired include Depomed's royalty and milestone payments accruing from and after October 1, 2013: (a) from Santarus, Inc. ("Santarus") (which was subsequently acquired by Salix Pharmaceuticals, Inc. ("Salix"), which itself was acquired by Valeant Pharmaceuticals International, Inc. ("Valeant")) with respect to sales of Glumetza (metformin HCL extended-release tablets) in the United States; (b) from Merck & Co., Inc. with respect to sales of Janumet® XR (sitagliptin and metformin HCL extended-release tablets); (c) from Janssen Pharmaceutica N.V. with respect to potential future development milestones and sales of its recently approved fixed-dose combination of Invokana® (canagliflozin) and extended-release metformin tablets, marketed as Invokamet XR®; (d) from Boehringer Ingelheim with respect to potential future development milestones and sales of the investigational fixed-dose combinations of drugs and extended-release metformin subject to Depomed's license agreement with Boehringer Ingelheim, including its recently approved product, Jentadueto XR®; and (e) from LG Life Sciences and Valeant for sales of extended-release metformin tablets in Korea and Canada, respectively.

Under the terms of the Depomed Royalty Agreement, the Company receives all royalty and milestone payments due under license agreements between Depomed and its licensees until the Company has received payments equal to two times the cash payment it made to Depomed, after which all net payments received by Depomed will be shared evenly between the Company and Depomed.

The Depomed Royalty Agreement terminates on the third anniversary following the date upon which the later of the following occurs: (a) October 25, 2021, or (b) at such time as no royalty payments remain payable under any license agreement and each of the license agreements has expired by its terms.

As of September 30, 2017, and December 31, 2016, the Company determined that its royalty purchase interest in Depo DR Sub represented a variable interest in a variable interest entity. However, the Company does not have the power to direct the activities of Depo DR Sub that most significantly impact Depo DR Sub's economic performance and is not the primary beneficiary of Depo DR Sub; therefore, Depo DR Sub is not subject to consolidation by the Company.

The financial asset acquired represents a single unit of accounting. The fair value of the financial asset acquired was determined by using a discounted cash flow analysis related to the expected future cash flows to be generated by each licensed product. This financial asset is classified as a Level 3 asset within the fair value hierarchy, as the Company's valuation utilized significant unobservable inputs, including estimates as to the probability and timing of future commercialization for products not yet approved by the U.S. Food and Drug Administration ("FDA") or other regulatory agencies. The discounted cash flows are based upon expected royalties from sales of licensed products over a nine-year period. The discount rates utilized range from approximately 15% to 25%. Significant judgment is required in selecting appropriate discount rates. At September 30,

2017, an evaluation was performed to assess those rates and general market conditions potentially affecting the fair market value. Should these discount rates increase or decrease by 2.5%, the fair value of the asset could decrease by \$12.5 million or increase by \$14.0 million, respectively. A third-party expert was engaged to help management develop its original estimate of the expected future cash flows. The estimated fair value of the asset is subject to variation should those cash flows vary significantly from those estimates. The Company periodically assesses the expected future cash flows and to the extent such payments are greater or less than its initial estimates, or the timing of such payments is materially different than the original estimates, the Company will adjust the estimated fair value of the asset. Should the expected royalties increase or decrease by 2.5%, the fair value of the asset could increase or decrease by \$5.6 million, respectively.

When the Company acquired the Depomed royalty rights, Glumetza was marketed by Santarus. In January 2014, Salix acquired Santarus and assumed responsibility for commercializing Glumetza, which was generally perceived to be a positive development because of Salix's larger sales force and track record in the successful commercialization of therapies. In late 2014, Salix made a number of disclosures relating to an excess of supply at the distribution level of Glumetza and other drugs that it commercialized and the practices leading to this excess of supply which were under review by Salix's audit committee in relation to the related accounting practices. Because of these disclosures and the Company's lack of direct access to information as to the levels of inventory of Glumetza in the distribution channels, the Company commenced a review of all public statements by Salix, publicly available historical third-party prescription data, analyst reports and other relevant data sources. The Company also engaged a third-party expert to specifically assess estimated inventory levels of Glumetza in the distribution channel and to ascertain the potential effects those inventory levels may have on expected future cash flows. Salix was acquired by Valeant in early April 2015. In mid-2015, Valeant implemented two price increases on Glumetza. At year-end 2015, a third-party expert was engaged by the Company to assess the impact of the Glumetza price adjustments and near-term market entrance of generic equivalents to the expected future cash flows. Based on the analysis performed, management revised the underlying assumptions used in the discounted cash flow analysis at year-end 2015. In February and August of 2016, a total of three generic equivalents to Glumetza were approved to enter the market. In February 2016, Lupin Pharmaceuticals, Inc. launched a generic equivalent approved product. To date, the other two generic equivalent approved products have not launched.

In May 2017, the Company received notification that a subsidiary of Valeant had launched an authorized generic equivalent product in February 2017, and the Company received royalties on such authorized generic equivalent product under the same terms as the branded Glumetza, retroactive to February 2017.

At June 30, 2017, management re-evaluated, with assistance of a third-party expert, the market share data, the gross-to-net revenue adjustment assumptions and Glumetza demand data, including the delay in launch of additional generic equivalent products and the entry of an authorized generic product by Valeant. These data and assumptions are based on available but limited information. At September 30, 2017, management updated the expected future cash flows based on the current period demand and supply data of Glumetza and the authorized generic equivalent product launched by Valeant.

As of September 30, 2017, the Company's discounted cash flow analysis reflects its expectations as to the amount and timing of future cash flows up to the valuation date, including future cash flows for the authorized generic equivalent product. The Company continues to monitor whether the generic competition further affects sales of Glumetza and thus royalties on such sales paid to the Company, and the impact of the launched authorized generic equivalent. Due to the uncertainty around Valeant's marketing and pricing strategy, as well as the recent generic competition and limited historical demand data after generic market entrance, the Company may need to further evaluate future cash flows in the event of more rapid reduction or increase in market share of Glumetza and its authorized generic equivalent product and/or a further erosion in net pricing. In February 2016, at the Company's request and pursuant to the Depomed Royalty Agreement, Depomed exercised its audit right with respect to Glumetza royalties. The independent auditors engaged to perform the royalty audit completed it in July 2017, and based upon the results of the audit, Depomed, on behalf of the Company, filed a lawsuit on September 7, 2017, against Valeant and one of its subsidiaries, claiming damages for unpaid royalties, fees and interest. Valeant, Depomed and the Company entered into a settlement agreement on October 27, 2017 whereby the parties agreed to dismiss the litigation, with prejudice, and Valeant agreed to pay to Depomed \$13.0 million. The settlement payment was transferred to the Company under the terms of the Depomed Royalty Agreement in November of 2017 and has been reflected in the Depomed royalty rights asset discounted cashflow valuation as of September 30, 2017.

On May 31, 2016, the Company obtained a notification indicating that the FDA approved Jentadueto XR for use in patients with Type 2 diabetes. In June 2016, the Company received a \$6.0 million FDA approval milestone pursuant to the terms of the Depomed Royalty Agreement. The product approval was earlier than initially expected. Based on the FDA approval and anticipated timing of the product launch, the Company adjusted the timing of future cash flows and discount rate used in the discounted cash flow model at June 30, 2016. Management re-evaluated, with assistance of a third-party expert, the cash flow

assumptions for Jentaducto XR and revised the discounted cash flow model. As of September 30, 2017, the Company's discounted cash flow analysis reflects its expectations as to the amount and timing of future cash flows up to the valuation date.

On September 21, 2016, the Company obtained a notification indicating that the FDA approved Invokamet XR for use in patients with Type 2 diabetes. The product approval triggered a \$5.0 million approval milestone payment to the Company pursuant to the terms of the Depomed Royalty Agreement. Based on the FDA approval and timing of the product launch, the Company adjusted the timing of future cash flows and discount rate used in the discounted cash flow model at September 30, 2017.

On December 13, 2016, the Company obtained a notification indicating that the FDA approved Synjardy XR for use in patients with Type 2 diabetes. The product approval triggered a \$6.0 million approval milestone payment to the Company pursuant to the terms of the Depomed Royalty Agreement. Based on the FDA approval and expected product launch, the Company adjusted the timing of future cash flows and discount rate used in the discounted cash flow model at September 30, 2017. In April 2017, Boehringer Ingelheim launched Synjardy XR.

As of September 30, 2017, the fair value of the asset acquired as reported in the Company's Condensed Consolidated Balance Sheet was \$222.7 million and the maximum loss exposure was \$222.7 million.

#### *VB Royalty Agreement*

On June 26, 2014, the Company entered into a Royalty Purchase and Sale Agreement (the "VB Royalty Agreement") with Viscogliosi Brothers, LLC ("VB"), whereby VB conveyed to the Company the right to receive royalties payable on sales of a spinal implant that has received pre-market approval from the FDA, in exchange for a \$15.5 million cash payment, less fees.

The royalty rights acquired includes royalties accruing from and after April 1, 2014. Under the terms of the VB Royalty Agreement, the Company receives all royalty payments due to VB pursuant to certain technology transfer agreements between VB and Paradigm Spine until the Company has received payments equal to 2.3 times the cash payment made to VB, after which all rights to receive royalties will be returned to VB. VB may repurchase the royalty right at any time on or before June 26, 2018, for a specified amount. The chief executive officer of Paradigm Spine is one of the owners of VB. The Paradigm Spine Credit Agreement and the VB Royalty Agreement were negotiated separately.

The fair value of the royalty right at September 30, 2017, was determined by using a discounted cash flow analysis related to the expected future cash flows to be received. This asset is classified as a Level 3 asset, as the Company's valuation utilized significant unobservable inputs, including estimates as to the probability and timing of future sales of the licensed product. The discounted cash flow was based upon expected royalties from sales of licensed product over a nine-year period. The discount rate utilized was approximately 17.5%. Significant judgment is required in selecting the appropriate discount rate. Should this discount rate increase or decrease by 2.5%, the fair value of this asset could decrease by \$1.2 million or increase by \$1.3 million, respectively. Should the expected royalties increase or decrease by 2.5%, the fair value of the asset could increase or decrease by \$0.4 million, respectively. A third-party expert was engaged to assist management with the development of its estimate of the expected future cash flows, when deemed necessary. The fair value of the asset is subject to variation should those cash flows vary significantly from the Company's estimates. At each reporting period, an evaluation is performed to assess those estimates, discount rates utilized and general market conditions affecting fair market value.

As of September 30, 2017, the fair value of the asset acquired as reported in the Company's Condensed Consolidated Balance Sheet was \$15.4 million and the maximum loss exposure was \$15.4 million.

#### *U-M Royalty Agreement*

On November 6, 2014, the Company acquired a portion of all royalty payments of the Regents of the University of Michigan's ("U-M") worldwide royalty interest in Cerdelga (elglustat) for \$65.6 million pursuant to the Royalty Purchase and Sale Agreement with U-M (the "U-M Royalty Agreement"). Under the terms of the U-M Royalty Agreement, the Company receives 75% of all royalty payments due under U-M's license agreement with Genzyme Corporation, a Sanofi company ("Genzyme") until expiration of the licensed patents, excluding any patent term extension. Cerdelga, an oral therapy for adult patients with Gaucher disease type 1, was developed by Genzyme. Cerdelga was approved in the United States on August 19, 2014, in the European Union on January 22, 2015, and in Japan in March 2015. In addition, marketing applications for Cerdelga are under review by other regulatory authorities. While marketing applications have been approved in the European Union and Japan, national pricing and reimbursement decisions are delayed in some countries. At June 30, 2016, a third-party expert was engaged by the Company to assess the impact of the delayed pricing and reimbursement decisions to Cerdelga's expected

future cash flows. Based on the analysis performed, management revised the underlying assumptions used in the discounted cash flow analysis at period end.

The fair value of the royalty right at September 30, 2017 was determined by using a discounted cash flow analysis related to the expected future cash flows to be received. This asset is classified as a Level 3 asset, as the Company's valuation utilized significant unobservable inputs, including estimates as to the probability and timing of future sales of the licensed product. The discounted cash flow was based upon expected royalties from sales of licensed product over a five-year period. The discount rate utilized was approximately 12.8%. Significant judgment is required in selecting the appropriate discount rate. Should this discount rate increase or decrease by 2.5%, the fair value of this asset could decrease by \$2.0 million or increase by \$2.2 million, respectively. Should the expected royalties increase or decrease by 2.5%, the fair value of the asset could increase by \$0.9 million or decrease by \$0.9 million, respectively. A third-party expert is engaged to assist management with the development of its estimate of the expected future cash flows, when deemed necessary. The fair value of the asset is subject to variation should those cash flows vary significantly from the Company's estimates. An evaluation of those estimates, discount rates utilized and general market conditions affecting fair market value is performed in each reporting period.

As of September 30, 2017, the fair value of the asset acquired as reported in the Company's Condensed Consolidated Balance Sheet was \$35.4 million and the maximum loss exposure was \$35.4 million.

#### *ARIAD Royalty Agreement*

On July 28, 2015, the Company entered into the revenue interest assignment agreement (the "ARIAD Royalty Agreement") with ARIAD Pharmaceuticals, Inc. ("ARIAD"), whereby the Company acquired the rights to receive royalties from ARIAD's net revenues generated by the sale, distribution or other use of Iclusig® (ponatinib), a cancer medicine for the treatment of adult patients with chronic myeloid leukemia, in exchange for up to \$200.0 million in cash payments. The purchase price of \$100.0 million was payable in two tranches of \$50.0 million each, with the first tranche having been funded on July 28, 2015 and the second tranche having been funded on July 28, 2016. Upon the occurrence of certain events, including a change of control of ARIAD, the Company had the right to require ARIAD to repurchase the royalty rights for a specified amount. The Company elected the fair value option to account for the hybrid instrument in its entirety. Any embedded derivative shall not be separated from the host contract. The asset acquired pursuant to the ARIAD Royalty Agreement represents a single unit of accounting.

In January 2017, Takeda Pharmaceutical Company Limited ("Takeda") announced that it had entered into a definitive agreement to acquire ARIAD. The acquisition was consummated on February 16, 2017 and the Company exercised its put option on the same day, which resulted in an obligation by Takeda to pay the Company a 1.2x multiple of the \$100.0 million funded by the Company under the ARIAD Royalty Agreement, less royalty payments already received by the Company.

On March 30, 2017, Takeda fulfilled its obligations under the put option and paid the Company the repurchase price of \$108.2 million for the royalty rights under the ARIAD Royalty Agreement.

#### *AcelRx Royalty Agreement*

On September 18, 2015, the Company entered into a royalty interest assignment agreement (the "AcelRx Royalty Agreement") with ARPI LLC, a wholly owned subsidiary of AcelRx Pharmaceuticals, Inc. ("AcelRx"), whereby the Company acquired the rights to receive a portion of the royalties and certain milestone payments on sales of Zalviso® (sufentanil sublingual tablet system) in the European Union, Switzerland and Australia by AcelRx's commercial partner, Grünenthal, in exchange for a \$65.0 million cash payment. Under the terms of the AcelRx Royalty Agreement, the Company will receive 75% of all royalty payments and 80% of the first four commercial milestone payments due under AcelRx's license agreement with Grünenthal until the earlier to occur of (i) receipt by the Company of payments equal to three times the cash payments made to AcelRx and (ii) the expiration of the licensed patents. Zalviso received marketing approval by the European Commission in September 2015. Grünenthal launched Zalviso in the second quarter of 2016 and the Company started to receive royalties in the third quarter of 2016.

As of September 30, 2017, and December 31, 2016, the Company determined that its royalty rights under the AcelRx Royalty Agreement represented a variable interest in a variable interest entity. However, the Company does not have the power to direct the activities of ARPI LLC that most significantly impact ARPI LLC's economic performance and is not the primary beneficiary of ARPI LLC; therefore, ARPI LLC is not subject to consolidation by the Company.

The fair value of the royalty right at September 30, 2017 was determined by using a discounted cash flow analysis related to the expected future cash flows to be received. This asset is classified as a Level 3 asset, as the Company's valuation utilized significant unobservable inputs, including estimates as to the probability and timing of future sales of the licensed product. The



discounted cash flow was based upon expected royalties from sales of licensed product over a fourteen-year period. The discount rate utilized was approximately 13.4%. Significant judgment is required in selecting the appropriate discount rate. Should this discount rate increase or decrease by 2.5%, the fair value of this asset could decrease by \$10.2 million or increase by \$12.6 million, respectively. Should the expected royalties increase or decrease by 2.5%, the fair value of the asset could increase or decrease by \$1.9 million, respectively. A third-party expert is engaged to assist management with the development of its estimate of the expected future cash flows, when deemed necessary. The fair value of the asset is subject to variation should those cash flows vary significantly from the Company's estimates. At each reporting period, an evaluation of those estimates, discount rates utilized and general market conditions affecting fair market value is performed in each reporting period.

As of September 30, 2017, the fair value of the asset acquired as reported in the Company's Condensed Consolidated Balance Sheet was \$74.1 million and the maximum loss exposure was \$74.1 million.

Dr. Stephen Hoffman is the President of 10x Capital, Inc., a third-party consultant to the Company, and is also a member of the board of directors of AcclRx. Dr. Hoffman recused himself from the AcclRx board of directors with respect to the entirety of its discussions and considerations of the transaction. Dr. Hoffman was compensated for his contribution to consummate this transaction by the Company as part of his consulting agreement with the Company. The Company concluded Dr. Hoffman is not considered a related party in accordance with ASC 850, *Related Party Disclosures* and SEC Regulation S-X, *Related Party Transactions Which Affect the Financial Statements*.

#### *Avinger Credit and Royalty Agreement*

On April 18, 2013, the Company entered into the Credit Agreement (the "Avinger Credit and Royalty Agreement") with Avinger, Inc. ("Avinger"), under which the Company made available to Avinger up to \$40.0 million (of which only \$20.0 million was funded) to be used by Avinger in connection with the commercialization of its lumivascular catheter devices and the development of Avinger's lumivascular atherectomy device. On September 22, 2015, Avinger elected to prepay the note receivable in whole (including interest and a prepayment fee) for a payment of \$21.4 million in cash.

Under the terms of the Avinger Credit and Royalty Agreement, the Company was entitled to receive royalties at a rate of 1.8% on Avinger's net revenues until the note receivable was repaid by Avinger. Upon the repayment of the note receivable by Avinger, which occurred on September 22, 2015, the royalty rate was reduced to 0.9%, subject to certain minimum payments from the prepayment date until April 2018. The Company has accounted for the royalty rights in accordance with the fair value option. The fair value of the royalty right at September 30, 2017 was determined by using a discounted cash flow analysis related to the expected future cash flows to be received. This asset is classified as a Level 3 asset, as the Company's valuation utilized significant unobservable inputs, including estimates as to the probability and timing of future sales of the licensed product. The discounted cash flow was based upon expected royalties from sales of licensed product over a one-year period. The discount rate utilized was approximately 15.0%. Significant judgment is required in selecting the appropriate discount rate. Should this discount rate increase or decrease by 5%, the fair value of this asset could decrease by \$16,000 or increase by \$17,000, respectively. Should the expected royalties increase or decrease by 5%, the fair value of the asset could increase or decrease by \$43,000, respectively. Management considered the contractual minimum payments when developing its estimate of the expected future cash flows. The fair value of the asset is subject to variation should those cash flows vary significantly from the Company's estimates. An evaluation of those estimates, discount rates utilized and general market conditions affecting fair market value is performed in each reporting period.

As of September 30, 2017, the fair value of the royalty asset as reported in the Company's Condensed Consolidated Balance Sheet was \$0.9 million and the maximum loss exposure was \$0.9 million.

#### *Kybella Royalty Agreement*

On July 8, 2016, the Company entered into a royalty purchase and sales agreement with an individual, whereby the Company acquired that individual's rights to receive certain royalties on sales of KYBELLA® by Allergan, in exchange for a \$9.5 million cash payment and up to \$1.0 million in future milestone payments based upon product sales targets. The Company started to receive royalty payments during the third quarter of 2016.

The fair value of the royalty right at September 30, 2017, was determined by using a discounted cash flow analysis related to the expected future cash flows to be received. This asset is classified as a Level 3 asset, as the Company's valuation utilized significant unobservable inputs, including estimates as to the probability and timing of future sales of the licensed product. The discounted cash flow was based upon expected royalties from sales of a licensed product over an eight-year period. The discount rate utilized was approximately 14.4%. Significant judgment is required in selecting the appropriate discount rate.

Should this discount rate increase or decrease by 2.5%, the fair value of this asset could decrease by \$0.3 million or increase by \$0.3 million, respectively. Should the expected royalties increase or decrease by 2.5%, the fair value of the asset could increase by \$0.1 million or decrease by \$0.1 million, respectively. A third-party expert is engaged to assist management with the development of its estimate of the expected future cash flows, when deemed necessary. The fair value of the asset is subject to variation should those cash flows vary significantly from the Company's estimates. At each reporting period, an evaluation of those estimates, discount rates utilized and general market conditions affecting fair market value is performed in each reporting period. Management re-evaluated the cash flow projections during the current period, concluding that lower demand data resulted in a reduction of expected future cash flows, which warranted a revision of the assumptions used in the discounted cash flow model at September 30, 2017.

As of September 30, 2017, the fair value of the asset acquired as reported in the Company's Condensed Consolidated Balance Sheet was \$3.5 million and the maximum loss exposure was \$3.5 million.

The following tables summarize the changes in Level 3 assets and liabilities and the gains and losses included in earnings for the nine months ended September 30, 2017:

**Fair Value Measurements Using Significant Unobservable Inputs (Level 3) - Royalty Rights Assets**

| <i>(in thousands)</i>                                  | <b>Royalty Rights -<br/>At Fair Value</b> |
|--|---|
| Fair value as of December 31, 2016                     | \$ 402,318                                |
| Financial instruments settled                          | (108,169)                                 |
| Total net change in fair for the period                |   |
| Change in fair value of royalty rights - at fair value | \$ 132,224                                |
| Proceeds from royalty rights - at fair value           | \$ (74,404)                               |
| Total net change in fair value for the period          | 57,820                                    |
| Fair value as of September 30, 2017                    | <u>\$ 351,969</u>                         |

**Fair Value Measurements Using Significant Unobservable Inputs (Level 3) - Royalty Rights Assets**

| <i>(in thousands)</i> | <b>Fair Value as of<br/>December 31, 2016</b> | <b>Change of<br/>Ownership</b> | <b>Royalty Rights -<br/>Change in Fair Value</b> | <b>Fair Value as of<br/>September 30, 2017</b> |
|-----------------------|---|--------------------------------|--|--|
| Depomed               | \$ 164,070                                    | \$ —                           | \$ 58,625  | \$ 222,695                                     |
| VB                    | 14,997  | —                              | 440  | 15,437   |
| U-M                   | 35,386  | —                              | 63   | 35,449   |
| ARIAD                 | 108,631                                       | (108,169)                      | (462)  | —  |
| AcelRx                | 67,483  | —                              | 6,582  | 74,065   |
| Avinger               | 1,638   | —                              | (777)  | 861  |
| KYBELLA               | 10,113  | —                              | (6,651)  | 3,462  |
|                       | <u>\$ 402,318</u>                             | <u>\$ (108,169)</u>            | <u>\$ 57,820</u>                                 | <u>\$ 351,969</u>                              |

**Fair Value Measurements Using Significant Unobservable Inputs (Level 3) - Liabilities**

| <i>(in thousands)</i>                   | <b>Anniversary<br/>Payment</b> | <b>Contingent<br/>Consideration</b> |
|---|--------------------------------|-------------------------------------|
| Fair value as of December 31, 2016      | \$ (88,001)                    | \$ (42,650)                         |
| Total net change in fair for the period | (999)                          | (2,350)                             |
| Settlement of financial instrument      | 89,000                         | —                                   |
| Fair value as of September 30, 2017     | <u>\$ —</u>                    | <u>\$ (45,000)</u>                  |

The fair value of the contingent consideration was determined using an income approach derived from the Noden Products (as defined in Note 18 below) revenue estimates and a probability assessment with respect to the likelihood of achieving (a) the level of net sales or (b) generic product launch that would trigger the milestone payments. The key assumptions in determining the fair value are the discount rate and the probability assigned to the potential milestones being achieved. The fair value of the contingent consideration is remeasured each reporting period, with changes in fair value recorded in the Condensed Consolidated Statements of Income. The change in fair value of the contingent consideration during the period ending September 30, 2017 is due primarily to the passage of time, as there have been no significant changes in the key assumptions used in the fair value calculation during the current period.

Gains and losses from changes in Level 3 assets included in earnings for each period are presented in “Royalty rights - change in fair value” and gains and losses from changes in Level 3 liabilities included in earnings for each period are presented in “Change in fair value of anniversary payment and contingent consideration” as follows:

| <i>(in thousands)</i>   | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---|---|-------------|--|-------------|
|   | <b>2017</b>                                 | <b>2016</b> | <b>2017</b>                                | <b>2016</b> |
| Total change in fair value for the period included in earnings for royalty right assets held at the end of the reporting period | \$ 35,353                                   | \$ 16,085   | \$ 132,224                                 | \$ (11,872) |
| Total change in fair value for the period included in earnings for liabilities held at the end of the reporting period          | \$ (700)                                    | \$ (2,083)  | \$ (3,349)                                 | \$ (2,083)  |

The following tables present the fair value of assets and liabilities not subject to fair value recognition by level within the valuation hierarchy:

|  | September 30, 2017 |                    |                    | December 31, 2016 |                    |                    |
|--|--------------------|--------------------|--------------------|-------------------|--------------------|--------------------|
|  | Carrying Value     | Fair Value Level 2 | Fair Value Level 3 | Carrying Value    | Fair Value Level 2 | Fair Value Level 3 |
| <i>(In thousands)</i>                              |                    |                    |                    |                   |                    |                    |
| Assets:  |                    |                    |                    |                   |                    |                    |
| Wellstat Diagnostics note receivable               | \$ 50,191          | \$ —               | \$ 52,288          | \$ 50,191         | \$ —               | \$ 52,260          |
| Hyperion note receivable                           | 1,200              | —                  | 1,200              | 1,200             | —                  | 1,200              |
| LENSAR note receivable <sup>(2)</sup>              | —                  | —                  | —                  | 43,909            | —                  | 43,900             |
| Direct Flow Medical note receivable <sup>(1)</sup> | —                  | —                  | —                  | 10,000            | —                  | 10,000             |
| kaléo note receivable <sup>(3)</sup>               | —                  | —                  | —                  | 146,685           | —                  | 142,539            |
| CareView note receivable                           | 19,245             | —                  | 19,900             | 18,965            | —                  | 19,200             |
| <b>Total</b>                                       | <b>\$ 70,636</b>   | <b>\$ —</b>        | <b>\$ 73,388</b>   | <b>\$ 270,950</b> | <b>\$ —</b>        | <b>\$ 269,099</b>  |
| Liabilities:                                       |                    |                    |                    |                   |                    |                    |
| February 2018 Notes                                | \$ 124,922         | \$ 126,131         | \$ —               | \$ 121,595        | \$ 123,918         | \$ —               |
| December 2021 Notes                                | 115,716            | 163,313            | —                  | 110,848           | 122,063            | —                  |
| <b>Total</b>                                       | <b>\$ 240,638</b>  | <b>\$ 289,444</b>  | <b>\$ —</b>        | <b>\$ 232,443</b> | <b>\$ 245,981</b>  | <b>\$ —</b>        |

<sup>(1)</sup> As a result of the foreclosure proceedings, the Company obtained ownership of most of the Direct Flow Medical assets through the Company's wholly-owned subsidiary, DFM, LLC. Those assets are held for sale and carried at the lower of carrying amount or fair value, less estimated selling cost, as of September 30, 2017. For a further discussions on this topic, see Note 7.

<sup>(2)</sup> As a result of the Company receiving 100% of LENSAR, Inc.'s equity securities in exchange for the cancellation of the Company's claims as a secured creditor in the Chapter 11 case, LENSAR, Inc. became a wholly-owned subsidiary of the Company on May 11, 2017. For further discussions on this topic, see Note 18.

<sup>(3)</sup> On September 21, 2017, the Company entered into a note purchase agreement whereby it sold to a third party the kaléo, Inc. note receivable for an aggregate cash purchase price of \$141.7 million, subject to an 18-month escrow hold back of \$1.4 million against certain potential contingencies.

As of September 30, 2017 and December 31, 2016, the estimated fair values of the Hyperion Catalysis International, Inc. note receivable, and CareView Communications, Inc. note receivable were determined using one or more discounted cash flow models, incorporating expected payments and the interest rate extended on the notes receivable, with fixed interest rates and incorporating expected payments for notes receivable with a variable rate of return. As of December 31, 2016, the estimated fair values of the kaléo, Inc. note receivable, LENSAR, Inc. note receivable, and Direct Flow Medical note receivable were also determined using the same method.

When deemed necessary, the Company engages a third-party valuation expert to assist in evaluating its investments and the related inputs needed to estimate the fair value of certain investments. The Company determined its notes receivable assets are Level 3 assets as the Company's valuations utilized significant unobservable inputs, including estimates of future revenues, discount rates, expectations about settlement, terminal values and required yield. To provide support for the estimated fair value measurements, the Company considered forward-looking performance related to the investment and current measures associated with high yield indices, and reviewed the terms and yields of notes placed by specialty finance and venture firms both across industries and in similar sectors.

The CareView note receivable is secured by substantially all assets and equity interests in CareView Communications, Inc. The Wellstat Diagnostics note is supported by a guaranty from the Wellstat Diagnostics Guarantors. The estimated fair value of the collateral assets was determined by using an asset approach and discounted cash flow model related to the underlying collateral and was adjusted to consider estimated costs to sell the assets.

On September 30, 2017, the carrying values of several of the Company's notes receivable differed from their estimated fair value. This is the result of discount rates used when performing a discounted cash flow for fair value valuation purposes. The

Company determined these notes receivable to be Level 3 assets, as its valuations utilized significant unobservable inputs, estimates of future revenues, expectations about settlement and required yield. To provide support for the fair value measurements, the Company considered forward-looking performance, and current measures associated with high yield and published indices, and reviewed the terms and yields of notes placed by specialty finance and venture firms both across industries and in a similar sector.

The fair values of the Company's convertible notes were determined using quoted market pricing or dealer quotes.

The following table represents significant unobservable inputs used in determining the estimated fair value of impaired notes receivable investments:

| Asset  | Valuation Technique    | Unobservable Input       | September 30, 2017 | December 31, 2016 |
|--|------------------------|--------------------------|--------------------|-------------------|
| <b><u>Wellstat Diagnostics</u></b>               |                        |                          |                    |                   |
| <i>Wellstat Guarantors Intellectual Property</i> | <i>Income Approach</i> |                          |                    |                   |
|  |                        | Discount rate            | 12%                | 13%               |
|  |                        | Royalty amount           | \$60 million       | \$54-74 million   |
| <i>Real Estate Property</i>                      | <i>Market Approach</i> |                          |                    |                   |
|  |                        | Annual appreciation rate | 4%                 | 4%                |
|  |                        | Estimated realtor fee    | 6%                 | 6%                |
|  |                        | Estimated disposal date  | 12/31/2018         | 12/31/2017        |
| <b><u>Direct Flow Medical</u></b>                |                        |                          |                    |                   |
| <i>All Assets</i>                                | <i>Income Approach</i> |                          |                    |                   |
|  |                        | Discount rate            | N/A                | 27%               |
|  |                        | Implied revenue multiple | N/A                | 6.9               |
| <b><u>LENSAR</u></b>                             |                        |                          |                    |                   |
| <i>All Assets</i>                                | <i>Income Approach</i> |                          |                    |                   |
|  |                        | Discount rate            | N/A                | 25%               |
|  |                        | Implied revenue multiple | N/A                | 2.5               |

At September 30, 2017, the Company had two notes receivable investments on non-accrual status with a cumulative investment cost and fair value of approximately \$51.4 million and \$53.5 million, respectively, compared to four note receivable investments on non-accrual status at December 31, 2016 with a cumulative investment cost and fair value of approximately \$105.3 million and \$107.4 million, respectively. For the three months ended September 30, 2017 and 2016, the Company did not recognize any interest for note receivable investments on non-accrual status. During the nine months ended September 30, 2017 and 2016, the Company recognized losses on extinguishment of notes receivable of \$12.2 million and zero, respectively.

#### 4. Cash, Cash Equivalents and Short-term Investments

As of September 30, 2017, and December 31, 2016, the Company had invested its excess cash balances primarily in cash, money market funds and commercial paper. The Company's securities are classified as available-for-sale and are carried at estimated fair value, with unrealized gains and losses reported in "Accumulated other comprehensive income" in stockholders' equity, net of estimated taxes. See Note 3 for fair value measurement information. The cost of securities sold is based on the specific identification method. To date, the Company has not experienced credit losses on investments in these instruments, and it does not require collateral for its investment activities.

The following tables summarize the Company's cash and available-for-sale securities' amortized cost, gross unrealized gains, gross unrealized losses, and fair value by significant investment category reported as cash and cash equivalents, or short-term investments as of September 30, 2017, and December 31, 2016:

|                           | Amortized Cost    | Unrealized Gains | Estimated Fair Value | Reported as:              |                        |
|---------------------------|-------------------|------------------|----------------------|---------------------------|------------------------|
|                           |                   |                  |                      | Cash and Cash Equivalents | Short-Term Investments |
| <i>(In thousands)</i>     |                   |                  |                      |                           |                        |
| <b>September 30, 2017</b> |                   |                  |                      |                           |                        |
| Cash                      | \$ 495,380        | \$ —             | \$ 495,380           | \$ 495,380                | \$ —                   |
| Money market funds        | 14,705            | —                | 14,705               | 14,705                    | —                      |
| Commercial paper          | 2,060             | —                | 2,060                | —                         | 2,060                  |
| Corporate securities      | 3,352             | 997              | 4,349                | —                         | 4,349                  |
| Total                     | <u>\$ 515,497</u> | <u>\$ 997</u>    | <u>\$ 516,494</u>    | <u>\$ 510,085</u>         | <u>\$ 6,409</u>        |
| <b>December 31, 2016</b>  |                   |                  |                      |                           |                        |
| Cash                      | \$ 147,150        | \$ —             | \$ 147,150           | \$ 147,150                | \$ —                   |
| Money market funds        | 4                 | —                | 4                    | 4                         | —                      |
| Commercial paper          | 19,987            | —                | 19,987               | —                         | 19,987                 |
| Total                     | <u>\$ 167,141</u> | <u>\$ —</u>      | <u>\$ 167,141</u>    | <u>\$ 147,154</u>         | <u>\$ 19,987</u>       |

The unrealized gains on investments included in "Other comprehensive income (loss), net of tax" was approximately \$648,000 and zero as of September 30, 2017, and December 31, 2016, respectively.

## 5. Concentration of Credit Risk

### Customer Concentration

The percentage of total revenue recognized, which individually accounted for 10% or more of the Company's total revenues, was as follows:

| Licensee  | Product Name  | Three Months Ended<br>September 30, |      | Nine Months Ended<br>September 30, |      |
|-----------|---|-------------------------------------|------|------------------------------------|------|
|           |   | 2017                                | 2016 | 2017                               | 2016 |
| Genentech | <i>Avastin</i>  | —%                                  | —%   | —%                                 | 22%  |
|           | <i>Herceptin</i>  | —%                                  | —%   | —%                                 | 22%  |
| Biogen    | <i>Tysabri®</i>   | 2%                                  | 28%  | 13%                                | 24%  |
| Depomed   | <i>Glumetza, Janumet XR, Jentaducto XR and Invokamet XR</i> | 50%                                 | 18%  | 50%                                | N/A  |
| N/A       | <i>Tekturna, Tekturna HCT, Rasilez and Rasilez HCT</i>      | 24%                                 | 26%  | 17%                                | 8%   |

*N/A = Not applicable*

## 6. Foreign Currency Hedging

The Company designates the foreign currency exchange contracts used to hedge its royalty revenues based on underlying Euro-denominated sales as cash flow hedges. Euro forward contracts are presented on a net basis on the Company's Condensed Consolidated Balance Sheets as it has entered into a netting arrangement with the counterparty. All Euro forward contracts were classified as cash flow hedges. There were no Euro forward contracts outstanding as of September 30, 2017 or December 31, 2016.

The effect of the Company's derivative instruments in its Condensed Consolidated Statements of Income and its Condensed Consolidated Statements of Comprehensive Income were as follows:

|   | Three Months Ended |      | Nine Months Ended |          |
|---|--------------------|------|-------------------|----------|
|   | September 30,      |      | September 30,     |          |
|   | 2017               | 2016 | 2017              | 2016     |
| <i>(In thousands)</i>   |                    |      |                   |          |
| Gain (loss) reclassified from accumulated OCI into "Queen et al. royalty revenue," net of tax (2) | \$ —               | \$ — | \$ —              | \$ 1,821 |

(1) Net change in the fair value of cash flow hedges, net of tax.

(2) Effective portion classified as royalty revenue.

## 7. Notes and Other Long-Term Receivables

Notes and other long-term receivables included the following significant agreements:

### *Wellstat Diagnostics Note Receivable and Credit Agreement and Related Litigation*

On November 2, 2012, the Company and Wellstat Diagnostics entered into a \$40.0 million credit agreement pursuant to which the Company was to accrue quarterly interest payments at the rate of 5% per annum (payable in cash or in kind). In addition, the Company was to receive quarterly royalty payments based on a low double-digit royalty rate of Wellstat Diagnostics' net revenues, generated by the sale, distribution or other use of Wellstat Diagnostics' products, if any, commencing upon the commercialization of its products. A portion of the proceeds of the \$40.0 million credit agreement were used to repay certain notes receivable which Wellstat Diagnostics entered into in March 2012.

In January 2013, the Company was informed that, as of December 31, 2012, Wellstat Diagnostics had used funds contrary to the terms of the credit agreement and breached Sections 2.1.2 and 7 of the credit agreement. The Company sent Wellstat Diagnostics a notice of default on January 22, 2013, and accelerated the amounts owed under the credit agreement. In connection with the notice of default, the Company exercised one of its available remedies and transferred approximately \$8.1 million of available cash from a bank account of Wellstat Diagnostics to the Company and applied the funds to amounts due under the credit agreement. On February 28, 2013, the parties entered into a forbearance agreement whereby the Company agreed to refrain from exercising additional remedies for 120 days. During such forbearance period, the Company provided approximately \$1.3 million to Wellstat Diagnostics to fund ongoing operations of the business. During the year ended December 31, 2013, approximately \$8.7 million was advanced pursuant to the forbearance agreement.

On August 15, 2013, the Company entered into an amended and restated credit agreement with Wellstat Diagnostics. The Company determined that the new agreement should be accounted for as a modification of the existing agreement.

Except as otherwise described herein, the material terms of the amended and restated credit agreement are substantially the same as those of the original credit agreement, including quarterly interest payments at the rate of 5% per annum (payable in cash or in kind). In addition, the Company was to continue to receive quarterly royalty payments based on a low double-digit royalty rate of Wellstat Diagnostics' net revenues. However, pursuant to the amended and restated credit agreement: (i) the principal amount was reset to approximately \$44.1 million, which was comprised of approximately \$33.7 million original loan principal and interest, \$1.3 million term loan principal and interest and \$9.1 million forbearance principal and interest; (ii) the specified internal rates of return increased; (iii) the default interest rate was increased; (iv) Wellstat Diagnostics' obligation to provide certain financial information increased in frequency to monthly; (v) internal financial controls were strengthened by requiring Wellstat Diagnostics to maintain an independent, third-party financial professional with control over fund disbursements; (vi) the Company waived the existing events of default; and (vii) the owners and affiliates of Wellstat Diagnostics were required to contribute additional capital to Wellstat Diagnostics upon the sale of an affiliate entity. The amended and restated credit agreement had an ultimate maturity date of December 31, 2021 (but has subsequently been accelerated as described below).

In June 2014, the Company received information from Wellstat Diagnostics showing that it was generally unable to pay its debts as they became due, constituting an event of default under the amended and restated credit agreement.

On August 5, 2014, the Company delivered a notice of default (the "Wellstat Diagnostics Borrower Notice") to Wellstat Diagnostics, which accelerated all obligations under the amended and restated credit agreement and demanded immediate payment in full in an amount equal to approximately \$53.9 million (which amount, in accordance with the terms of the

amended and restated credit agreement, included an amount that, together with interest and royalty payments already made to the Company, would generate a specified internal rate of return to the Company), plus accruing fees, costs and interest, and demanded that Wellstat Diagnostics protect and preserve all collateral securing its obligations.

On August 7, 2014, the Company delivered a notice (the “Wellstat Diagnostics Guarantor Notice”) to each of the guarantors of Wellstat Diagnostics’ obligations to the Company (collectively, the “Wellstat Diagnostics Guarantors”) under the credit agreement, which included a demand that the guarantors remit payment to the Company in the amount of the outstanding obligations. The guarantors include certain affiliates and related companies of Wellstat Diagnostics, including Wellstat Therapeutics and Wellstat Diagnostics’ stockholders.

On September 24, 2014, the Company filed an ex-parte petition for appointment of receiver with the Circuit Court of Montgomery County, Maryland (the “Wellstat Diagnostics Petition”), which was granted on the same day. Wellstat Diagnostics remained in operation during the period of the receivership with incremental additional funding from the Company. On May 24, 2017, Wellstat Diagnostics transferred substantially all of its assets to the Company pursuant to a credit bid. The credit bid reduced the outstanding balance of the loan by an immaterial amount.

On September 4, 2015, the Company filed in the Supreme Court of New York a motion for summary judgment in lieu of complaint which requested that the court enter judgment against certain of the Wellstat Diagnostics Guarantors for the total amount due on the Wellstat Diagnostics debt, plus all costs and expenses including lawyers’ fees incurred by the Company in enforcement of the related guarantees. On September 23, 2015, the Company filed in the same court an ex parte application for a temporary restraining order and order of attachment of the Wellstat Diagnostics Guarantor defendants’ assets. Although the court denied the Company’s request for a temporary restraining order at a hearing on September 24, 2015, it ordered that assets of the Wellstat Diagnostics Guarantor defendants should be held in *status quo ante* and only used in the normal course of business pending the outcome of the matters under consideration at the hearing.

On July 29, 2016, the Supreme Court of New York granted the Company’s motion for summary judgment and held that the Wellstat Diagnostics Guarantor defendants are liable for all “Obligations” owed by Wellstat Diagnostics to the Company. After appeal by the Wellstat Diagnostics Guarantor defendants, on February 14, 2017, the Appellate Division of the Supreme Court of New York reversed on procedural grounds a portion of the Memorandum of Decision granting the Company summary judgment in lieu of complaint, but affirmed the portion of the Memorandum of Decision denying the Wellstat Diagnostics Guarantor defendants’ motion for summary judgment in which they sought a determination that the guarantees had been released. As a result, the litigation has been remanded to the Supreme Court of New York to proceed on the Company’s claims as a plenary action. On June 21, 2017, the Supreme Court of New York ordered the Company to file a Complaint, which was filed by the Company on July 20, 2017. The Wellstat Diagnostics Guarantors filed their answer on August 9, 2017, including counterclaims against the Company alleging breach of contract breach of fiduciary duty, and tortious interference with prospective economic advantage. This case is currently pending and in the pre-trial phase.

On October 14, 2016, the Company sent a notice of default and reference to foreclosure proceedings to certain of the Wellstat Diagnostics Guarantors which are not defendants in the New York action, but which are owners of real estate assets over which a deed of trust in favor of the Company securing the guarantee of the loan to Wellstat Diagnostics had been executed. On March 2, 2017, the Company sent a second notice to foreclose on the real estate assets, and noticed the sale for March 29, 2017. The sale was taken off the calendar by the trustee under the deed of trust and has not been re-scheduled yet. On March 6, 2017, the Company sent a letter to the Wellstat Diagnostics Guarantors seeking information in preparation for a UCC Article 9 sale of some or all of the intellectual property-related collateral of the Wellstat Diagnostics Guarantors. The Wellstat Diagnostics Guarantors did not respond to the Company’s letter, but on March 17, 2017, filed an order to show cause with the New York Supreme Court to enjoin the Company’s sale of the real estate or enforcing its security interests in the Wellstat Diagnostics Guarantors’ intellectual property during the pendency of any action involving the guarantees at issue. The court has not yet decided the Wellstat Diagnostics Guarantor motions, but reaffirmed the Wellstat Diagnostics Guarantors’ obligations to maintain the status quo with respect to their assets. In October 2017, the Company filed a motion with the New York Supreme Court requesting an attachment of a potential \$55.8 million damages award, plus interest, entered against BTG International, Inc. in favor of Wellstat Therapeutics in Delaware Chancery Court on September 19, 2017. The New York Supreme Court has not yet considered the Company’s motion.

On October 22, 2015, certain of the Wellstat Diagnostics Guarantors filed a separate complaint against the Company in the Supreme Court of New York seeking a declaratory judgment that certain contractual arrangements entered into between the parties subsequent to Wellstat Diagnostics’ default, and which relate to a split of proceeds in the event that the Wellstat Diagnostics Guarantors voluntarily monetize any assets that are the Company’s collateral, is of no force or effect. This case is currently pending and the Supreme Court has instructed the Parties to coordinate this case with the pending case filed by the Company against the Wellstat Diagnostics Guarantors’ discussed above with respect to pre-trial activities.



Effective April 1, 2014, and as a result of the event of default, the Company determined the loan to be impaired and it ceased to accrue interest revenue. At that time and as of September 30, 2017, it has been determined that an allowance on the carrying value of the note was not necessary, as the Company believes the value of the collateral securing Wellstat Diagnostics' obligations exceeds the carrying value of the asset and is sufficient to enable the Company to recover the current carrying value of \$50.2 million. The Company continues to closely monitor the timing and expected recovery of amounts due, including litigation and other matters related to Wellstat Diagnostics Guarantors' assets. There can be no assurance that an allowance on the carrying value of the notes receivable investment will not be necessary in a future period depending on future developments.

#### *Hyperion Agreement*

On January 27, 2012, the Company and Hyperion Catalysis International, Inc. ("Hyperion") (which is also a Wellstat Diagnostics Guarantor) entered into an agreement whereby Hyperion sold to the Company the royalty streams due from SDK related to a certain patent license agreement between Hyperion and SDK dated December 31, 2008. The agreement assigned the patent license agreement royalty stream accruing from January 1, 2012 through December 31, 2013, to the Company in exchange for the lump sum payment to Hyperion of \$2.3 million. In exchange for the lump sum payment, the Company was to receive two equal payments of \$1.2 million on each of March 5, 2013 and 2014. The first payment of \$1.2 million was paid on March 5, 2013, but Hyperion has not made the second payment that was due on March 5, 2014. The Company completed an impairment analysis as of September 30, 2017. Effective with this date and as a result of the event of default, the Company ceased to accrue interest revenue. As of September 30, 2017, the estimated fair value of the collateral was determined to be in excess of the carrying value. There can be no assurance that this will be true in the event of the Company's foreclosure on the collateral, nor can there be any assurance of realizing value from such collateral.

#### *Avinger Credit and Royalty Agreement*

Under the terms of the Avinger Credit and Royalty Agreement, the Company receives a low, single-digit royalty on Avinger's net revenues until April 2018. Commencing in October 2015, after Avinger repaid \$21.4 million pursuant to its note receivable prior to its maturity date, the royalty on Avinger's net revenues reduce by 50%, subject to certain minimum payments from the prepayment date until April 2018. The Company has accounted for the royalty rights in accordance with the fair value option. For a further discussion of the Avinger Credit and Royalty Agreement, see Note 3.

#### *LENSAR Credit Agreement*

On October 1, 2013, the Company entered into a credit agreement with LENSAR, Inc. ("LENSAR"), pursuant to which the Company made available to LENSAR up to \$60.0 million to be used by LENSAR in connection with the commercialization of its currently marketed LENSAR™ Laser System. Of the \$60.0 million available to LENSAR, an initial \$40.0 million, net of fees, was funded by the Company at the close of the transaction. The remaining \$20.0 million, in the form of a second tranche is no longer available to LENSAR under the terms of the credit agreement. Outstanding borrowings under the loans bore interest at the rate of 15.5% per annum, payable quarterly in arrears.

On May 12, 2015, the Company entered into a forbearance agreement with LENSAR, pursuant to which the Company agreed to refrain from exercising certain remedies available to it resulting from the failure of LENSAR to comply with a liquidity covenant and make interest payments due under the credit agreement. Under the forbearance agreement, the Company agreed to provide LENSAR with up to an aggregate of \$8.5 million in weekly increments through the period ended September 30, 2015 plus employee retention amounts of approximately \$0.5 million in the form of additional loans, subject to LENSAR meeting certain milestones related to LENSAR obtaining additional capital to fund the business or sell the business and repay outstanding amounts under the credit agreement. In exchange for the forbearance, LENSAR agreed to additional reporting covenants, the engagement of a chief restructuring officer and an increase on the interest rate to 18.5%, applicable to all outstanding amounts under the credit agreement.

On September 30, 2015, the Company agreed to extend the forbearance agreement until October 9, 2015 and provide for up to an additional \$0.8 million in funding while LENSAR negotiated a potential sale of its assets. On October 9, 2015, the forbearance agreement expired, but the Company agreed to fund LENSAR's operations while LENSAR continued to negotiate a potential sale of its assets.

On November 15, 2015, LENSAR, LLC ("LENSAR/Alphaeon"), a wholly owned subsidiary of Alphaeon Corporation ("Alphaeon"), and LENSAR entered into the Asset Purchase Agreement whereby LENSAR/Alphaeon agreed to acquire certain assets of LENSAR and assumed certain liabilities of LENSAR. The acquisition was consummated on December 15, 2015.

In connection with the closing of the acquisition, LENSAR/Alphaeon entered into an amended and restated credit agreement with the Company, assuming \$42.0 million in loans as part of the borrowings under the Company's prior credit agreement with LENSAR. In addition, Alphaeon issued 1.7 million shares of its Class A common stock to the Company.

The Company has estimated a fair value of \$3.84 per share for the 1.7 million shares of Alphaeon Class A common stock received in connection with the transactions and recognized this investment as a cost-method investment of \$6.6 million included in other long-term assets. The Alphaeon Class A common stock is subject to other-than-temporary impairment assessments in future periods. There is no other-than-temporary impairment charge incurred as of September 30, 2017.

In December 2016, LENSAR, re-acquired the assets from LENSAR/Alphaeon and the Company entered into a second amended and restated credit agreement with LENSAR whereby LENSAR assumed all obligations under the amended and restated credit agreement with LENSAR/Alphaeon. Also in December, LENSAR filed for a voluntary petition under Chapter 11 of the U.S. Bankruptcy Code ("Chapter 11 case") with the support of the Company. In January 2017, the Company agreed to provide debtor-in-possession financing of up to \$2.8 million in new advances to LENSAR so that it could continue to operate its business during the Chapter 11 case. LENSAR filed a Chapter 11 plan of reorganization with the Company's support under which LENSAR would issue 100% of its equity securities to the Company in exchange for the cancellation of the Company's claims as a secured creditor in the Chapter 11 case, other than with respect to the debtor-in-possession financing, and would thereby become an operating subsidiary of the Company. On April 26, 2017, the bankruptcy court approved the plan of reorganization.

Pursuant to the plan of reorganization, LENSAR emerged from bankruptcy on May 11, 2017 as a wholly-owned subsidiary of the Company, and the Company started to consolidate LENSAR's financial statements under the voting interest model beginning May 11, 2017.

For additional information on LENSAR please refer to Note 9 under "Intangible Assets and Goodwill," Note 18 under "Business Combinations" and Note 19 under "Segment Information."

#### *Direct Flow Medical Credit Agreement*

On November 5, 2013, the Company entered into a credit agreement with Direct Flow Medical, Inc. ("Direct Flow Medical") under which the Company agreed to provide up to \$50.0 million to Direct Flow Medical. Of the \$50.0 million available to Direct Flow Medical, an initial \$35.0 million (tranche one), net of fees, was funded by the Company at the close of the transaction.

On November 10, 2014, the Company and Direct Flow Medical agreed to an amendment to the credit agreement to permit Direct Flow Medical to borrow the \$15.0 million second tranche upon receipt by Direct Flow Medical of a specified minimum amount of proceeds from an equity offering prior to December 31, 2014. In exchange, the parties amended the credit agreement to provide for additional fees associated with certain liquidity events, such as a change of control or the consummation of an initial public offering, and granted the Company certain board of director observation rights. On November 19, 2014, upon Direct Flow Medical satisfying the amended tranche two milestone, the Company funded the \$15.0 million second tranche to Direct Flow Medical, net of fees.

Outstanding borrowings under tranche one bore interest at the rate of 15.5% per annum, payable quarterly in arrears, until the occurrence of the second tranche. Upon occurrence of the borrowing of this second tranche, the interest rate applicable to all loans under the credit agreement was decreased to 13.5% per annum, payable quarterly in arrears.

Under the terms of the credit agreement, Direct Flow Medical's obligation to repay loan principal commenced on the twelfth interest payment date, September 30, 2016. The principal amount outstanding at commencement of repayment was required to be repaid in equal installments until final maturity of the loans. The loans were to mature on November 5, 2018. The obligations under the credit agreement were secured by a pledge of substantially all the assets of Direct Flow Medical and any of its subsidiaries.

On December 21, 2015, Direct Flow Medical and the Company entered into a waiver to the credit agreement in anticipation of Direct Flow Medical being unable to comply with the liquidity covenant and make interest payments due under the credit agreement, which was subsequently extended on January 14, 2016, and further delayed the timing of the interest payments through the period ending September 30, 2016 while Direct Flow Medical sought additional financing to operate its business.

On January 28, 2016, the Company funded an additional \$5.0 million to Direct Flow Medical in the form of a short-term secured promissory note.

On February 26, 2016, the Company and Direct Flow Medical entered into the fourth amendment to the credit agreement that, among other things, (i) converted the \$5.0 million short-term secured promissory note into a loan under the credit agreement with substantially the same interest and payment terms as the existing loans, (ii) added a conversion feature whereby the \$5.0 million loan would convert into equity of Direct Flow Medical upon the occurrence of certain events and (iii) provided for a second \$5.0 million convertible loan tranche commitment, to be funded at the option of the Company. The commitment for the second tranche was not funded and has since expired. In addition, (i) the Company agreed to waive the liquidity covenant and delay the timing of the unpaid interest payments until September 30, 2016 and (ii) Direct Flow Medical agreed to issue to the Company a specified amount of warrants to purchase shares of convertible preferred stock on the first day of each month for the duration of the waiver period at an exercise price of \$0.01 per share.

On July 15, 2016, the Company and Direct Flow Medical entered into the fifth amendment and limited waiver to the credit agreement. The Company funded an additional \$1.5 million to Direct Flow Medical in the form of a note with substantially the same interest and payment terms as the existing loans and a conversion feature whereby the \$1.5 million loan would convert into equity of Direct Flow Medical upon the occurrence of certain events. In addition, Direct Flow Medical agreed to issue to the Company warrants to purchase shares of convertible preferred stock at an exercise price of \$0.01 per share.

On September 12, 2016, the Company and Direct Flow Medical entered into the sixth amendment and limited waiver to the credit agreement under which the Company funded an additional \$1.5 million to Direct Flow Medical in the form of a note with substantially the same interest and payment terms as the existing loans. In addition, Direct Flow Medical agreed to issue to the Company a specified amount of warrants to purchase shares of convertible preferred stock at an exercise price of \$0.01 per share.

On September 30, 2016, the Company and Direct Flow Medical entered into a waiver to the credit agreement where the parties agreed, among other things, to (i) delay payment on all overdue interest payments until October 31, 2016, (ii) waive the initial principal repayment until October 31, 2016 and (iii) continue to waive the liquidity requirements until October 31, 2016. Further, Direct Flow Medical agreed to issue to the Company a specified amount of warrants to purchase shares of convertible preferred stock at an exercise price of \$0.01 per share.

On October 31, 2016, the Company agreed to extend the waivers described above until November 30, 2016 and on November 14, 2016, the Company advanced an additional \$1.0 million loan while Direct Flow Medical continued to seek additional financing.

On November 16, 2016, Direct Flow Medical advised the Company that its potential financing source had modified its proposal from an equity investment to a loan with a substantially smaller amount and under less favorable terms. Direct Flow Medical shut down its operations in December 2016 and in January 2017 made an assignment for the benefit of creditors. The Company then initiated foreclosure proceedings, resulting in the Company obtaining ownership of most of the Direct Flow Medical assets through the Company's wholly-owned subsidiary, DFM, LLC. The assets are held for sale and carried at the lower of carrying amount or fair value, less estimated selling costs, which is primarily based on supporting data from market participant sources, and valid offers from third parties.

At December 31, 2016, the Company completed an impairment analysis and concluded that the situation qualified as a troubled debt restructuring and recognized an impairment loss of \$51.1 million.

In January 2017, the Company started to actively market the asset held for sale. On January 23, 2017, the Company and DFM, LLC entered into an Intellectual Property Assignment Agreement with Hong Kong Haisco Pharmaceutical Co., Limited ("Haisco"), a Chinese pharmaceutical company, whereby Haisco acquired former Direct Flow Medical clinical, regulatory and commercial information and intellectual property rights exclusively in China for \$7.0 million. The Company, through DFM, LLC also sold Haisco certain manufacturing equipment for \$450,000 and collected \$692,000 on outstanding Direct Flow Medical accounts receivable during the nine months ended September 30, 2017. The Company is exploring alternatives to further monetize the remaining assets of Direct Flow Medical and has ascribed a carrying value of \$1.8 million to the remaining assets held for sale at September 30, 2017.

#### *Paradigm Spine Credit Agreement*

On February 14, 2014, the Company entered into the Credit Agreement (the "Paradigm Spine Credit Agreement") with Paradigm Spine, LLC ("Paradigm Spine"), under which it made available to Paradigm Spine up to \$75.0 million to be used by

Paradigm Spine to refinance its existing credit facility and expand its domestic commercial operations. Of the \$75.0 million available to Paradigm Spine, an initial \$50.0 million, net of fees, was funded by the Company at the close of the transaction. The second and third tranches of up to an additional \$25.0 million in the aggregate, net of fees, are no longer available under the terms of the Paradigm Spine Credit Agreement.

On October 27, 2015, the Company and Paradigm Spine entered into an amendment to the Paradigm Spine Credit Agreement to provide additional term loan commitments of up to \$7.0 million payable in two tranches, of which the first tranche of \$4.0 million was drawn on the closing date of the amendment, net of fees. Paradigm Spine chose not to draw down the second tranche of \$3.0 million and such tranche is no longer available. Borrowings under the credit agreement bore interest at the rate of 13.0% per annum, payable quarterly in arrears.

On August 26, 2016, the Company received \$57.5 million in connection with the prepayment of the loans under the Paradigm Spine Credit Agreement, which included a repayment of the full principal amount outstanding of \$54.7 million, plus accrued interest and a prepayment fee.

#### *kaléo Note Purchase Agreement*

On April 1, 2014, the Company entered into a note purchase agreement with Accel 300, LLC (“Accel 300”), a wholly-owned subsidiary of kaléo, Inc. (“kaléo”), pursuant to which the Company acquired \$150.0 million of secured notes due 2029 (the “kaléo Note”). The kaléo Note was issued pursuant to an indenture between Accel 300 and U.S. Bank, National Association, as trustee, and was secured by 20% of net sales of its first approved product, Auvi-Q® (epinephrine auto-injection, USP) (known as Allerject® in Canada) and 10% of net sales of kaléo’s second proprietary auto-injector based product, EVZIO (naloxone hydrochloride injection) (the “kaléo Revenue Interests”), and a pledge of kaléo’s equity ownership in Accel 300.

On September 21, 2017, the Company entered into an agreement (the “kaléo Note Sale Agreement”) with MAM-Kangaroo Lender, LLC, a Delaware limited liability company (the “Purchaser”), pursuant to which the Company sold its entire interest in the kaléo Note.

Pursuant to the kaléo Note Sale Agreement, the Purchaser paid to the Company an amount equal to 100% of the then outstanding principal, a premium of 1% of such amount and accrued interest under the kaléo Note, for an aggregate cash purchase price of \$141.7 million, subject to an 18-month escrow holdback of \$1.4 million against certain potential contingencies. For further discussion on this topic, see Note 11.

The kaléo Note bore interest at 13% per annum, paid quarterly in arrears on principal outstanding. The principal balance of the kaléo Note was to be repaid to the extent that the kaléo Revenue Interests exceed the quarterly interest payment, as limited by a quarterly payment cap. The final maturity of the kaléo Note was June 2029; although, kaléo had the right to redeem the kaléo Note at any time, subject to a redemption premium.

#### *CareView Credit Agreement*

On June 26, 2015, the Company entered into a credit agreement with CareView, under which the Company made available to CareView up to \$40.0 million in two tranches of \$20.0 million each. Under the terms of the credit agreement, the first tranche of \$20.0 million, net of fees, was funded by the Company upon CareView’s attainment of a specified milestone relating to the placement of CareView Systems®, on October 7, 2015. On October 7, 2015, the Company and CareView entered into an amendment of the credit agreement to modify certain definitions related to the first and second tranche milestones. The second \$20.0 million tranche would be funded upon CareView’s attainment of specified milestones relating to the placement of CareView Systems and consolidated earnings before interest, taxes, depreciation and amortization, to be accomplished no later than June 30, 2017. Such milestones were not achieved, and there is no additional funding obligation due from the Company. Outstanding borrowings under the credit agreement will bear interest at the rate of 13.5% per annum and are payable quarterly in arrears.

As part of the transaction, the Company received a warrant to purchase approximately 4.4 million shares of common stock of CareView at an exercise price of \$0.45 per share. The Company has accounted for the warrant as derivative asset with an offsetting credit as debt discount. At each reporting period, the warrant is marked to market for changes in fair value.

In connection with the October 2015 amendment of the credit agreement, the Company and CareView also agreed to amend the warrant to purchase common stock agreement by reducing the warrant’s exercise price from \$0.45 to \$0.40 per share. At September 30, 2017, the Company determined an estimated fair value of the warrant to be less than \$0.1 million.

For carrying value and fair value information related to the Company's Notes and Other Long-term Receivables, see Note 3.

## 8. Inventories

Inventories consisted of the following (in thousands):

|                 | September 30,<br>2017 | December 31,<br>2016 |
|-----------------|-----------------------|----------------------|
| Raw materials   | \$ 1,204              | \$ —                 |
| Work in process | 3,950                 | 1,625                |
| Finished goods  | 7,062                 | 1,259                |
| Total inventory | <u>\$ 12,216</u>      | <u>\$ 2,884</u>      |

In addition, as of September 30, 2017 and December 31, 2016, the Company deferred approximately \$1.1 million and \$0.1 million, respectively, of costs associated with inventory transfer made under the Company's third party logistic provider service arrangement. These costs have been recorded as other assets on the Company's Condensed Consolidated Balance Sheet as of September 30, 2017 and December 31, 2016. The Company will recognize the cost of product sold as inventory is transferred from its third party logistic provider to the Company's customers.

During the third quarter of 2017 and fourth quarter of 2016, the Company recognized an inventory write-down of \$0.1 million and \$0.3 million, respectively, related to Noden Products that the Company would not be able to sell prior to their expiration.

## 9. Intangible Assets and Goodwill

### *Intangible Assets, Net*

The components of intangible assets as of September 30, 2017 and December 31, 2016 were as follows:

| <i>(in thousands)</i>                    | September 30, 2017 |                             |                   | December 31, 2016 |                             |                   |
|--|--------------------|-----------------------------|-------------------|-------------------|-----------------------------|-------------------|
|  | Cost               | Accumulated<br>Amortization | Net               | Cost              | Accumulated<br>Amortization | Net               |
| <b>Finite-lived intangible assets:</b>   |                    |                             |                   |                   |                             |                   |
| Acquired products rights <sup>(1)</sup>  | \$ 216,690         | \$ (27,086)                 | \$ 189,604        | \$ 216,690        | \$ (10,834)                 | \$ 205,856        |
| Customer relationships <sup>(1)(2)</sup> | 26,080             | (3,077)                     | 23,003            | 23,880            | (1,194)                     | 22,686            |
| Acquired technology <sup>(2)</sup>       | 9,200              | (255)                       | 8,945             | —                 | —                           | —                 |
| Acquired trademarks <sup>(2)</sup>       | 570                | (48)                        | 522               | —                 | —                           | —                 |
|  | <u>\$ 252,540</u>  | <u>\$ (30,466)</u>          | <u>\$ 222,074</u> | <u>\$ 240,570</u> | <u>\$ (12,028)</u>          | <u>\$ 228,542</u> |

(1) The Company acquired certain intangible assets as part of the Noden Transaction, as described further in Note 18. They are amortized on a straight-line basis over a weighted average period of 10.0 years.

(2) The Company acquired certain intangible assets as part of the LENSAR transaction, as described further in Note 18. They are amortized over a weighted average period of 15 years. The intangible assets for acquired technology and trademarks are being amortized over their estimated useful lives using the straight-line method of amortization. The intangible assets for customer relationships are being amortized using a double-declining method of amortization as such method better represents the economic benefits to be obtained.

Amortization expense for the nine months ended September 30, 2017 was \$18.4 million.

Based on the intangible assets recorded at September 30, 2017, and assuming no subsequent additions to or impairment of the underlying assets, the remaining estimated amortization expense is expected to be as follows (in thousands):

| <b>Fiscal Year</b>               | <b>Amount</b>     |
|----------------------------------|-------------------|
| 2017 (Remaining three months)    | \$ 6,251          |
| 2018                             | 24,989            |
| 2019                             | 24,969            |
| 2020                             | 24,950            |
| 2021                             | 24,934            |
| 2022                             | 24,843            |
| Thereafter                       | 91,138            |
| Total intangible assets acquired | <u>\$ 222,074</u> |

### **Goodwill**

Goodwill is the excess of the cost of an acquired entity over the net amounts assigned to tangible and intangible assets acquired and liabilities assumed. The Company applies ASC 350, Goodwill and Other Intangible Assets, which requires testing goodwill for impairment on an annual basis. The Company assesses goodwill for impairment as part of its annual reporting process in the fourth quarter. The Company evaluates goodwill on a reporting unit basis as the Company is organized as a multiple reporting unit.

### **10. Accrued Liabilities**

Accrued liabilities consist of the following:

| <i>(in thousands)</i>                                   | <b>September 30,<br/>2017</b> | <b>December 31,<br/>2016</b> |
|---|-------------------------------|------------------------------|
| Compensation  | \$ 8,332                      | \$ 3,131                     |
| Interest  | 2,218                         | 2,554                        |
| Deferred revenue  | 3,761                         | —                            |
| Dividend payable  | 122                           | 21                           |
| Legal   | 585                           | 1,594                        |
| Accrued rebates, chargebacks and other revenue reserves | 20,652                        | 12,338                       |
| Refund to manufacturer                                  | 693                           | 8,909                        |
| Customer advances                                       | 13,469                        | —                            |
| Other   | 1,775                         | 2,028                        |
| Total   | <u>\$ 51,607</u>              | <u>\$ 30,575</u>             |

The following table provides a summary of activity with respect to the Company's sales allowances and accruals for the nine months ended September 30, 2017:

| <i>(in thousands)</i>                     | <b>Discount and<br/>Distribution Fees</b> | <b>Government<br/>Rebates and<br/>Chargebacks</b> | <b>Assistance and<br/>Other Discounts</b> | <b>Product Return</b> | <b>Total</b>     |
|---|---|---|---|-----------------------|------------------|
| Balance at December 31, 2016:             | \$ 2,475                                  | \$ 5,514  | \$ 2,580                                  | \$ 1,769              | \$ 12,338        |
| Allowances for current period sales       | 6,565                                     | 14,455  | 6,625                                     | 3,054                 | 30,699           |
| Allowances for prior period sales         | —   | 253   | —   | —                     | 253              |
| Credits/payments for current period sales | (3,048)                                   | (4,720)   | (4,435)                                   | (1,145)               | (13,348)         |
| Credits/payments for prior period sales   | (2,425)                                   | (4,353)   | (1,488)                                   | (1,024)               | (9,290)          |
| Balance at September 30, 2017:            | <u>\$ 3,567</u>                           | <u>\$ 11,149</u>                                  | <u>\$ 3,282</u>                           | <u>\$ 2,654</u>       | <u>\$ 20,652</u> |

## 11. Commitments and Contingencies

### *PDL BioPharma, Inc. v Merck Sharp & Dohme, Corp.*

On January 22, 2016, the Company filed a complaint against Merck Sharp & Dohme, Corp (“Merck”) for patent infringement in the United States District Court for the District of New Jersey. In the complaint, the Company alleged that manufacture and sales of certain of Merck’s Keytruda product infringed one or more claims of the Company’s U.S. Patent No. 5,693,761 (the “761 Patent”). The Company requested judgment that Merck infringed the 761 Patent, an award of damages due to the infringement, a finding that such infringement was willful and deliberate and trebling of damages therefore, and a declaration that the case is exceptional and warrants an award of attorney’s fees and costs.

On April 21, 2017, the Company entered into a settlement agreement with Merck to resolve the patent infringement lawsuit between the parties pending in the U.S. District Court for the District of New Jersey related to Merck’s Keytruda humanized antibody product. Under the terms of the agreement, Merck paid the Company a one time, lump-sum payment of \$19.5 million, and the Company granted Merck a fully paid-up, royalty free, non-exclusive license to certain of the Company’s rights to issued patents in the United States and elsewhere, covering the humanization of antibodies (the “Queen et al. patent”) for use in connection with Keytruda as well as a covenant not to sue Merck for any royalties regarding Keytruda. In addition, the parties agreed to dismiss all claims in the relevant legal proceedings.

### *Wellstat Litigation*

On September 4, 2015, the Company filed in the Supreme Court of New York a motion for summary judgment in lieu of complaint which requested that the court enter judgment against Wellstat Diagnostics Guarantors for the total amount due on the Wellstat Diagnostics debt, plus all costs and expenses including lawyers’ fees incurred by the Company in enforcement of the related guarantees. On July 29, 2016, the court issued its Memorandum of Decision granting the Company’s motion for summary judgment and denying the Wellstat Diagnostics Guarantors’ cross-motion for summary judgment seeking a determination that they were no longer liable under the guarantees. The Supreme Court of New York held that the Wellstat Diagnostics Guarantors are liable for all “Obligations” owed by Wellstat Diagnostics to the Company. It did not set a specific dollar amount due, but ordered that a judicial hearing officer or special referee be designated to determine the amount of the Obligations owing, and awarded the Company its attorneys’ fees and costs in an amount to be determined. On July 29, 2016, the Wellstat Diagnostics Guarantors filed a notice of appeal from the Memorandum of Decision to the Appellate Division of the Supreme Court of New York. On February 14, 2017, the Appellate Division reversed the summary judgment decision of the Supreme Court in the Company’s favor, but affirmed the denial of the Wellstat Guarantors’ cross-motion for summary judgment. The Appellate Division determined that the action was inappropriate for summary judgment pursuant to New York Civil Practice Law & Rules section 3213 on procedural grounds, but specifically made no determination regarding whether the Company was entitled to a judgment on the merits. Pursuant to this decision, the action will be remanded to the Supreme Court for further proceedings on the merits. The proceeding will be conducted as a plenary proceeding, with both parties having the opportunity to take discovery and file dispositive motions in accordance with New York civil procedure.

### *Noden Pharma DAC v Anchen Pharmaceuticals, Inc. et al*

On June 12, 2017, Noden Pharma DAC (“Noden”) filed a complaint against Anchen Pharmaceuticals, Inc. (“Anchen”) and Par Pharmaceutical (“Par”) for infringement of U.S. Patent No. 8,617,595 based on their submission of an Abbreviated New Drug Application (“ANDA”) seeking authorization from the FDA to market a generic version of Tektuma® aliskiren hemifumarate tablets, 150 mg and 300 mg, in the United States. Noden’s suit triggered a 30-month stay of FDA approval of that application under the Hatch Waxman Act. Par filed a counterclaim seeking a declaratory judgment that their proposed generic version of Tektuma HCT® aliskiren hemifumarate hydrochlorothiazide tablets (150 mg eq. base/12.5 mg HCT, 150 mg eq. base/25 mg HCT, 300 mg eq. base/12.5 mg HCT, and 300 mg eq. base/25 mg HCT), described in a separate ANDA submitted by Par to FDA, alleging noninfringement of U.S. Patent No. 8,618,172, also owned by Noden Pharma DAC. This case is proceeding in the United States District Court for the District of Delaware. Noden Pharma DAC intends to continue to take appropriate legal action to protect its intellectual property in Tektuma® and Tektuma HCT®.

Noden is aware that Novartis received Paragraph IV certifications from Par for Tektuma HCT and Anchen on December 31, 2013. Novartis did not file a responsive patent infringement suit related to these certifications. However, to Noden’s knowledge, neither Par nor Anchen have in the meantime commercialized generic aliskiren products.

### ***Depomed, Inc. vs. Valeant Pharmaceuticals, Inc.***

On October 27, 2017, Valeant, Depomed and the Company entered into a settlement agreement (“Settlement Agreement”) to resolve all matters addressed in the lawsuit. Under the terms of the Settlement Agreement, the litigation will be dismissed, with prejudice, and Valeant will pay to Depomed a one-time, lump-sum payment of \$13.0 million. In addition, Depomed and the Company released Valeant and its subsidiary from any and all claims against them as a result of the audit, Valeant’s obligation to pay additional royalties under the commercialization agreement and/or the litigation; and Valeant released Depomed and the Company against any and all claims against them as a result of the audit and/or the litigation. The settlement payment was transferred to the Company under the terms of the Depomed Royalty Agreement in November of 2017 and has been reflected in the Depomed royalty rights asset discounted cashflow valuation as of September 30, 2017.

### ***Other Legal Proceedings***

From time to time, the Company is involved in lawsuits, arbitrations, claims, investigations and proceedings, consisting of intellectual property, commercial, employment and other matters, which arise in the ordinary course of business. The Company makes provisions for liabilities when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Such provisions are reviewed at least quarterly and adjusted to reflect the impact of settlement negotiations, judicial and administrative rulings, advice of legal counsel, and other information and events pertaining to a particular case. Litigation is inherently unpredictable. If any unfavorable ruling were to occur in any specific period, there exists the possibility of a material adverse impact on the results of the Company’s operations of that period and on its cash flows and liquidity.

### ***Lease Guarantee***

In connection with the spin-off (the “Spin-Off”) by the Company of Facet Biotech Corporation (“Facet”), the Company entered into amendments to the leases for the Company’s former facilities in Redwood City, California, under which Facet was added as a co-tenant, and a Co-Tenancy Agreement, under which Facet agreed to indemnify us for all matters related to the leases attributable to the period after the Spin-Off date. As of September 30, 2017, the total lease payments for the duration of the guarantee, which runs through December 2021, are approximately \$47.9 million. In April 2010, Abbott Laboratories acquired Facet and later renamed the entity AbbVie Biotherapeutics, Inc. (“AbbVie”). If AbbVie were to default under its lease obligations, the Company could be held liable by the landlord as a co-tenant and, thus, the Company has in substance guaranteed the payments under the lease agreements for the Redwood City facilities.

The Company prepared a discounted, probability weighted cash flow analysis to calculate the estimated fair value of the lease guarantee as of the Spin-Off. The Company was required to make assumptions regarding the probability of Facet’s default on the lease payment, the likelihood of a sublease being executed and the times at which these events could occur. These assumptions are based on information that the Company received from real estate brokers and the then-current economic conditions, as well as expectations of future economic conditions. The fair value of this lease guarantee was charged to additional paid-in capital upon the Spin-Off and any future adjustments to the carrying value of the obligation will also be recorded in additional paid-in capital.

The Company has recorded a liability of \$10.7 million on its Condensed Consolidated Balance Sheets as of September 30, 2017 and December 31, 2016, related to this guarantee. In future periods, the Company may adjust this liability for any changes in the ultimate outcome of this matter that are both probable and estimable.

### ***Irrevocable Letters of Credit***

On June 30, 2016, the Company purchased a \$75.0 million certificate of deposit, which is designated as cash collateral for the \$75.0 million letter of credit issued on July 1, 2016 with respect to the first anniversary payment under the Noden Purchase Agreement (as defined in Note 18 below). In addition, the Company provided an irrevocable and unconditional guarantee to Novartis Pharma AG (“Novartis”), to pay up to \$14.0 million of the remaining amount of the first anniversary payment not covered by the letter of credit. The Company concluded that both guarantees are contingent obligations and shall be accounted for in accordance with ASC 450, *Contingencies*. Further, it was concluded that both guarantees do not meet the conditions to be accrued at September 30, 2017. On July 3, 2017, the first anniversary payment of \$89.0 million was paid pursuant to the Noden Purchase Agreement and the \$14.0 million guarantee was extinguished. On July 31, 2017, the \$75.0 million certification of deposit matured, and on August 1, 2017, the letter of credit terminated and is no longer available to Novartis.



### **Purchase Obligations**

In connection with the Noden Transaction, Noden entered into an unconditional purchase obligation with Novartis to acquire all local finished goods inventory in certain countries upon transfer of the applicable marketing authorization rights in such country. The purchase is payable within 60 days after the transfer of the marketing authorization rights. The agreement does not specify minimum quantities but details pricing terms.

In addition, Noden and Novartis entered into a supply agreement pursuant to which Novartis will manufacture and supply to Noden a finished form of the Noden Products and bulk drug form of the Noden Products for specified periods of time prior to the transfer of manufacturing responsibilities for the Noden Products to another manufacturer. The supply agreement may be terminated by either party for material breach that remains uncured for a specified time period. The supply agreement commits the Company to a minimum purchase obligation of approximately \$17.1 million and \$120.7 million over the next twelve and twenty-four months, respectively. The Company expects to meet this requirement. For more information about the Noden Transaction, see Note 18.

LENSAR and Coherent, Inc. entered into an Original Equipment Manufacturer agreement pursuant to which Coherent, Inc. will manufacture and supply to LENSAR Staccato Lasers by December 31, 2017. The supply agreement commits LENSAR to a minimum purchase obligation of approximately \$1.1 million over the next three months. The Company expects that LENSAR will meet this requirement. For more information about the LENSAR transaction, see Note 18.

### **Escrow Receivable**

On September 21, 2017, the Company entered into the kaléo Note Sale Agreement, pursuant to which the Company sold its entire interest in the kaléo Note.

Pursuant to the kaléo Note Sale Agreement, the purchaser paid to the Company an amount equal to 100% of the then outstanding principal, a premium of 1% of such amount and accrued interest under the kaléo Notes, for an aggregate cash purchase price of \$141.7 million.

Pursuant to the terms of the kaléo Note Sale Agreement, \$1.4 million of the aggregate purchase price was deposited into an escrow account as a potential payment against certain contingencies and on the 18th month anniversary of the closing date, the Escrow Agent will release any funds remaining in the escrow account to the Company.

The Company does not believe that it will be subject to claims contemplated under the escrow agreement. However, in the event that such a claim is made, and if successful, the amount of such a claim up to \$1.4 million would be released from the escrow account, which may reduce the amount ultimately returned to the Company when the 18 months escrow period has ended. As of September 30, 2017, the Company is not aware of any claims by the purchaser that would reduce the escrow receivable.

## **12. Convertible Notes**

| <b>Description</b>       | <b>Maturity Date</b> | <b>Principal Balance</b> | <b>Carrying Value</b> |                     |
|--------------------------|----------------------|--------------------------|-----------------------|---------------------|
|                          |                      | <b>Outstanding</b>       | <b>September 30,</b>  | <b>December 31,</b> |
|                          |                      | <b>September 30,</b>     | <b>2017</b>           | <b>2016</b>         |
|                          |                      | <b>2017</b>              |                       |                     |
| <i>(In thousands)</i>    |                      |                          |                       |                     |
| <b>Convertible Notes</b> |                      |                          |                       |                     |
| February 2018 Notes      | February 1, 2018     | \$ 126,447               | \$ 124,922            | \$ 121,595          |
| December 2021 Notes      | December 1, 2021     | \$ 150,000               | 115,716               | 110,848             |
| Total                    |                      |                          | <u>\$ 240,638</u>     | <u>\$ 232,443</u>   |

### **February 2018 Notes**

On February 12, 2014, the Company issued \$300.0 million in aggregate principal amount, at par, of the February 2018 Notes in an underwritten public offering, for net proceeds of \$290.2 million. The February 2018 Notes are due February 1, 2018, and the Company pays interest at 4.0% on the February 2018 Notes semiannually in arrears on February 1 and August 1 of each year.

beginning August 1, 2014. A portion of the proceeds from the February 2018 Notes, net of amounts used for purchased call option transactions and provided by the warrant transactions described below, were used to redeem \$131.7 million of the Company's 2.975% Convertible Senior Notes due February 17, 2016. Upon the occurrence of a fundamental change, as defined in the indenture, holders have the option to require the Company to repurchase their February 2018 Notes at a purchase price equal to 100% of the principal, plus accrued interest.

On November 20, 2015, the Company's agent initiated the repurchase of \$53.6 million in aggregate principal amount of its February 2018 Notes for \$43.7 million in cash in four open market transactions. The closing of these transactions occurred on November 30, 2015. It was determined that the repurchase of the principal amount shall be accounted for as a partial extinguishment of the February 2018 Notes. As a result, a gain on extinguishment of \$6.5 million was recorded at closing of the transaction. The \$6.5 million gain on extinguishment included the de-recognition of the original issuance discount of \$3.1 million, outstanding deferred issuance costs of \$0.9 million and agent fees of \$0.1 million. Immediately following the repurchase, \$246.4 million principal amount of the February 2018 Notes was outstanding with \$14.1 million of remaining original issuance discount and \$4.1 million of debt issuance costs to be amortized over the remaining life of the February 2018 Notes.

In connection with this repurchase of the February 2018 Notes, the Company unwound a portion of the purchased call options related to the notes. As a result of this unwinding, the Company received \$0.3 million in cash. The payments received have been recorded as an increase to additional paid-in-capital. In addition, the Company unwound a portion of the warrants for \$0.2 million in cash, payable by the Company. The payments have been recorded as a decrease to additional paid-in-capital. At the time of the transaction, the Company concluded that the remaining purchased call options and warrants continue to meet all criteria for equity classification.

On November 22, 2016, the Company repurchased \$120.0 million in aggregate principal amount of its February 2018 Notes for approximately \$121.5 million in cash (including \$1.5 million of accrued interest) in open market transactions. It was determined that the repurchase of the principal amount shall be accounted for as an extinguishment. The extinguishment included the de-recognition of the original issuance discount of \$4.3 million and outstanding deferred issuance costs of \$1.3 million. Immediately following the repurchase, \$126.4 million principal amount of the February 2018 Notes was outstanding with \$4.6 million of remaining original issuance discount and \$1.4 million of debt issuance costs to be amortized over the remaining life of the February 2018 Notes.

In connection with the repurchase of the February 2018 Notes, the Company unwound a portion of the purchased call options. The unwind transaction of the purchased call option did not result in any cash payments between the parties. In addition, the Company and the counterparties agreed to unwind a portion of the warrants, which also did not result in any cash payments between the parties. At the time of the transaction, the Company concluded that the remaining purchased call options and warrants continue to meet all criteria for equity classification.

The February 2018 Notes are convertible under any of the following circumstances:

- During any fiscal quarter ending after the quarter ended June 30, 2014, if the last reported sale price of the Company's common stock for at least 20 trading days in a period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter exceeds 130% of the conversion price for the notes on the last day of such preceding fiscal quarter;
- During the five business-day period immediately after any five consecutive trading-day period in which the trading price per \$1,000 principal amount of notes for each trading day of that measurement period was less than 98% of the product of the last reported sale price of the Company's common stock and the conversion rate for the notes for each such day;
- Upon the occurrence of specified corporate events as described further in the indenture; or
- At any time on or after August 1, 2017.

The initial conversion rate for the February 2018 Notes is 109.1048 shares of the Company's common stock per \$1,000 principal amount of February 2018 Notes, which is equivalent to an initial conversion price of approximately \$9.17 per share of common stock, subject to adjustments upon the occurrence of certain specified events as set forth in the indenture. Upon conversion, the Company will be required to pay cash and, if applicable, deliver shares of the Company's common stock as described in the indenture.

As of September 30, 2017, the Company's February 2018 Notes are convertible. At September 30, 2017, the if-converted value of the February 2018 Notes did not exceed the principal amount.

In accordance with the accounting guidance for convertible debt instruments that may be settled in cash or other assets on conversion, the Company was required to separately account for the liability component of the instrument in a manner that reflects the market interest rate for a similar nonconvertible instrument at the date of issuance. As a result, the Company separated the principal balance of the February 2018 Notes between the fair value of the debt component and the fair value of the common stock conversion feature. Using an assumed borrowing rate of 7.0%, which represents the estimated market interest rate for a similar nonconvertible instrument available to the Company on the date of issuance, the Company recorded a total debt discount of \$29.7 million, allocated \$19.3 million to additional paid-in capital and allocated \$10.4 million to deferred tax liability. The discount is being amortized to interest expense over the term of the February 2018 Notes and increases interest expense during the term of the February 2018 Notes from the 4.0% cash coupon interest rate to an effective interest rate of 6.9%. As of September 30, 2017, the remaining discount amortization period is 0.3 years.

The carrying value and unamortized discount of the February 2018 Notes were as follows:

| <i>(In thousands)</i>                         | September 30, 2017 | December 31, 2016 |
|---|--------------------|-------------------|
| Principal amount of the February 2018 Notes   | \$ 126,447         | \$ 126,447        |
| Unamortized discount of liability component   | (1,525)            | (4,852)           |
| Net carrying value of the February 2018 Notes | \$ 124,922         | \$ 121,595        |

Interest expense for the February 2018 Notes on the Company's Condensed Consolidated Statements of Income was as follows:

| <i>(In thousands)</i>               | Three Months Ended |          | Nine Months Ended |           |
|-------------------------------------|--------------------|----------|-------------------|-----------|
|                                     | September 30,      |          | September 30,     |           |
|                                     | 2017               | 2016     | 2017              | 2016      |
| Contractual coupon interest         | \$ 1,264           | \$ 2,465 | \$ 3,793          | \$ 7,393  |
| Amortization of debt issuance costs | 259                | 457      | 758               | 1,337     |
| Amortization of debt discount       | 870                | 1,591    | 2,569             | 4,696     |
| Total                               | \$ 2,393           | \$ 4,513 | \$ 7,120          | \$ 13,426 |

#### *Purchased Call Options and Warrants*

In connection with the issuance of the February 2018 Notes, the Company entered into purchased call option transactions with two hedge counterparties. The Company paid an aggregate amount of \$31.0 million for the purchased call options with terms substantially similar to the embedded conversion options in the February 2018 Notes. The purchased call options cover, subject to anti-dilution and certain other customary adjustments substantially similar to those in the February 2018 Notes, approximately 13.8 million shares of the Company's common stock. The Company may exercise the purchased call options upon conversion of the February 2018 Notes and require the hedge counterparty to deliver shares to the Company in an amount equal to the shares required to be delivered by the Company to the note holder for the excess conversion value. The purchased call options expire on February 1, 2018, or the last day any of the February 2018 Notes remain outstanding.

In addition, the Company sold to the hedge counterparties warrants exercisable, on a cashless basis, for the sale of rights to receive shares of common stock that will initially underlie the February 2018 Notes at a strike price of \$10.3610 per share, which represents a premium of approximately 30% over the last reported sale price of the Company's common stock of \$7.97 on February 6, 2014. The warrant transactions could have a dilutive effect to the extent that the market price of the Company's common stock exceeds the applicable strike price of the warrants on the date of conversion. The Company received an aggregate amount of \$11.4 million for the sale from the two counterparties. The warrant counterparties may exercise the warrants on their specified expiration dates that occur over a period of time. If the VWAP of the Company's common stock, as defined in the warrants, exceeds the strike price of the warrants, the Company will deliver to the warrant counterparties shares equal to the spread between the VWAP on the date of exercise or expiration and the strike price. If the VWAP is less than the strike price, neither party is obligated to deliver anything to the other.

The purchased call option transactions and warrant sales effectively serve to reduce the potential dilution associated with conversion of the February 2018 Notes. The strike price is subject to further adjustment in the event that future quarterly dividends exceed \$0.15 per share.

The purchased call options and warrants are considered indexed to the Company stock, require net-share settlement, and met all criteria for equity classification at inception and at September 30, 2017. The purchased call options cost of \$31.0 million, less deferred taxes of \$10.8 million, and the \$11.4 million received for the warrants, was recorded as adjustments to additional paid-in capital. Subsequent changes in fair value will not be recognized as long as the purchased call options and warrants continue to meet the criteria for equity classification.

**December 2021 Notes**

On November 22, 2016, the Company issued \$150.0 million in aggregate principal amount, at par, of the December 2021 Notes in an underwritten public offering, for net proceeds of \$145.7 million. The December 2021 Notes are due December 1, 2021, and the Company pays interest at 2.75% on the December 2021 Notes semiannually in arrears on June 1 and December 1 of each year, beginning June 1, 2017. A portion of the proceeds from the December 2021 Notes was used to extinguish \$120.0 million of the February 2018 Notes.

Upon the occurrence of a fundamental change, as defined in the indenture, holders have the option to require the Company to repurchase their December 2021 Notes at a purchase price equal to 100% of the principal, plus accrued interest.

The December 2021 Notes are convertible under any of the following circumstances:

- During any fiscal quarter (and only during such fiscal quarter) commencing after the fiscal quarter ended June 30, 2017, if the last reported sale price of Company common stock for at least 20 trading days (whether or not consecutive), in the period of 30 consecutive trading days, ending on, and including, the last trading day of the immediately preceding fiscal quarter, exceeds 130% of the conversion price for the notes on each applicable trading day;
- During the five business-day period immediately after any five consecutive trading-day period, which the Company refers to as the measurement period, in which the trading price per \$1,000 principal amount of notes for each trading day of that measurement period was less than 98% of the product of the last reported sale price of Company common stock and the conversion rate for the notes for each such trading day; or
- Upon the occurrence of specified corporate events as described in the indenture.

The initial conversion rate for the December 2021 Notes is 262.2951 shares of the Company’s common stock per \$1,000 principal amount of December 2021 Notes, which is equivalent to an initial conversion price of approximately \$3.81 per share of common stock, subject to adjustments upon the occurrence of certain specified events as set forth in the indenture.

In accordance with the accounting guidance for convertible debt instruments that may be settled in cash or other assets on conversion, the Company was required to separately account for the liability component of the instrument in a manner that reflects the market interest rate for a similar nonconvertible instrument at the date of issuance. As a result, the Company separated the principal balance of the December 2021 Notes between the fair value of the debt component and the fair value of the common stock conversion feature. Using an assumed borrowing rate of 9.5%, which represents the estimated market interest rate for a similar nonconvertible instrument available to us on the date of issuance, the Company recorded a total debt discount of \$4.3 million, allocated \$23.8 million to additional paid-in capital and allocated \$12.8 million to deferred tax liability. The discount is being amortized to interest expense over the term of the December 2021 Notes and increases interest expense during the term of the December 2021 Notes from the 2.75% cash coupon interest rate to an effective interest rate of 3.4%. As of September 30, 2017, the remaining discount amortization period is 4.2 years.

The carrying value and unamortized discount of the December 2021 Notes were as follows:

| <i>(In thousands)</i>                         | <b>September 30, 2017</b> | <b>December 31, 2016</b> |
|---|---------------------------|--------------------------|
| Principal amount of the December 2021 Notes   | \$ 150,000                | \$ 150,000               |
| Unamortized discount of liability component   | (34,284)                  | (39,152)                 |
| Net carrying value of the December 2021 Notes | <u>\$ 115,716</u>         | <u>\$ 110,848</u>        |

Interest expense for the December 2021 Notes on the Company's Condensed Consolidated Statements of Income was as follows:

| <i>(In thousands)</i>               | Three Months Ended |      | Nine Months Ended |      |
|-------------------------------------|--------------------|------|-------------------|------|
|                                     | September 30,      |      | September 30,     |      |
|                                     | 2017               | 2016 | 2017              | 2016 |
| Contractual coupon interest         | \$ 1,031           | \$ — | \$ 3,094          | \$ — |
| Amortization of debt issuance costs | 18                 | —    | 54                | —    |
| Amortization of debt discount       | 132                | —    | 393               | —    |
| Amortization of conversion feature  | 1,522              | —    | 4,421             | —    |
| Total                               | \$ 2,703           | \$ — | \$ 7,962          | \$ — |

As of September 30, 2017, the December 2021 Notes are not convertible. At September 30, 2017, the if-converted value of the December 2021 Notes did not exceed the principal amount.

#### *Capped Call Transaction*

In connection with the offering of the December 2021 Notes, the Company entered into a privately-negotiated capped call transaction with an affiliate of the underwriter of such issuance. The aggregate cost of the capped call transaction was \$14.4 million. The capped call transaction is generally expected to reduce the potential dilution upon conversion of the December 2021 Notes and/or partially offset any cash payments the Company is required to make in excess of the principal amount of converted December 2021 Notes in the event that the market price per share of the Company's common stock, as measured under the terms of the capped call transaction, is greater than the strike price of the capped call transaction. This initially corresponds to the approximate \$3.81 per share conversion price of the December 2021 Notes and is subject to anti-dilution adjustments substantially similar to those applicable to the conversion rate of the December 2021 Notes. The cap price of the capped call transaction was initially \$4.88 per share, and is subject to certain adjustments under the terms of the capped call transaction. The Company will not be required to make any cash payments to the option counterparty upon the exercise of the options that are a part of the capped call transaction, but the Company will be entitled to receive from it an aggregate amount of cash and/or number of shares of the Company's common stock, based on the settlement method election chosen for the related convertible notes, with a value equal to the amount by which the market price per share of the Company's common stock, as measured under the terms of the capped call transaction, is greater than the strike price of the capped call transaction during the relevant valuation period under the capped call transaction, with such number of shares of the Company's common stock and/or amount of cash subject to the cap price.

The Company evaluated the capped call transaction under authoritative accounting guidance and determined that they should be accounted for as separate transactions and classified as a net reduction to additional paid-in capital within stockholders' equity with no recurring fair value measurement recorded.

### 13. Other Long-Term Liabilities

Other long-term liabilities consist of the following:

|                             | September 30, | December 31, |
|-----------------------------|---------------|--------------|
|                             | 2017          | 2016         |
| <i>(In thousands)</i>       |               |              |
| Accrued lease liability     | \$ 10,700     | \$ 10,700    |
| Long-term incentive accrual | 4,255         | 1,995        |
| Uncertain tax positions     | 30,488        | 41,591       |
| Dividend payable            | 149           | 270          |
| Other                       | 416           | —            |
| Total                       | \$ 46,008     | \$ 54,556    |

In connection with the Spin-Off, the Company entered into amendments to the leases for the Company's former facilities in Redwood City, California, under which Facet was added as a co-tenant, and a Co-Tenancy Agreement, under which Facet

agreed to indemnify the Company for all matters related to the leases attributable to the period after the Spin-Off date. As of September 30, 2017, the total lease payments for the duration of the guarantee, which runs through December 2021, are approximately \$47.9 million. If Facet were to default, the Company could also be responsible for lease-related costs including utilities, property taxes and common area maintenance that may be as much as the actual lease payments. The Company has recorded a liability of \$10.7 million on the Company's Condensed Consolidated Balance Sheets as of September 30, 2017, and December 31, 2016, related to this guarantee.

#### 14. Stock-Based Compensation

The Company grants restricted stock awards pursuant to a stockholder approved stock-based incentive plan. This incentive plan is described in further detail in Note 15, Stock-Based Compensation, of Notes to the Condensed Consolidated Financial Statements in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2016.

In September 2017, the Company made inducement grants in the form of stock options and restricted stock awards. See the Company's Current Report on Form 8-K filed with the SEC on September 11, 2017 for additional details.

The following table summarizes the Company's stock option and restricted stock award activity during the nine months ended September 30, 2017:

|  | Stock Options                |                                 | Restricted Stock Awards      |  |
|--|------------------------------|---------------------------------|------------------------------|--|
|  | Number of Shares Outstanding | Weighted Average Exercise Price | Number of Shares Outstanding | Weighted Average Grant-date Fair Value Per Share |
| <i>(In thousands except per share amounts)</i> |                              |                                 |                              |  |
| Balance at December 31, 2016                   | —                            | \$ —                            | 1,472                        | \$ 3.96  |
| Granted  | 961                          | \$ 3.21                         | 2,157                        | \$ 2.27  |
| Vested or released                             | —                            | \$ —                            | (426)                        | \$ 3.52  |
| Forfeited or canceled                          | —                            | \$ —                            | (10)                         | \$ 3.12  |
| Balance at September 30, 2017                  | 961                          | \$ 3.21                         | 3,193                        | \$ 2.88  |

#### 15. Income Taxes

Income tax expense for the three months ended September 30, 2017 and 2016, was \$4.8 million and \$14.4 million, respectively, and for the nine months ended September 30, 2017 and 2016, was \$65.2 million and \$50.0 million, respectively, which resulted primarily from applying the federal statutory income tax rate to income before income taxes. The Company's effective tax rates for the current period differs from the U.S. federal statutory rate of 35% due primarily to the effect of Subpart F income as result of the product acquisition triggering U.S. tax on the Company's pro rata share of income earned by Noden as a controlled foreign corporation. The Company intends to indefinitely reinvest all of its undistributed foreign earnings outside of the United States.

The uncertain tax positions increased during the three months ended September 30, 2017 and 2016, by zero and \$0.6 million, respectively, and increased during the nine months ended September 30, 2017 and 2016, by \$29.7 million and \$2.4 million, respectively, resulting from an increase in tax uncertainties and estimated tax liabilities.

The Company's income tax returns are subject to examination by U.S. federal, state and local tax authorities for tax years 1996 forward. In May 2012, the Company received a "no-change" letter from the Internal Revenue Service ("IRS") upon completion of an examination of the Company's 2008 federal tax return. The Company is currently under income tax examination in the state of California for the tax years 2009 through 2015. Although the timing of the resolution of income tax examinations is highly uncertain, and the amounts ultimately paid, if any, upon resolution of the issues raised by the taxing authorities may differ materially from the amounts accrued for each year, the Company does not anticipate any material change to the amount of its unrecognized tax benefit over the next 12 months.

## 16. Stockholders' Equity

### *Stock Repurchase Program*

On March 1, 2017, the Company's board of directors authorized the repurchase through March 2018 of issued and outstanding shares of the Company's common stock having an aggregate value of up to \$30.0 million pursuant to a share repurchase program. The repurchases under the share repurchase program were made from time to time in the open market or in privately negotiated transactions and were funded from the Company's working capital. All shares of common stock repurchased under the Company's share repurchase program were retired and restored to authorized but unissued shares of common stock at June 30, 2017. The Company repurchased 13.3 million shares of its common stock under the share repurchase program during the nine months ended September 30, 2017 for an aggregate purchase price of \$30.0 million, or an average cost of \$2.25 per share, including trading commission.

On September 25, 2017, the Company's board of directors authorized the repurchase of issued and outstanding shares of the Company's common stock having an aggregate value of up to \$25.0 million pursuant to a new share repurchase program. The repurchases under the new share repurchase program are made from time to time in the open market or in privately negotiated transactions and are funded from the Company's working capital. The amount and timing of such repurchases are dependent upon the price and availability of shares, general market conditions and the availability of cash. Repurchases may also be made under a trading plan under Rule 10b-5, which would permit shares to be repurchased when the Company might otherwise be precluded from doing so because of self-imposed trading blackout periods or other regulatory restrictions. All shares of common stock repurchased under the Company's new share repurchase program are expected to be retired and restored to authorized but unissued shares of common stock. As of September 30, 2017, the Company has not repurchased shares under this plan. The repurchase program may be suspended or discontinued at any time without notice.

## 17. Accumulated Other Comprehensive Income

Comprehensive income is comprised of net income and other comprehensive income (loss). The Company includes unrealized net gains (losses) on investments held in our available-for-sale securities in other comprehensive income (loss), and present the amounts net of tax. Our other comprehensive income (loss) is included in our Condensed Consolidated Statements of Comprehensive Income.

The balance of accumulated other comprehensive income, net of tax, was as follows:

|   | Unrealized gains<br>(losses) on available-<br>for-sale securities | Total Accumulated<br>Other Comprehensive<br>Income |
|---|---|--|
| <i>(In thousands)</i>                                 |   |  |
| Beginning Balance at December 31, 2016                | \$ —  | \$ —   |
| Activity for the nine months ended September 30, 2017 | 648   | 648  |
| Ending Balance at September 30, 2017                  | \$ 648  | \$ 648   |

## 18. Business Combinations

### **NODEN TRANSACTION**

#### *Description of the Noden Transaction*

On July 1, 2016, Noden Pharma DAC, entered into an asset purchase agreement ("Noden Purchase Agreement") where by it purchased from Novartis the exclusive worldwide rights to manufacture, market, and sell the branded prescription medicine product sold under the name Tektuma® and Tektuma HCT® in the United States and Rasilez® and Rasilez HCT® in the rest of the world (collectively the "Noden Products") and certain related assets and assumed certain related liabilities (the "Noden Transaction"). In addition, pursuant the terms of the Noden Purchase Agreement, Noden Pharma DAC is committed to pay Novartis the following amounts in cash: \$89.0 million payable on the first anniversary of the closing date, and up to an additional \$95.0 million contingent on achievement of sales targets and the date of the launch of a generic drug containing the pharmaceutical ingredient aliskiren.

On July 1, 2016, upon the consummation of the Noden Transaction, a noncontrolling interest holder acquired a 6% equity interest in Noden Pharma DAC and Noden Pharma USA Inc. (together, with any subsidiaries, "Noden"). The equity interest of the noncontrolling interest holder is subject to vesting and repurchase rights over a four-year period. In May 2017, such equity interest was purchased for \$2.2 million in cash by the Company. The Company accounted for the repurchase in accordance with ASC 810 and recognized the difference between the fair value of the consideration paid and the amount by which the noncontrolling interest is adjusted for in equity attributable to the Company.

The Company determined that Noden shall be consolidated under the voting interest model as of September 30, 2017.

On July 3, 2017, Noden made the \$89.0 million anniversary payment to Novartis pursuant to the terms of the Noden Purchase Agreement, of which \$32.0 million was funded by the Company in the form of an equity contribution. The Company expects to make additional equity contributions to Noden of at least \$38.0 million to fund a portion of certain milestone payments under the Noden Purchase Agreement, subject to the occurrence of such milestones.

#### ***Fair Value of Consideration Transferred***

The fair value of consideration transferred totals \$244.3 million, which consists of \$216.7 million in acquired product rights, \$23.9 million in customer relationships, \$47.4 million in contingent consideration and \$87.0 million in anniversary payments. Contingent consideration includes the future payments that the Company may pay to Novartis based on achieving certain milestones.

The contingent consideration was measured at fair value and will be recognized as of the acquisition date. The Company determined the acquisition date fair value of the contingent consideration obligation based on an income approach derived from the Noden Products revenue estimates and a probability assessment with respect to the likelihood of achieving (a) the level of net sales or (b) generic product launch that would trigger the milestone payments. The fair value measurement is based on significant inputs not observable in the market and thus represents a Level 3 measurement as defined in fair value measurement accounting. The key assumptions in determining the fair value are the discount rate and the probability assigned to the potential milestones being achieved. At each reporting date, the Company will re-measure the contingent consideration obligation to estimated fair value. Any changes in the fair value of contingent consideration will be recognized in operating expenses until the contingent consideration arrangement is settled.

As of the effective time of the acquisition, the identifiable intangible assets are required to be measured at fair value and these assets could include assets that are not intended to be used or sold or that are intended to be used in a manner other than their highest and best use. For purposes of the valuation, it is assumed that all assets will be used in the manner that represents the highest and best use of those assets, but it is not assumed that any market synergies will be achieved. The consideration of synergies has been excluded because they are not considered to be factually supportable.

The fair value of identifiable assets is determined primarily using the "income method," which starts with a forecast of all expected future cash flows. Some of the more significant assumptions inherent in the development of intangible asset values, from the perspective of a market participant, include, among other factors: the amount and timing of projected future cash flows (including net revenue, cost of product sales, research and development costs, sales and marketing expenses, income tax expense, capital expenditures and working capital requirements) and estimated contributory asset charges; the discount rate selected to measure the risks inherent in the future cash flows; and the assessment of the asset's life cycle and the competitive trends impacting the asset.

Goodwill represents expected synergies resulting from other intangible assets that do not qualify for separate recognition. Goodwill is calculated as the difference between the acquisition date fair value of the consideration expected to be transferred and the values assigned to the assets acquired. Goodwill is not amortized but tested for impairment on an annual basis or when indications for impairment exist.

The following table presents a summary of the total fair value of consideration transferred for the Noden Products acquisition (in thousands):

|   |                   |
|---|-------------------|
| Consideration paid in cash at closing         | \$ 109,938        |
| Discounted anniversary payment                | 87,007            |
| Fair value of contingent consideration        | 47,360            |
| Total fair value of consideration transferred | <u>\$ 244,305</u> |



### ***Assets Acquired and Liabilities Assumed***

In accordance with the authoritative guidance for business combinations, the Noden Transaction was determined to be a business combination and was accounted for using the acquisition method of accounting.

The following table summarizes the fair values of the identifiable intangible assets acquired and liabilities assumed at the acquisition date (in thousands):

|                         |    |                |
|-------------------------|----|----------------|
| Acquired product rights | \$ | 216,690        |
| Customer relationships  |    | 23,880         |
| Goodwill                |    | 3,735          |
| Net intangible assets   | \$ | <u>244,305</u> |

The acquired product rights represent developed technology of products approved for sales in the market, which the Company refers to as marketed products, and have finite useful lives. They are amortized on a straight-line basis over a weighted average period of 10 years.

### **LENSAR TRANSACTION**

#### ***Description of the LENSAR Transaction***

In December 2016, LENSAR filed the Chapter 11 case with the support of the Company, as its largest senior secured creditor under a credit agreement, as amended, that the Company and LENSAR had entered into in 2013. For more information regarding the credit agreement between the Company and LENSAR, please see Note 7. In January 2017, the Company agreed to provide debtor-in-possession financing of up to \$2.8 million in new advances to LENSAR so that it could continue to operate its business during the remainder of the Chapter 11 case. As part of the Chapter 11 case, LENSAR filed a Chapter 11 plan of reorganization, with the Company's support, under which LENSAR would issue 100% of its equity securities to the Company in exchange for the cancellation of the Company's claims as a secured creditor in the Chapter 11 case. Following consummation of the Plan, LENSAR would become an operating subsidiary of the Company and the Company provided LENSAR a new, senior-secured, first-priority term loan facility (the "Exit Facility").

On April 26, 2017, the bankruptcy court approved the plan of reorganization. On May 11, 2017, LENSAR and the Company consummated the plan of reorganization and LENSAR emerged from bankruptcy. Pursuant to the plan of reorganization, the Company obtained control of 100% of the outstanding voting shares of LENSAR. All assets of the LENSAR bankruptcy estate re-vested in reorganized LENSAR free and clear of all liens, claims or charges. The consummation of the plan of reorganization related transactions effect binding and valid transfers to reorganized LENSAR with all rights, title and interest in the acquired assets. Upon consummation of the plan of reorganization, all debt owed to the Company was eliminated other than the Exit Facility. Liabilities to other creditors, including general unsecured creditors, were satisfied through the plan of reorganization.

The Company concluded that the LENSAR transaction shall be accounted in accordance with ASC 805, *Business Combinations*, that do not involve a transfer of consideration ("combinations by contract") by applying the acquisition method.

#### ***Fair Value of Consideration Transferred***

Contemporaneously with the cancellation of the Company's notes receivable with a carrying value of \$43.9 million, the Company acquired 100% equity interests in LENSAR, at fair value, for \$31.7 million, resulting in a loss on extinguishment of notes receivable of \$12.2 million. The fair value of the equity interest in LENSAR was determined primarily using the "income method," which starts with a forecast of all expected future cash flows of the acquired business. The acquisition resulted in a gain on bargain purchase because the fair value of assets acquired and liabilities assumed exceeded the total of the fair value of the equity interest in LENSAR by approximately \$4.0 million, which was recorded in the Condensed Consolidated Statement of Income for the period ended June 30, 2017.

#### ***Out of Period Adjustment***

During the quarter ended September 30, 2017, the Company identified and corrected an immaterial error in the computation of the gain on bargain purchase of the LENSAR transaction in the prior quarter. This adjustment resulted in a decrease to the Company's net income by \$2.2 million for the three-month period ended September 30, 2017.

### Assets Acquired and Liabilities Assumed

Due to the timing of the LENSAR transaction, certain amounts are provisional and subject to change. The provisional amounts consist primarily of the estimates of the fair value of intangible assets acquired. The Company will finalize these amounts as it obtains the information necessary to complete the measurement process. Any changes resulting from facts and circumstances that existed as of the acquisition date may result in adjustments to the provisional amounts recognized at the acquisition date. These changes could be significant. The Company will finalize these amounts no later than one year from the closing date.

The following table summarizes the fair values of the identifiable intangible assets acquired and liabilities assumed at the acquisition date (in thousands):

|   |                  |
|---|------------------|
| Cash  | \$ 1,983         |
| Tangible assets   | 18,647           |
| Intangible assets <sup>(1)</sup>  | 11,970           |
| Net deferred tax assets   | 20,411           |
| <b>Total identifiable assets</b>  | <b>53,011</b>    |
| Current liabilities   | (6,674)          |
| <b>Total liabilities assumed</b>  | <b>(6,674)</b>   |
| Gain on bargain purchase, net of loss on extinguishment of notes receivable | 3,995            |
| <b>Total fair value of consideration</b>                                    | <b>\$ 31,726</b> |

<sup>(1)</sup> As of the effective date of the transaction, identifiable intangible assets are required to be measured at fair value. The fair value measurement is based on significant inputs that are unobservable in the market and thus represents a Level 3 measurement. The Company used an income approach to estimate the preliminary fair value of the intangibles which includes technology, trademarks and customer relationships. The assumptions used to estimate the cash flows of the business included a discount rate of 16%, estimated gross margins ranging from 37-72%, income tax rate of 35%, and operating expenses consisting of direct costs based on the anticipated level of revenues. The intangible assets have a weighted-average useful life of approximately 15.0 years. The intangible assets for acquired technology and trademarks are being amortized over their estimated useful lives using the straight-line method of amortization. The intangible assets for customer relationship are being amortized using a double-declining method of amortization as such method better represents the economic benefits to be obtained.

### Pro Forma Impact of Business Combination

The following table represents the unaudited consolidated financial information for the Company on a pro forma basis for the three and nine months ended September 30, 2017 and 2016, assuming that the Noden Transaction had closed on January 1, 2015 and the LENSAR transaction had closed on January 1, 2016. The historical financial information has been adjusted to give effect to pro forma items that are directly attributable to the acquisitions and are expected to have a continuing impact on the consolidated results. Additionally, the following table sets forth unaudited financial information and has been compiled from historical financial statements and other information, but is not necessarily indicative of the results that actually would have been achieved had the transactions occurred on the dates indicated or that may be achieved in the future.

|  | Three Months Ended |           | Nine Months Ended |            |
|--|--------------------|-----------|-------------------|------------|
|  | September 30,      |           | September 30,     |            |
|  | 2017               | 2016      | 2017              | 2016       |
| <i>(in thousands)</i>                    |                    |           |                   |            |
| Pro forma revenues                       | \$ 62,749          | \$ 57,629 | \$ 257,569        | \$ 262,671 |
| Pro forma net income                     | \$ 20,732          | \$ 10,016 | \$ 84,856         | \$ 70,246  |
| Pro forma net income per share - basic   | \$ 0.14            | \$ 0.06   | \$ 0.54           | \$ 0.43    |
| Pro forma net income per share - diluted | \$ 0.14            | \$ 0.06   | \$ 0.54           | \$ 0.43    |

The unaudited pro forma consolidated results include historical revenues and expenses of assets acquired in the Noden Transaction with the following adjustments:

- Adjustment to recognize incremental amortization expense based on the fair value of intangibles acquired;
- Elimination of transaction costs and non-recurring charges directly related to the acquisition that were included in the historical results of operations for the Company; and
- Adjustment to recognize pro forma income tax based on income tax benefit on the amortization of intangible asset at the statutory tax rate of Ireland (12.5%), and the income tax benefit on the interest expense at the statutory tax rate of the United States (35.0%).

## 19. Segment Information

In connection with acquiring 100% of the equity interests of LENSAR in May 2017, the Company added a third reportable segment, “medical devices” and renamed the previous product sales segment “pharmaceutical”.

Information regarding the Company’s segments for the three and nine months ended September 30, 2017 and 2016 is as follows:

### Revenues by segment

| <i>(in thousands)</i>    | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |            |
|--------------------------|-------------------------------------|-----------|------------------------------------|------------|
|                          | 2017                                | 2016      | 2017                               | 2016       |
| Income generating assets | \$ 42,682                           | \$ 39,510 | \$ 200,547                         | \$ 163,681 |
| Pharmaceutical           | 15,104                              | 14,128    | 43,897                             | 14,128     |
| Medical devices          | 4,963                               | —         | 7,580                              | —          |
| Total revenues           | \$ 62,749                           | \$ 53,638 | \$ 252,024                         | \$ 177,809 |

### Income (loss) by segment

| <i>(in thousands)</i>    | Three Months Ended<br>September 30, |           | Nine Months Ended<br>September 30, |           |
|--------------------------|-------------------------------------|-----------|------------------------------------|-----------|
|                          | 2017                                | 2016      | 2017                               | 2016      |
| Income generating assets | \$ 25,248                           | \$ 14,049 | \$ 98,746                          | \$ 74,084 |
| Pharmaceutical           | 1,082                               | (142)     | (3,560)                            | (142)     |
| Medical devices          | (5,598)                             | —         | (6,774)                            | —         |
| Total net income         | \$ 20,732                           | \$ 13,907 | \$ 88,412                          | \$ 73,942 |

### Long-lived assets by segment

| <i>(in thousands)</i>    | September 30,<br>2017 | December 31,<br>2016 |
|--------------------------|-----------------------|----------------------|
| Income generating assets | \$ 145                | \$ 38                |
| Pharmaceutical           | 860                   | —                    |
| Medical devices          | 7,125                 | —                    |
| Total long-lived assets  | \$ 8,130              | \$ 38                |

The operations for the Company’s Pharmaceutical and Medical Devices segments are primarily located in Ireland and the United States, respectively.

## 20. Subsequent Events

### Valeant Settlement

On October 27, 2017, Valeant, Depomed and the Company entered into a settlement agreement (“Settlement Agreement”) to resolve all matters addressed in the lawsuit. Under the terms of the Settlement Agreement, the litigation will be dismissed, with prejudice, and Valeant will pay to Depomed a one-time, lump-sum payment of \$13.0 million. In addition, Depomed and the

Company released Valeant and its subsidiary from any and all claims against them as a result of the audit, Valeant's obligation to pay additional royalties under the commercialization agreement and/or the litigation; and Valeant released Depomed and the Company against any and all claims against them as a result of the audit and/or the litigation. The settlement payment was transferred to PDL from Depomed pursuant to the terms of the Depomed Royalty Agreement, in November of 2017 and has been reflected in the Depomed royalty rights asset discounted cashflow valuation as of September 30, 2017.

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

*This Quarterly Report on Form 10-Q contains "forward-looking statements" within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended. All statements other than statements of historical facts are "forward-looking statements" for purposes of these provisions, including any projections of earnings, revenues or other financial items, any statements of the plans and objectives of management for future operations, including any statements concerning new licensing, any statements regarding future economic conditions or performance, and any statement of assumptions underlying any of the foregoing. These statements involve known and unknown risks, uncertainties and other important factors that may cause our actual results, performance or achievements to be materially different from any future results, performance or achievements expressed or implied by the forward-looking statements. In some cases, forward-looking statements can be identified by the use of terminology such as "may," "will," "intends," "plans," "believes," "anticipates," "expects," "estimates," "predicts," "potential," "continue" or "opportunity," or the negative thereof or other comparable terminology. The forward-looking statements in this quarterly report are only predictions. Although we believe that the expectations presented in the forward-looking statements contained herein are reasonable at the time they were made, there can be no assurance that such expectations or any of the forward-looking statements will prove to be correct. These forward-looking statements, including with regards to our future financial condition and results of operations, are subject to inherent risks and uncertainties, including but not limited to the risk factors set forth below or incorporated by reference herein, and for the reasons described elsewhere in this Quarterly Report on Form 10-Q. All forward-looking statements and reasons why results may differ included in this Quarterly Report on Form 10-Q are made as of the date hereof. New risk factors and uncertainties may emerge from time to time, and it is not possible for management to predict all risk factors and uncertainties. Except as required by applicable law, we do not plan to publicly update or revise any forward-looking statements contained herein, whether as a result of any new information, future events, changed circumstances or otherwise.*

### OVERVIEW

We seek to provide a significant return for our shareholders by acquiring and managing a portfolio of companies, products, royalty agreements and debt facilities in the biotech, pharmaceutical and medical device industries. In 2012, we began providing alternative sources of capital through royalty monetizations and debt facilities, and in 2016, we began acquiring commercial-stage products and launching specialized companies dedicated to the commercialization of these products. To date, we have consummated 17 of such transactions, of which nine are active and outstanding. We have one debt transaction outstanding, representing deployed and committed capital of \$20.0 million: CareView; we have one hybrid royalty/debt transaction outstanding, representing deployed and committed capital of \$44.0 million: Wellstat Diagnostics; and we have five royalty transactions outstanding, representing deployed and committed capital of \$396.1 million and \$397.1 million, respectively: KYBELLA®, AcelRx, University of Michigan, Viscogliosi Brothers and Depomed. Our equity and loan investments in Noden represent deployed and committed capital of \$179.0 million and \$202.0 million, respectively, and our converted equity and loan investment in LENSAR represents deployed capital of \$40.0 million.

In connection with our acquisition of Tektuma through Noden, we began operating in two reportable segments: income generating assets and product sales. In connection with acquiring 100% of the equity interest of LENSAR in May 2017, we added a third reportable segment, "medical devices" and renamed the previous product sales segment "pharmaceutical".

Our income generating assets segment consists of (i) notes and other long-term receivables, (ii) royalty rights - at fair value, (iii) equity investments and (iv) royalties from issued patents in the United States and elsewhere, covering the humanization of antibodies, which we refer to as the Queen et al. patents. Our pharmaceutical segment consists of revenue derived from Tektuma®, Tektuma HCT®, Rasilez® and Rasilez HCT® (collectively, the "Noden Products" or "Tektuma") sales. Our medical devices segment consists of revenue derived from the LENSAR Laser System sales. Prospectively, we expect to focus on the acquisition of additional products and expect to transact fewer royalty transactions and still fewer debt transactions. We anticipate that over time more of our revenues will come from our pharmaceutical segment and less of our revenues will come from our income generating assets segment.

### Pharmaceutical

In 2016 we began acquiring, and plan to continue to acquire, commercial-stage products and companies who own or are acquiring pharmaceutical products. Our investment objective with respect to these transactions is to maximize our portfolio's total return by generating current income from product sales. We consummated our first investment of this type with the acquisition of Tektuma in July 2016.

### *Noden Purchase Agreement*

On July 1, 2016, Noden Pharma DAC, entered into an asset purchase agreement (“Noden Purchase Agreement”) whereby it purchased from Novartis the exclusive worldwide rights to manufacture, market, and sell the Noden Products and certain related assets and assumed certain related liabilities (the “Noden Transaction”). Upon the consummation of the Noden Transaction, a noncontrolling interest holder acquired 6% equity interests in Noden Pharma DAC and Noden Pharma USA, Inc. (together, with any subsidiaries, “Noden”). We purchased the equity interests of the noncontrolling interest holder in May 2017.

Tektuma (or Rasilez outside the United States) contains aliskiren, a direct renin inhibitor, for the treatment of hypertension. While indicated as a first line treatment, it is more commonly used as a third line treatment in those patients who are intolerant of angiotensin converting enzyme inhibitors (“ACEIs”) and angiotensin II receptor blockers (“ARBs”). It is not indicated for use with ACEIs and ARBs in patients with diabetes or renal impairment. Tektuma HCT (or Rasilez HCT outside the United States) is a combination of aliskiren and hydrochlorothiazide, a diuretic, for the treatment of hypertension in patients not adequately controlled by monotherapy and as an initial therapy in patients likely to need multiple drugs to achieve their blood pressure goals. It is not indicated for use with ACEIs and ARBs in patient with diabetes or renal impairment and not for use in patients with known anuria or hypersensitivity to sulfonamide derived drugs. Studies indicate that approximately 12% of hypertension patients are ACEI/ARB inhibitor-intolerant. Tektuma and Tektuma HCT are contraindicated for use by pregnant women.

The agreement between Novartis and Noden provides for various transition periods for development and commercialization activities relating to the Noden Products. Initially, Novartis will continue to distribute the four products on behalf of Noden worldwide and Noden will receive a profit transfer on such sales. In the United States, the duration of the profit transfer ran from July 1, 2016 through October 4, 2016. Outside the United States, the profit transfer is expected to run from July 1, 2016 through the fourth quarter of 2017. The event that terminates the profit transfer arrangement is the transfer of the marketing authorization for the four products from Novartis to Noden. Generally, the profit transfer to Noden is defined as gross revenues less product cost, a low single digit percentage as a fee to Novartis. Prior to the transfer of the marketing authorization, revenue will be recognized on a “net” basis; after the transfer of the marketing authorization, revenue will be recognized on a “gross” basis.

Because Novartis has not actively commercialized the four products for a number of years, and sales of the four products have been declining annually since that time, the ability of Noden to promote these four products successfully and efficiently will determine whether revenues can be stabilized and grown.

### **Medical Devices**

In May 2017, we acquired 100% of the equity interests of LENSAR, who previously was a borrower under a credit facility with us.

#### *LENSAR*

On May 11, 2017, pursuant to the terms of a Chapter 11 plan of reorganization, most of LENSAR’s outstanding debt owed to us was converted to equity and LENSAR became our wholly-owned subsidiary.

LENSAR is a medical device company focused on the next generation femtosecond cataract laser technology for refractive cataract surgery. Cataract surgery is the highest volume surgical procedure performed worldwide with over 24.9 million surgeries performed in 2016. The LENSAR Laser System offers cataract surgeons automation and customization for their astigmatism treatment planning and other essential steps of the refractive cataract surgery procedure with the highest levels of precision, accuracy, and efficiency. These features assist surgeons in managing astigmatism treatment for optimal overall visual outcomes.

The LENSAR Laser System has been approved by the FDA for anterior capsulotomy, lens fragmentation, and corneal and arcuate incisions.

For details regarding LENSAR see Note 18 to the Condensed Consolidated Financial Statements included in Item 1.

## **Income Generating Assets**

We acquire income generating assets when such assets can be acquired on terms that we believe allow us to increase return to our stockholders. The income generating assets are typically in the form of notes receivables, royalty rights and hybrid notes/royalty receivables and in some cases, equity. We primarily focus our income generating asset acquisition strategy on commercial-stage therapies and medical devices having strong economic fundamentals. However, our acquired income generating assets will not, in the near term, replace completely the revenues we generated from our license agreements related to our Queen et al. patents. In the second quarter of 2016, our revenues materially decreased after we stopped receiving payments from certain Queen et al. patent licenses and legal settlements, which accounted for 68%, 82% and 84% of our 2016, 2015 and 2014 revenues.

### *Royalty Rights - At Fair Value*

We have entered into various royalty purchase agreements with counterparties, whereby the counterparty conveys to us the right to receive royalties that are typically payable on sales revenue generated by the sale, distribution or other use of the counterparties' products. Certain of our royalty agreements provide the counterparty with the right to repurchase the royalty rights at any time for a specified amount.

We record the royalty rights at fair value using discounted cash flows related to the expected future cash flows to be received. We use significant judgment in determining our valuation inputs, including estimates as to the probability and timing of future sales of the licensed product. A third-party expert is generally engaged to assist us with the development of our estimate of the expected future cash flows. The estimated fair value of the asset is subject to variation should those cash flows vary significantly from our estimates. At each reporting period, an evaluation is performed to assess those estimates, discount rates utilized and general market conditions affecting fair market value.

While we currently maintain this portfolio of royalty rights, our intention is to pursue fewer of these transactions while we focus on acquiring additional specialty pharmaceutical products or companies. At September 30, 2017, we had a total of six royalty rights transactions outstanding.

### *Notes and Other Long-Term Receivables*

We have entered, and may continue to enter, into credit agreements with borrowers across the healthcare industry, under which we make available cash loans to be used by the borrower. Obligations under these credit agreements are typically secured by a pledge of substantially all the assets of the borrower and any of its subsidiaries. While we currently maintain this portfolio of notes receivable, our intention is to pursue fewer debt transactions, and focus on acquiring additional specialty pharmaceutical products or companies. At September 30, 2017, we had a total of two notes receivable transaction outstanding.

### *Royalties from Queen et al. patents*

While the Queen et al. patents have expired and the resulting royalty revenue has dropped substantially since the first quarter of 2016, we continue to receive royalty revenue from one product under the Queen et al. patent licenses, Tysabri®, as a result of sales of licensed product that was manufactured prior to patent expiry.

## **Intellectual Property**

### *Patents*

Tektuma is protected by multiple patents worldwide, which specifically cover the composition of matter, the pharmaceutical formulations and methods of production. In the United States, the FDA Orange Book lists one patent, U.S. patent No. 5,559,111 (the "111 Patent"), which covers compositions of matter comprising aliskiren. The '111 Patent expires on January 21, 2019, including a pediatric extension. In addition, the FDA Orange Book for Tektuma lists U.S. Patent No. 8,617,595, which covers certain compositions comprising aliskiren, together with other formulation components, and will expire on February 19, 2026. The FDA Orange Book for Tektuma HCT lists U.S. patent No. 8,618,172, which covers certain compositions comprising aliskiren, together with other formulation components, and will expire on July 13, 2028. In Europe, European patent No. 678 503B (the "503B Patent") expired in 2015. However, numerous SPCs have been granted which are based on the '503B Patent and which will provide for extended protection. These SPCs generally expire in April of 2020.

The LENSAR Laser System technology is protected by over 35 patents in the United States and over 60 pending patents in the United States and rest of the world.

We have been issued patents in the United States and elsewhere, covering the humanization of antibodies, which we refer to as our Queen et al. patents. Our Queen et al. patents, for which final patent expiry was in December 2014, covered, among other things, humanized antibodies, methods for humanizing antibodies, polynucleotide encoding in humanized antibodies and methods of producing humanized antibodies.

Our U.S. patent No. 5,693,761 (the “761 Patent”), which expired on December 2, 2014, covered methods and materials used in the manufacture of humanized antibodies. In addition to covering methods and materials used in the manufacture of humanized antibodies, coverage under our 761 Patent typically extended to the use or sale of compositions made with those methods and/or materials. Our European patent no. 0 451 216B (the “216B Patent”) expired in Europe in December 2009. We have been granted Supplementary Protection Certificates (“SPCs”) for the Avastin®, Herceptin®, Lucentis®, Xolair® and Tysabri® products in many of the jurisdictions in the European Union in connection with the 216B Patent. The SPCs effectively extended our patent protection with respect to Avastin, Herceptin, Lucentis, Xolair and Tysabri generally until December 2014, except that the SPCs for Herceptin expired in July 2014. Because SPCs are granted on a jurisdiction-by-jurisdiction basis, the duration of the extension varies slightly in certain jurisdictions. Our revenue from payments made from the Queen et al. patents license and settlement materially decreased in the second quarter of 2016, with only revenue from Tysabri being recognized after such period.

### *Licensing Agreements*

We have entered into licensing agreements under our Queen et al. patents with numerous entities that are independently developing or have developed humanized antibodies. Although the Queen et al. patents and related rights have expired, we are entitled under our license agreements to continue to receive royalties in certain instances based on net sales of products that were made prior to but sold after patent expiry. In addition, we are entitled to royalties based on know-how provided to a licensee. In general, these agreements cover antibodies targeting antigens specified in the license agreements. Under our licensing agreements, we are entitled to receive a flat-rate royalty based upon our licensees’ net sales of covered antibodies.

Our total revenues from licensees under our Queen et al. patents were \$1.4 million and \$15.0 million, net of rebates and foreign exchange hedge adjustments, for the three months ended September 30, 2017 and 2016, respectively, and \$31.9 million and \$150.6 million for the nine months ended September 30, 2017 and 2016.

### *Licensing Agreements for Marketed Products*

In the nine months ended September 30, 2017 and 2016, we received royalties on sales of Tysabri from Biogen, and in the three months ended March 31, 2016, we received royalties on sales of the six humanized antibody products listed below.

| <b>Licensee</b> | <b>Product Names</b> |
|-----------------|----------------------|
| Genentech       | Avastin              |
|                 | Herceptin            |
|                 | Xolair               |
|                 | Lucentis             |
|                 | Perjeta®             |
|                 | Kadcyla®             |

### *Genentech*

We entered into a master patent license agreement, effective September 25, 1998, under which we granted Genentech, Inc. (“Genentech”) a license under our Queen et al. patents to make, use and sell certain antibody products.

On January 31, 2014, we entered into the Settlement Agreement (the “Settlement Agreement”) with Genentech and F. Hoffman LaRoche, Ltd. (“Roche”) that resolved all existing legal disputes between the parties.

The Settlement Agreement precluded Genentech and Roche from challenging the validity of our patents, including our SPCs in Europe, from contesting their obligation to pay royalties to us, from contesting patent coverage for Avastin, Herceptin, Lucentis, Xolair, Perjeta, Kadcyla and Gazyva (collectively, the “Genentech Products”) and from assisting or encouraging any third party in challenging our patents and SPCs. The Settlement Agreement further outlined the conduct of any audits initiated by us of the books and records of Genentech in an effort to ensure a full and fair audit procedure. Finally, the Settlement



Agreement clarified that the sales amounts from which the royalties are calculated do not include certain taxes and discounts. Under the terms of the Settlement Agreement, we ceased receiving any revenue from Genentech after the first quarter of 2016.

### *Biogen*

We entered into a patent license agreement, effective April 24, 1998, under which we granted to Elan Corporation, plc (“Elan”) a license under our Queen et al. patents to make, use and sell antibodies that bind to the cellular adhesion molecule  $\alpha 4$  in patients with multiple sclerosis. Under the agreement, we are entitled to receive a flat royalty rate in the low, single digits based on Elan’s net sales of the Tysabri product. This license agreement entitles us to royalties following the expiration of our patents with respect to sales of licensed product manufactured prior to patent expiry in jurisdictions providing patent protection. In April 2013, Biogen, Inc. (“Biogen”) completed its purchase of Elan’s interest in Tysabri, and in connection with such purchase all obligations under our patent license agreement with Elan were assumed by Biogen.

### **Economic and Industry-wide Factors**

Various economic and industry-wide factors are relevant to our business, including changes to laws and interpretation of those laws that protect our intellectual property rights, our licensees’ ability to obtain or retain regulatory approval for products licensed under our patents, fluctuations in foreign currency exchange rates, the ability to attract, retain and integrate qualified personnel, as well as overall global economic conditions. We actively monitor economic, industry and market factors affecting our business; however, we cannot predict the impact such factors may have on our future results of operations, liquidity and cash flows. See also the risk factors included in “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016 and our subsequent quarterly filings for additional factors that may impact our business and results of operations.

### **Critical Accounting Policies and Use of Estimates**

Our management’s discussion and analysis of our financial condition and results of operations is based on our financial statements, which we have prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses and the disclosure of contingent assets and liabilities in our financial statements. We base our estimates on our limited historical experience, known trends and events and various other factors that we believe are reasonable under the circumstances, 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.

During the nine months ended September 30, 2017, there have been no significant changes to our critical accounting policies and estimates from those presented in Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended December 31, 2016, that are of significance, or potential significance, to us.

### **Operating Results**

*Three and nine months ended September 30, 2017, compared to three and nine months ended September 30, 2016*

## Revenues

|                                       | Three Months Ended<br>September 30, |           | Change from<br>Prior<br>Year % | Nine Months Ended<br>September 30, |            | Change from<br>Prior<br>Year % |
|---------------------------------------|-------------------------------------|-----------|--------------------------------|------------------------------------|------------|--------------------------------|
|                                       | 2017                                | 2016      |                                | 2017                               | 2016       |                                |
| <i>(Dollars in thousands)</i>         |                                     |           |                                |                                    |            |                                |
| Revenues                              |                                     |           |                                |                                    |            |                                |
| Royalties from Queen et al. patents   | \$ 1,443                            | \$ 14,958 | (90%)                          | \$ 31,884                          | \$ 150,645 | (79%)                          |
| Royalty rights - change in fair value | 35,353                              | 16,085    | 120%                           | 132,224                            | (11,872)   | 1,214%                         |
| Interest revenue                      | 6,051                               | 8,594     | (30%)                          | 16,968                             | 24,901     | (32%)                          |
| Product revenue, net                  | 20,067                              | 14,128    | 42%                            | 51,477                             | 14,128     | 264%                           |
| License and other                     | (165)                               | (127)     | (30%)                          | 19,471                             | 7          | 278,057%                       |
| Total revenues                        | \$ 62,749                           | \$ 53,638 | 17%                            | \$ 252,024                         | \$ 177,809 | 42%                            |

Total revenues were \$62.7 million for the three months ended September 30, 2017, compared with \$53.6 million for the three months ended September 30, 2016. Our total revenues increased by 17%, or \$9.1 million, for the three months ended September 30, 2017, when compared to the same period of 2016. The increase was primarily due to the increase in estimated fair value of the Depomed royalty asset recognized in revenues and the product revenues from the Noden Products and LENSAR. Total revenues were \$252.0 million for the nine months ended September 30, 2017, compared with \$177.8 million for the nine months ended September 30, 2016. Our total revenues increased by 42%, or \$74.2 million, for the nine months ended September 30, 2017, when compared to the same period of 2016. The increase was primarily due to the increase in estimated fair value of the Depomed royalty asset recognized in revenues, the Merck settlement payment and revenues from Noden and LENSAR product sales.

Revenue from our pharmaceutical segment for the three and nine months ended September 30, 2017 were \$15.1 million and \$43.9 million, respectively, compared to the same periods last year. All pharmaceutical revenues were derived from sales of the Noden Products. While we acquired the exclusive worldwide rights to manufacture, market, and sell the Noden Products from Novartis on July 1, 2016, Novartis was still the primary obligor during the first through third quarters of 2017 for ex-U.S. sales, therefore revenue is presented on a “net” basis for those periods for all ex-U.S. sales. Our revenue recognition policies require estimated product returns, pricing discounts including rebates offered pursuant to mandatory federal and state government programs and chargebacks, prompt pay discounts and distribution fees and co-pay assistance for product sales at each period.

The following table provides a summary of activity with respect to our sales allowances and accruals for the nine months ended September 30, 2017:

| <i>(in thousands)</i>                     | Discount and<br>Distribution Fees | Government<br>Rebates and<br>Chargebacks | Assistance and<br>Other Discounts | Product Return | Total     |
|---|-----------------------------------|--|-----------------------------------|----------------|-----------|
| Balance at December 31, 2016:             | \$ 2,475                          | \$ 5,514                                 | \$ 2,580                          | \$ 1,769       | \$ 12,338 |
| Allowances for current period sales       | 6,565                             | 14,455                                   | 6,625                             | 3,054          | 30,699    |
| Allowances for prior period sales         | —                                 | 253                                      | —                                 | —              | 253       |
| Credits/payments for current period sales | (3,048)                           | (4,720)                                  | (4,435)                           | (1,145)        | (13,348)  |
| Credits/payments for prior period sales   | (2,425)                           | (4,353)                                  | (1,488)                           | (1,024)        | (9,290)   |
| Balance at September 30, 2017             | \$ 3,567                          | \$ 11,149                                | \$ 3,282                          | \$ 2,654       | \$ 20,652 |

Revenue from our income generating assets segment for the three months ended September 30, 2017 were \$42.7 million, an increase of 8.0%, or \$3.2 million, compared to the same period last year, primarily due to the increase in fair value of the Depomed royalty asset and the Merck settlement payment in the second quarter of 2017. Revenues from our income generating assets segment for the nine months ended September 30, 2017 were \$200.5 million, an increase of 23%, or \$36.9 million, compared to the same period last year, primarily due to the increase in fair value of the Depomed royalty asset and the Merck settlement payment, partially offset by ceasing to receive revenue from Genentech after the first quarter of 2016.

Revenue from our medical devices segment for the three and nine months ended September 30, 2017 were \$5.0 million and \$7.6 million, respectively. All revenues from our medical devices segment were derived from LENSAR laser system revenue, procedures and consumables and service revenue which we began to recognize beginning May 11, 2017.

The following tables provides a summary of activity with respect to our royalty rights - change in fair value for the nine months ended September 30, 2017 (in thousands):

|         | Cash Royalties   | Change in Fair Value | Royalty Rights - Change in Fair Value |
|---------|------------------|----------------------|---------------------------------------|
| Depomed | \$ 66,465        | \$ 58,625            | \$ 125,090                            |
| VB      | 1,005            | 440                  | 1,445                                 |
| U-M     | 2,717            | 63                   | 2,780                                 |
| ARIAD   | 3,081            | (462)                | 2,619                                 |
| AcelRx  | 88               | 6,582                | 6,670                                 |
| Avinger | 915              | (777)                | 138                                   |
| KYBELLA | 133              | (6,651)              | (6,518)                               |
|         | <u>\$ 74,404</u> | <u>\$ 57,820</u>     | <u>\$ 132,224</u>                     |

The following table summarizes the percentage of our total revenues that individually accounted for 10% or more of our total revenues for the three and nine months ended September 30, 2017 and 2016:

| Licensee  | Product Name  | Three Months Ended September 30, |      | Nine Months Ended September 30, |      |
|-----------|---|----------------------------------|------|---------------------------------|------|
|           |   | 2017                             | 2016 | 2017                            | 2016 |
| Genentech | <i>Avastin</i>  | —%                               | —%   | —%                              | 22%  |
|           | <i>Herceptin</i>  | —%                               | —%   | —%                              | 22%  |
| Biogen    | <i>Tysabri</i>  | 2%                               | 28%  | 13%                             | 24%  |
| Depomed   | <i>Glumetza, Janumet XR, Jentadueto XR and Invokamet XR</i> | 50%                              | 18%  | N/M                             | N/A  |
| N/M       | <i>Tekturna, Tekturna HCT, Rasilez and Rasilez HCT</i>      | 24%                              | 26%  | 17%                             | 8%   |

*N/M = Not meaningful*

Foreign currency exchange rates impact our reported revenues, primarily from licenses of the Queen et al. patents. Our revenues may fluctuate due to changes in foreign currency exchange rates and are subject to foreign currency exchange risk. While foreign currency conversion terms vary by license agreement, generally most agreements require that royalties first be calculated in the currency of sale and then converted into U.S. dollars using the average daily exchange rates for that currency for a specified period at the end of the calendar quarter. Accordingly, when the U.S. dollar weakens against other currencies, the converted amount is greater than it otherwise would have been had the U.S. dollar strengthened. For example, in a quarter in which we generate \$10.0 million in royalty revenues, and when approximately \$5.0 million of such royalty revenues are based on sales in currencies other than U.S. dollar, if the U.S. dollar strengthens across all currencies by 10% during the reporting period for that quarter, when compared to the same amount of local currency royalties for the prior year, U.S. dollar converted royalties will be approximately \$0.5 million less in the current quarter than in the prior year's quarter.

We previously hedged certain Euro-denominated currency exposures related to our licensees' product sales with Euro forward contracts. We designated foreign currency exchange contracts used to hedge royalty revenues based on underlying Euro-denominated sales as cash flow hedges. The aggregate unrealized gain or loss, net of tax, on the effective portion of the hedge was recorded in stockholders' equity as "Accumulated other comprehensive income". Realized gains or losses on cash flow hedges were recognized as an adjustment to royalty revenue in the same period that the hedged transaction impacts earnings. For the three months ended September 30, 2017 and 2016, we recognized no additions in royalty revenues from our Euro forward contracts, for the nine months ended September 30, 2017 and 2016, we recognized zero and \$2.8 million, respectively.

## Operating Expenses

|  | Three Months Ended<br>September 30, |           | Change from<br>Prior<br>Year % | Nine Months Ended<br>September 30, |           | Change from<br>Prior<br>Year % |
|--|-------------------------------------|-----------|--------------------------------|------------------------------------|-----------|--------------------------------|
|  | 2017                                | 2016      |                                | 2017                               | 2016      |                                |
| <i>(In thousands)</i>  |                                     |           |                                |                                    |           |                                |
| Cost of product revenue, (excluding intangible amortization)         | \$ 5,565                            | \$ —      | N/M                            | \$ 12,632                          | \$ —      | N/M                            |
| Amortization of intangible assets                                    | 6,275                               | 6,014     | 4%                             | 18,438                             | 6,014     | 207%                           |
| General and administrative   | 11,989                              | 10,396    | 15%                            | 35,853                             | 27,193    | 32%                            |
| Sales and marketing  | 4,994                               | 11        | N/M                            | 11,194                             | 11        | N/M                            |
| Research and development   | 605                                 | 1,933     | (69)%                          | 6,652                              | 1,933     | 244%                           |
| Change in fair value of acquisition-related contingent consideration | 700                                 | 2,083     | (66)%                          | 3,349                              | 2,083     | 61%                            |
| Acquisition-related costs  | —                                   | 546       | N/M                            | —                                  | 3,505     | N/M                            |
| Total operating expenses   | \$ 30,128                           | \$ 20,983 | 44%                            | \$ 88,118                          | \$ 40,739 | 116%                           |
| Percentage of total revenues   | 48%                                 | 39%       |                                | 35%                                | 23%       |                                |

N/M = Not meaningful

The increase in operating expenses for the three months ended September 30, 2017, as compared to the same period in 2016, was a result of acquisitions in the pharmaceutical and medical devices segment, contributing an additional \$5.6 million of cost of product revenue, \$0.3 million of acquisition intangible amortization, \$5.0 million in sales and marketing, partially offset by a reduction of \$1.3 million in research and development costs for the completion of a pediatric trial for the acquired branded prescription medicines Tekturma and \$1.4 million in a change in fair value in acquisition-related contingent consideration. General and administrative expenses increased by \$1.6 million of which \$1.2 million was related to acquisitions in the medical device segment, \$1.7 million relates to increased Noden operating costs, partially offset by a \$1.0 million decrease in our legal expenses related to the Merck suit and \$0.5 million decrease of our asset purchase expenses.

The increase in operating expenses for the nine months ended September 30, 2017, as compared to the same period in 2016, was a result of acquisitions in pharmaceutical and medical devices segment, contributing an additional \$12.6 million of cost of product revenue, \$12.4 million of acquisition intangible amortization, \$11.2 million in sales and marketing, \$4.7 million in research and development costs for the completion of a pediatric trial for the acquired branded prescription medicines Tekturma, \$1.3 million in a change in fair value in acquisition-related contingent consideration and \$2.7 million in general and administrative expenses. General administrative expenses increased by \$8.7 million of which \$6.8 million was related to acquisitions in the pharmaceutical and medical devices segment, \$1.7 million relates to asset management expenses for LENSAR and Direct Flow Medical and approximately \$0.7 million of our professional consulting service expenses, partially offset by a decrease of \$0.9 million in our asset purchase expenses.

### Non-operating Expense, Net

Non-operating expense, net, for the three and nine months ended September 30, 2017 increased, as compared to the same periods in 2016, primarily due to the increase in interest expense from the December 2021 Note entered into during the fourth quarter of 2016, partially offset by the partial repayment of the February 2018 Notes in November 2016. The increase in interest expense for the three and nine months ended September 30, 2017, as compared to the same periods in 2016, consisted primarily of non-cash interest expense as we are required to compute interest expense using the interest rate for similar nonconvertible instruments in accordance with the accounting guidance for convertible debt instruments that may be settled in cash or other assets on conversion.

### Income Taxes

Income tax expense for the three months ended September 30, 2017 and 2016, was \$4.8 million and \$14.4 million, respectively, and for the nine months ended September 30, 2017 and 2016, by \$65.2 million and \$50.0 million, respectively, which resulted primarily from applying the federal statutory income tax rate to income before income taxes. Our effective tax rates for the current period differs from the U.S. federal statutory rate of 35% due primarily to the effect of Subpart F income as result of the

product acquisition triggering U.S. tax on our pro rata share of income earned by Noden as a controlled foreign corporation during the transitional service period. We intend to indefinitely reinvest all our undistributed foreign earnings outside the United States.

The uncertain tax positions increased during the three months ended September 30, 2017 and 2016, by zero and \$0.6 million, respectively, and increased during the nine months ended September 30, 2017 and 2016, by \$29.7 million and \$2.4 million, resulting from an increase in tax uncertainties and estimated tax liabilities.

### **Net Income per Share**

Net income per share for the three and nine months ended September 30, 2017 and 2016, is presented below:

|                                       | <b>Three Months Ended<br/>September 30,</b> |             | <b>Nine Months Ended<br/>September 30,</b> |             |
|---------------------------------------|---|-------------|--|-------------|
|                                       | <b>2017</b>                                 | <b>2016</b> | <b>2017</b>                                | <b>2016</b> |
| <b>Net income per share - basic</b>   | \$ 0.14                                     | \$ 0.08     | \$ 0.56                                    | \$ 0.45     |
| <b>Net income per share - diluted</b> | \$ 0.14                                     | \$ 0.08     | \$ 0.56                                    | \$ 0.45     |

### **Liquidity and Capital Resources**

We finance our operations primarily through royalty and other license-related revenues, public and private placements of debt and equity securities, interest income on invested capital and revenues from product sales. We currently have one part-time and ten full-time employees managing our intellectual property, our asset acquisitions and other corporate activities as well as providing for certain essential reporting and management functions of a public company.

We had cash, cash equivalents and short-term investments in the aggregate of \$516.5 million and \$167.1 million at September 30, 2017, and December 31, 2016, respectively. The increase was primarily attributable to the sale of note receivables for \$144.8 million, the repurchase by Takeda of the ARIAD royalty right asset for \$108.2 million, payment of the \$89.0 million anniversary payment, maturity of the investment-other asset for \$75.0 million, proceeds from royalty right payments of \$74.4 million, and the proceeds from sale of assets held for sale of \$8.1 million, partially offset by the repurchase of common stock for \$30.0 million, cash paid for the purchase of noncontrolling interest of \$2.2 million, the purchase of fixed assets of \$1.2 million, and cash used in operating activities of \$58.1 million.

On March 1, 2017, we announced that our board of directors authorized the repurchase of up to \$30.0 million of our common stock through March 2018. The repurchases under the share repurchase program were made from time to time in the open market or in privately negotiated transactions and were funded from the our working capital. All shares of common stock repurchased under this share repurchase program were retired and restored to authorized but unissued shares of common stock as of June 30, 2017. We repurchased 13.3 million shares of its common stock under the share repurchase program during the nine months ended September 30, 2017 for an aggregate purchase price of \$30.0 million, or an average cost of \$2.25 per share.

On September 25, 2017, we announced that our board of directors authorized the repurchase of issued and outstanding shares of the our common stock having an aggregate value of up to \$25.0 million pursuant to a share repurchase program. The repurchases under the share repurchase program are made from time to time in the open market or in privately negotiated transactions and are funded from the our working capital. The amount and timing of such repurchases are dependent upon the price and availability of shares, general market conditions and the availability of cash. Repurchases may also be made under a trading plan under Rule 10b5-1, which would permit shares to be repurchased when we might otherwise be precluded from doing so because of self-imposed trading blackout periods or other regulatory restrictions. All shares of common stock repurchased under the share repurchase program are expected to be retired and restored to authorized but unissued shares of common stock. As of September 30, 2017, we have not repurchased shares under this plan. The repurchase program may be suspended or discontinued at any time without notice.

Although the last of our Queen et al. patents expired in December 2014, we have received royalties beyond expiration based on the terms of our licenses and our legal settlements. We believe that cash from future revenues from acquired income generating assets and products, net of operating expenses, debt service and income taxes, plus cash on hand, will be sufficient to fund our operations over the next several years. However, our acquired income generating assets and products will not result in cash flows to us, in the near term, that will replace the cash flows we received from our license agreements related to the Queen et al. patents. In the second quarter of 2016, our cash flows materially decreased after we stopped receiving payments from certain of the Queen et al. patent licenses and our legal settlements. Our continued success is dependent on our ability to

acquire new income generating assets and products, and the timing of these transactions, in order to provide recurring cash flows going forward and to support our business model, and to pay amounts due on our debt as they become due.

We continuously evaluate alternatives to increase return for our stockholders, including, for example, purchasing income generating assets, selling discreet assets, buying back our convertible notes, repurchasing our common stock and selling our company.

We may consider additional debt or equity financings to support the growth of our business if cash flows from existing investments are not sufficient to fund future potential investment opportunities and acquisitions.

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

As of September 30, 2017, we did not have any off-balance sheet arrangements, as defined under SEC Regulation S-K Item 303(a)(4)(ii).

#### **Contractual Obligations**

##### *Convertible Notes*

As of September 30, 2017, our convertible note obligation consisted of our February 2018 Notes and December 2021 Notes, which in the aggregate totaled \$276.4 million in principal.

We expect that our debt service obligations over the next several years will consist of interest payments and repayment of our February 2018 Notes and December 2021 Notes. We may further seek to exchange, repurchase or otherwise acquire the convertible notes in the open market in the future, which could adversely affect the amount or timing of any distributions to our stockholders. We would make such exchanges or repurchases only if we deemed it to be in our stockholders' best interest. We may finance such repurchases with cash on hand and/or with public or private equity or debt financings if we deem such financings to be available on favorable terms.

##### *Noden Purchase Agreement*

Pursuant to the Noden Purchase Agreement, Noden is required to pay up to \$95.0 million in milestone payments, subject to the occurrence of such milestones. If the milestones are achieved, we expect to fund at least \$38.0 million in the form of additional equity contributions to Noden.

##### *Kybella Royalty Agreement*

On July 8, 2016, we entered into a royalty purchase and sales agreement with an individual, whereby we acquired that individual's rights to receive certain royalties on sales of KYBELLA by Allergan, in exchange for a \$9.5 million cash payment and up to \$1.0 million in a future milestone payment based upon product sales targets.

#### **Guarantees**

##### *Novartis Anniversary Payment Guarantee*

On June 30, 2016, we purchased a \$75.0 million certificate of deposit, which is designated as cash collateral for the \$75.0 million letter of credit issued on July 1, 2016 with respect to the first anniversary payment under the Noden Purchase Agreement. In addition, we provided an irrevocable and unconditional guarantee to Novartis, to pay up to \$14.0 million of the remaining amount of the first anniversary payment not covered by the letter of credit. We concluded that both guarantees are contingent obligations and shall be accounted for in accordance with ASC 450, *Contingencies*. Further, it was concluded that both guarantees do not meet the conditions to be accrued at September 30, 2017. On July 3, 2017, the first anniversary payment of \$89.0 million was paid pursuant to the Noden Purchase Agreement and the \$14.0 million guarantee expired. On July 31, 2017, the \$75.0 million certificate of deposit matured, and on August 1, 2017, the letter of credit terminated.

### *Redwood City Lease Guarantee*

In connection with the Spin-Off of Facet, we entered into amendments to the leases for our former facilities in Redwood City, California, under which Facet was added as a co-tenant, and a Co-Tenancy Agreement, under which Facet agreed to indemnify us for all matters related to the leases attributable to the period after the Spin-Off date.

### **Purchase Obligation**

In connection with the Noden Transaction, Noden entered into an unconditional purchase obligation with Novartis to acquire all local finished goods inventory in certain countries upon transfer of the applicable marketing authorization rights in such country. The purchase is payable within 60 days after the transfer of the marketing authorization rights. The agreement does not specify quantities but details pricing terms.

In addition, Noden and Novartis entered into a supply agreement pursuant to which Novartis will manufacture and supply to Noden a finished form of the Noden Products and bulk drug form of the Noden Products for specified periods of time prior to the transfer of manufacturing responsibilities for the Noden Products to another manufacturer. The supply agreement commits Noden to a minimum purchase obligation of approximately \$17.1 million and \$120.7 million over the next twelve and twenty-four months, respectively. Noden expects to meet this requirement.

LENSAR and Coherent, Inc. entered into an Original Equipment Manufacturer agreement pursuant to which Coherent, Inc. will manufacture and supply to LENSAR Staccato Lasers by December 31, 2017. The supply agreement commits LENSAR to a minimum purchase obligation of approximately \$1.1 million over the next three months. We expect LENSAR to meet this requirement.

### **Escrow Receivable**

On September 21, 2017, we entered into an agreement (the “kaléo Note Sale Agreement”) with MAM-Kangaroo Lender, LLC, a Delaware limited liability company (the “Purchaser”), pursuant to which we sold our entire interest in the notes issued by Accel 300, LLC (“Accel 300”) pursuant to that certain Indenture, dated as of April 1, 2014, by and between Accel 300 and U.S. Bank National Association, as the current trustee of the notes described therein (the “kaléo Note”).

Pursuant to the kaléo Note Sale Agreement, the Purchaser paid to us an amount equal to 100% of the then outstanding principal, a premium of 1% of such amount and accrued interest under the kaléo Notes, for an aggregate cash purchase price of \$141.7 million.

Pursuant to the terms of the kaléo Note Sale Agreement, \$1.4 million of the aggregate purchase price was deposited into an escrow account as a potential payment against certain contingencies and on the 18th month anniversary of the closing date, the escrow agent will release any funds remaining in the escrow account to us.

We do not believe that it will be subject to claims contemplated under the escrow agreement. However, in the event that such a claim is made, and if successful, the amount of such a claim up to \$1.4 million would be released from the escrow, which may reduce the amount ultimately returned to us when the 18 months escrow period has ended. As of September 30, 2017, we are not aware of any claims by the Purchaser that would reduce the escrow receivable.

**ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK**

As of September 30, 2017, there have been no material changes in our market risk from that described in “Item 7A. Quantitative and Qualitative Disclosures About Market Risk” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016.



## **ITEM 4. CONTROLS AND PROCEDURES**

### **Evaluation of Disclosure Controls and Procedures**

Under the supervision and with the participation of our Chief Executive Officer and Chief Financial Officer, we evaluated the effectiveness of the design and operation of our disclosure controls and procedures (as defined in Rules 13a-15(e) and 15d-15(e) of the Securities Exchange Act of 1934, as amended) as of September 30, 2017. Based on this evaluation, our Chief Executive Officer and Chief Financial Officer have concluded that, as of September 30, 2017, our disclosure controls and procedures were effective.

### **Changes in Internal Control Over Financial Reporting**

There have been no changes in our internal control over financial reporting that occurred during the quarter ended September 30, 2017, that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting. However, on July 1, 2016, we acquired the Noden Products. In accordance with the SEC's published guidance, our Annual Report on Form 10-K for the year ending December 31, 2016 did not include consideration of the internal controls of the acquired Noden Products within management's assessment of the effectiveness of internal control over financial reporting as of December 31, 2016. We are in the process of integrating the acquired Noden Products into our overall internal control over financial reporting process and will incorporate the acquired Noden Products into our annual assessment of internal control over financial reporting as of December 31, 2017.

In addition, on May 11, 2017, we acquired LENSAR. We are in the process of integrating the acquired LENSAR business and our management is in the process of evaluating any related changes to our internal control over financial reporting as a result of this integration. Except for any changes relating to this integration, there has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) for the nine months ended September 30, 2017, that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

### ***Limitations on the Effectiveness of Controls***

A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Because of inherent limitations in all control systems, including the possibility of collusion or improper management override of controls, material misstatements due to error or fraud may not be prevented or detected on a timely basis, and no evaluation of controls can provide absolute assurance that all control issues, if any, within an organization have been detected. We continue to improve and refine our internal controls and our compliance with existing controls is an ongoing process.

## PART II. OTHER INFORMATION

### ITEM 1. LEGAL PROCEEDINGS

The information set forth in Note 11 “Commitments and Contingencies” to our Notes to Condensed Consolidated Financial Statements included in Part I, Item 1, of this Quarterly Report on Form 10-Q is incorporated by reference herein.

### ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors included in “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2016, other than as previously disclosed in our Quarterly Report on Form 10-Q for the quarter period ended June 30, 2017.

### ITEM 2. UNREGISTERED SALES OF EQUITY SECURITIES AND USE OF PROCEEDS

There were no unregistered sales of equity securities during the period covered by this report.

#### Issuer Purchases of Equity Securities

On September 25, 2017, our board of directors authorized the repurchase of issued and outstanding shares of the Company’s common stock having an aggregate value of up to \$25.0 million pursuant to a new share repurchase program. As of September 30, 2017, we have not repurchased shares under this plan. The repurchase program may be suspended or discontinued at any time without notice.

### ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

### ITEM 4. MINE SAFETY DISCLOSURES

None.

### ITEM 5. OTHER INFORMATION

None.

### ITEM 6. EXHIBITS

The exhibits listed in the exhibit index following the signature page are filed or furnished as part of this report.

**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.

Dated: November 13, 2017  
PDL BIOPHARMA, INC. (REGISTRANT)

*/s/ John P. McLaughlin*

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**John P. McLaughlin**  
**Chief Executive Officer**  
**(Principal Executive Officer)**

*/s/ Peter S. Garcia*

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**Peter S. Garcia**  
**Vice President and Chief Financial Officer (Principal**  
**Financial Officer)**

*/s/ Steffen Pietzke*

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**Steffen Pietzke**  
**Vice President, Finance and Chief Accounting Officer**  
**(Principal Accounting Officer)**

## EXHIBIT INDEX

| Exhibit Number | Exhibit Title   |
|----------------|---|
| 3.1            | Restated Certificate of Incorporation effective March 23, 1993 (incorporated by reference to Exhibit 3.1 to Annual Report on Form 10-K filed March 31, 1993)  |
| 3.2            | <a href="#">Certificate of Amendment of Certificate of Incorporation effective August 21, 2001 (incorporated by reference to Exhibit 3.3 to Annual Report on Form 10-K filed March 14, 2002)</a>  |
| 3.3            | <a href="#">Certificate of Amendment of Certificate of Incorporation effective January 9, 2006 (incorporated by reference to Exhibit 99.1 to Current Report on Form 8-K filed January 10, 2006)</a>   |
| 3.4            | <a href="#">Certificate of Designation, Preferences and Rights of the Terms effective August 25, 2006 (incorporated by reference to Exhibit 3.4 to Registration Statement on Form 8-A filed September 6, 2006)</a>  |
| 3.5            | <a href="#">Third Amended and Restated Bylaws effective December 4, 2014 (incorporated by reference to Exhibit 99.1 to Current Report on Form 8-K filed December 9, 2014)</a>   |
| 3.6            | <a href="#">Certificate of Amendment of Restated Certificate of Incorporation effective May 22, 2013 (incorporated by reference to Exhibit 4.4 to Registration Statement on Form S-3 filed June 21, 2013)</a>   |
| 10.1*          | <a href="#">Offer Letter between the Company and Dominique Monnet, dated August 31, 2017 (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed September 11, 2017)</a>   |
| 10.2*#         | <a href="#">Confidential Separation Agreement and Release of All Claims between Danny Hart and the Company, dated as of October 23, 2017.</a>   |
| 10.3*          | <a href="#">Form of Nonstatutory Inducement Stock Option Grant Notice and Nonstatutory Inducement Stock Option Agreement between PDL BioPharma, Inc. and Dominique Monnet. (incorporated by reference to Exhibit 99.1 to Form S-8 Registration Statement filed September 12, 2017).</a> |
| 10.4*          | <a href="#">Form of Inducement Restricted Stock Grant Notice and Inducement Restricted Stock Agreement between PDL BioPharma, Inc. and Dominique Monnet (incorporated by reference to Exhibit 99.2 to Form S-8 Registration Statement filed September 12, 2017).</a>                    |
| 12.1#          | <a href="#">Ratio of Earnings to Fixed Charges</a>  |
| 31.1#          | <a href="#">Certification of Principal Executive Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended</a>  |
| 31.2#          | <a href="#">Certification of Principal Financial Officer pursuant to Rule 13a-14(a) or Rule 15d-14(a) of the Securities Exchange Act of 1934, as amended</a>  |
| 32.1***#       | <a href="#">Certifications of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002</a>  |
| 101.INS        | XBRL Instance Document  |
| 101.SCH        | XBRL Taxonomy Extension Schema  |
| 101.CAL        | XBRL Taxonomy Extension Calculation Linkbase  |
| 101.DEF        | XBRL Taxonomy Extension Definition Linkbase   |
| 101.LAB        | XBRL Taxonomy Extension Label Linkbase  |
| 101.PRE        | XBRL Taxonomy Extension Presentation Linkbase   |

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# Filed herewith.

\* Management contract or compensatory plan or arrangement.

\*\* This certification accompanies the Quarterly Report on Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of the registrant under the Securities Act of 1933, as amended, or the Securities Exchange Act of 1934, as amended (whether made before or after the date of the Quarterly Report on Form 10-Q), irrespective of any general incorporation language contained in such filing.

**CONFIDENTIAL SEPARATION AGREEMENT AND RELEASE OF ALL CLAIMS**

This Confidential Separation Agreement and Release of All Claims (“Agreement”) is made and entered into by and between **DANNY J. HART, JR** (hereinafter referred to as “Executive”) and **PDL BIOPHARMA, INC.**, including any and all affiliates, parents, subsidiaries, representatives, agents, insurers, officers, directors, and employees (hereinafter “PDL” or “the Company”).

**W I T N E S S E T H:**

WHEREAS, the Parties entered into a Severance Agreement as of December 12, 2012 which, as pertinent, provided Executive with certain “Termination Benefits” in exchange for a Release in the event he resigned from the Company for “Good Reason” as defined in Article 2 of that agreement; and

WHEREAS, Executive Claims that “Good Reason” exists for him to resign all of his affiliations including his employment with the Company;

WHEREAS, Executive has submitted his resignation to the Company effective October 20, 2017 (“the Termination Date”);

WHEREAS, the Parties have by this Agreement agreed to the terms applicable to Executive given his resignation from the Company;

NOW, THEREFORE, in consideration of the mutual covenants and promises herein contained and other good and valuable consideration, receipt of which is hereby acknowledged, it is hereby agreed by and between the Parties as follows:

1. **No Admission:** This Agreement and compliance with this Agreement shall not be construed as an admission by the Company of any liability whatsoever, or as an admission of any violation of Executive’s rights or the rights of any person, or the violation of any order, law, statute, duty, or contract whatsoever against Executive or any person. The Company specifically disclaims any liability to Executive or to any other person for any alleged violation of the rights of Executive or any person, or for any alleged violation of any order, law, statute, duty, or contract on the part of the Company, its Executives or agents or related companies or their Executives or agents.
2. **Consideration:** In consideration for entering this Agreement, the Company agrees to provide to Executive: **a one-time payment of \$2,305,438.00 USD.**

The foregoing is hereinafter referred to as the “Severance Amount.” Executive acknowledges and agrees that he is not entitled to any part of the Severance Amount but for his entering into this Agreement.

3. **Entire Consideration.** Executive agrees that the Severance Amount shall constitute the entire monetary consideration provided to Executive under this Agreement, and that he will not seek any further remuneration from the Company for any other damage, penalty, expense, wage, bonus, compensation, incentive equity program, commission, benefit, action, attorney fee or cost either individually or as part of a class in connection with the matters encompassed or released by this Agreement and/or arising out of Executive’s employment with and/or termination from the
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Company or any conduct or omissions occurring prior to the time Executive signs this Agreement after the Termination Date.

4. **Accord and Satisfaction.** As a material condition to the receipt of any severance Executive receives under this Agreement, Executive represents and warrants that he does not claim entitlement to, and shall not receive, any further compensation and/or benefits under any current or former employment agreement with, and/or any policy and/or any stock option, incentive equity, long-term incentive plan, severance agreement, Executive stock purchase and/or other benefit plan of the Company other than that included in the Severance Amount. In that regard, Executive further represents and warrants that he has been paid for all hours worked, that he has received all wages including accrued but unused vacation or PTO to which he was or is entitled, that he took all meal and rest periods to which he was entitled, that he has been reimbursed for all expenses to which he was or is entitled, and that he received all itemized wage statements to which Executive was entitled during his employment. To the extent any other compensation, penalties, interest, and/or benefits be claimed to exist by the Executive, this Agreement and the consideration hereunder expressly are agreed to and shall constitute an accord and satisfaction of any and all such claims and/or obligations, and extinguishes them.
5. **No Pending Actions.** Executive represents that he has not filed any complaints, claims, or actions against the Company, its officers, agents, directors, supervisors, Executives, or representatives with any state, federal, or local agency or court as of the date of execution of this Agreement.
6. **Covenant Not to Sue and No Suits Filed.** A “covenant not to sue” is a legal term that means a person promises not to file a lawsuit or other legal proceeding. It is different from the general release of claims contained above. Besides waiving and releasing the claims above, Executive promises never to file or prosecute a lawsuit or claim, charge or complaint of any kind against any Releasee in any forum for any reason based on any act, omission, event, occurrence or nonoccurrence, covered by the General Release. Excluded from this covenant not to sue are suits to enforce the terms of this Agreement or to challenge its validity under the ADEA. If Executive violates this covenant not to sue, Executive shall: (i) pay the Company’s reasonable attorney’s fees and other legal costs incurred in defending against Executive’s suit; or (ii) at the Company’s option, Executive shall be required to repay to the Company all but \$200 of the Monetary Consideration Executive received under this Agreement. Executive represents that, as of the date Executive executes this Agreement, he has not filed or caused to be filed any suits against any Releasee and that no such suits have been filed on his behalf.
7. **Confidentiality; Confidential Information; Non-Disparagement; Return of PDL Property.**
  - a. Executive agrees that he will keep the facts and terms of this Agreement completely confidential and that he will not hereafter disclose any information concerning this Agreement to anyone other than his spouse, lawyers and/or accountants, provided that any party hereto may make such disclosures as are required by law and as are necessary for legitimate law.
  - b. Executive acknowledges that during the course of his employment with PDL, he had access to and was entrusted with confidential personnel and business information (the “Confidential Information”). Executive agrees that he was obligated during employment with the Company

not to disclose at any time any Confidential Information to any person or entity without prior written permission from the President/CEO of the Company and understands that he will continue to be so obligated forever.

- c. Executive agrees that he does not have any of PDL's property in his possession, custody and control, including, but not limited to, all equipment (including electronic equipment such as hard drives), files, documents and data of any kind, whether stored in paper, disk, tape, or any other electronic form containing any information of PDL, all keys, cards, badges or other access devices. Executive agrees that to the extent that he has any PDL property in his possession, custody or control, he will immediately return all PDL property in both hard and soft form and will delete any such information for any computer or other device he has in his possession, custody or control.
8. **Non-Disparagement.** Executive agrees not to make any disparaging or defamatory comments to any third party concerning any Releasee or the Company's clients, Executives, products, services, methods of doing business or employment practices. Executive further agrees not to encourage or assist in any litigation against any Releasee, except insofar as Executive's testimony is required by law. Executive agrees further not to testify in any matter in which the Company has an interest unless he is under compulsory process or is asked to testify by the Company. If Executive is served with process concerning any matter in which the Employer has an interest, then Executive will immediately notify the President of the Company of such in writing and provide the President of the Company a copy of the process received by the Executive or Executive's representative.
9. **Non-Disparagement of Clients/Prospects.** Executive also agrees, on behalf of himself and his spouse, attorneys, representatives and agents, that neither he nor any of them will make any disparaging or defamatory comments to any third party concerning the Company's prospects and/or clients, their respective Executives, products, services, methods of doing business and/or employment practices.
10. **Breach.** If Executive breaches Paragraphs 8 or 9, then the Company shall have, in addition to and without limiting any other remedy or right it may have at law or in equity, the right to a temporary and permanent injunction restraining any such breach, without any bond or security being required. In any such proceeding, Executive waives any defense that the Company has an adequate remedy at law or that the injury suffered as a consequence of such breach is not irreparable.
11. **Non-Disclosure of Confidential or Proprietary Information.** Executive further understands and agrees that Executive shall not disclose to any third party any confidential or proprietary information of the Company and/or its clients regardless of how acquired or learned. By way of example and not limitation, such information includes client lists and/or related information, product plans and design, pricing, management organization or other organization charts, sales or marketing plans, compensation structures and data, product quality, research and development plans, and other business activities and plans. This Paragraph shall not restrict Executive's obligation to disclose such information pursuant to legal requirements, provided Executive first gives the Company prompt notice of such legal process and a copy of same in order that it shall have the opportunity to object to the disclosure of such information. Executive reaffirms the obligations Executive undertook when Executive signed the Proprietary Information And Invention Assignment (For Employees), attached

hereto as **Attachment A** and made a part of this Agreement as if fully set forth herein.

12. **Enforcement of Agreement.** Should any party to this Agreement seek intervention of a court to resolve a dispute under this Agreement the prevailing party shall be entitled to recover costs and expenses, including reasonable attorney fees incurred.

13. **Release.**

- a. In consideration of the benefits provided to Executive described in this Agreement, Executive, for himself, his spouse, and his successors and assigns, hereby irrevocably and unconditionally releases and forever discharges the Company and each and all of its owners, parents, subsidiaries, representatives, agents, insurers, directors, officers, agents, supervisors, Executives, attorneys, and their successors and assigns and all persons acting by, through, under, or in concert with any of them, from any and all charges, complaints, claims, and liabilities of any kind or nature whatsoever, known or unknown, suspected or unsuspected (“claim” or “claims”) which Executive at any time heretofore had or claimed to have, including, without limitation, any and all claims related or in any manner incidental to Executive’s employment with PDL or the ending of that relationship.
- b. The parties understand the word “claims” to include all actions, complaints, claims, and grievances, whether actual or potential, known or unknown, and specifically but not exclusively, all claims arising out of Executive’s employment with THE COMPANY and the termination thereof. All such claims (including related attorneys’ fees and costs) as may exist as of the date of this Agreement are forever barred, including but not limited to any and all tort claims, contract claims, wrongful termination claims, public policy claims, retaliation claims, statutory claims, personal injury claims, emotional distress claims, privacy claims, defamation claims, fraud claims, and any and all claims arising under any federal, state or other governmental statute, law, regulation or ordinance relating to employment, including but not limited to Title VII of the Civil Rights Act of 1964, as amended, the Americans with Disabilities Act, the Family and Medical Leave Act, the Executive Retirement Income Security Act, the Fair Labor Standards Act, the Nevada Fair Employment Practices Act (codified in Nevada Revised Statutes Chapter 613.310, *et. seq.*), and any federal, state or local laws covering discrimination in employment, including race, color, religious creed, national origin, ancestry, physical or mental disability, medical condition, marital status, military status, family care leave, pregnancy, sex, sexual orientation and harassment or retaliation. The only claims that are not released by this Agreement are claims that controlling law clearly states may not be released by settlement and claims that may arise after the execution of this Agreement.
- c. **Release of Age Discrimination Claims.** In accordance with the Older Workers Benefit Protection Act of 1990, Executive acknowledges that he agrees to the release of all known and unknown claims as of the date of this Agreement, including expressly the waiver of any rights or claims arising out of the Age Discrimination in Employment Act (“ADEA”) 29 U.S.C. § 621, et seq., and in connection with such waiver:
  - (i) Executive is hereby advised to consult with an attorney prior to signing this Agreement.



- (ii) Executive shall have a period of twenty-one (21) days from the date of receipt of this Agreement in which to consider the terms of the Agreement. Executive may at his option execute this Agreement at any time during the 21- day period. Executive acknowledges receipt of this Agreement as of October 20, 2017.
- (iii) Executive may revoke this Agreement at any time during the first seven (7) days following the execution of this Agreement, and this Agreement shall not be effective or enforceable until the seven-day period has expired. Executive may revoke this Agreement by notifying Chris Stone of the Company at [Chris.Stone@pdl.com](mailto:Chris.Stone@pdl.com) prior to the expiration of the 7-day period. This Agreement shall not become valid, effective or enforceable until the seven day period has expired, assuming that Executive has not previously revoked his assent to this Agreement (the “Effective Date”).
- (iv) Executive acknowledges and agrees that the consideration provided in this Agreement is in addition to anything of value that Executive would otherwise be entitled to receive from the Company and constitutes valid consideration in exchange for the releases set forth in this Agreement.

Executive understands that rights or claims under the Age Discrimination in Employment Act of 1967 (29 U.S.C. § 621 et seq.) that may arise after the date of this Agreement is executed are not waived.

- d. Nothing in this Release prevents Executive from filing a charge or complaint with, or from participating in, an investigation or proceeding conducted by the EEOC, the National Labor Relations Board, the Securities and Exchange Commission, or any other federal, state or local agency charged with the enforcement of any laws, including providing documents or other information, or prevents Executive from exercising rights under Section 7 of the NLRA to engage in protected, concerted activity with other Executives, although by signing this Release, Executive is waiving the right to recover any individual relief (including back pay, front pay, reinstatement or other legal or equitable relief) in any charge, complaint, or lawsuit or other proceeding brought by Executive or on his behalf by any third party, except for any right Executive may have to receive a payment from a government agency (and not the Company) for information provided to the government agency.

14. **Miscellaneous Acknowledgments by Executive.** Executive understands and agrees that he:

- a. Has had a reasonable opportunity to consider this Agreement before executing it.
- b. Has carefully read and fully understands all of the provisions of this Agreement.
- c. Is, through this Agreement, releasing the Company from any and all claims Executive may have against the Company.
- d. Knowingly and voluntarily agrees to all of the terms set forth in this Agreement.
- e. Knowingly and voluntarily intends to be legally bound by the same.

- f. Was advised and hereby is advised in writing to consider the terms of this Agreement and consult with an attorney of his choice prior to executing this Agreement.
15. **Assignment.** This Agreement shall be binding upon the parties hereto and upon their heirs, administrators, representatives, executors, successors, and assigns, and shall inure to the benefit of said parties and each of them and to their heirs, administrators, representatives, executors, successors, and assigns. Executive expressly warrants that he has not transferred to any person or entity any rights, causes of action, or claims released in this Agreement.
16. **General Provisions.** This Agreement shall be interpreted in accordance with the plain meaning of its terms and not strictly for or against any of the parties hereto. Additionally, this Agreement shall be governed by the laws of the State of Nevada. This Agreement shall constitute the complete and total agreement between the Company and Executive. Executive represents that he is not relying on any other agreements or oral representations not fully expressed in this Agreement. Executive agrees that this Agreement shall not be modified, altered, or discharged except by written instrument signed by an authorized Company representative and Executive. The headings in this Agreement are for reference only, and shall not in any way affect the meaning or interpretation of this Agreement. Executive further agrees that this Agreement may be used as evidence in a subsequent proceeding in which the Company or Executive alleges a breach of this Agreement or as a complete defense to any lawsuit. Other than this exception, Executive agrees that this Agreement will not be introduced as evidence in any legal or administrative proceeding or in any lawsuit.
17. **Enforceability.** Should any provision of this Agreement be declared or be determined by any court of competent jurisdiction to be wholly or partially illegal, invalid, or unenforceable, the legality, validity, and enforceability of the remaining parts, terms, or provisions shall not be affected thereby, and said illegal, unenforceable, or invalid part, term, or provision shall be deemed not to be a part of this Agreement.
18. **Complete Agreement.** This Agreement supersedes all prior agreements entered into between the Parties. The Parties represent that they are not relying on anything not contained in this Agreement.
19. **Execution.** To be valid, effective and enforceable, within 21 days of Executive's receipt of this Agreement, and no earlier than after the Termination Date, he must place his initials in the lower-right hand corner of each page, sign and date it at its end, then send an executed copy to Chris Stone at [Chris.Stone@pdl.com](mailto:Chris.Stone@pdl.com).
20. **Agreement Is Knowing and Voluntary.** Executive understands and agrees that Executive:
- a. has had a reasonable time within which to consider this Agreement before executing it;
  - b. has carefully read and fully understands all of the provisions of this Agreement;
  - c. knowingly and voluntarily agrees to all of the terms set forth in this Agreement; and

d. knowingly and voluntarily intends to be legally bound by the same.

**THE UNDERSIGNED STATE THAT THEY HAVE CAREFULLY READ THE AGREEMENT, KNOW, UNDERSTAND, ACCEPT AND AGREE TO ITS CONTENTS.**

WHEREFORE, the Parties have read all of the foregoing, understand the same and agree to all of the provisions contained herein.

Dated: October 22, 2017 /s/ Danny J. Hart, Jr.  
Danny J. Hart, Jr.

PDL BIOPHARMA, INC.

Dated: October 23, 2017 By: /s/ John McLaughlin  
John McLaughlin, Chief Executive Officer

**PDL BIOPHARMA, INC.**  
**COMPUTATION OF RATIO OF EARNINGS TO FIXED CHARGES**  
**(Unaudited)**  
**(Amount in thousands, except for ratios)**

|   | <b>2012</b>       | <b>2013</b>       | <b>2014</b>       | <b>2015</b>       | <b>2016</b>       | <b>For the Nine Months<br/>Ended September<br/>30, 2017</b> |
|---|-------------------|-------------------|-------------------|-------------------|-------------------|---|
| <b>Earnings:</b>  |                   |                   |                   |                   |                   |   |
| Income before income taxes                              | \$ 327,133        | \$ 401,876        | \$ 501,272        | \$ 530,138        | \$ 106,670        | \$ 153,545  |
| Add: fixed charges                                      | 29,097            | 24,931            | 39,274            | 27,123            | 18,330            | 15,253  |
| Earnings  | <u>\$ 356,230</u> | <u>\$ 426,807</u> | <u>\$ 540,546</u> | <u>\$ 557,261</u> | <u>\$ 125,000</u> | <u>\$ 168,798</u>   |
| <b>Fixed Charges:</b>                                   |                   |                   |                   |                   |                   |   |
| Interest expense <sup>1</sup>                           | \$ 29,036         | \$ 24,871         | \$ 39,211         | \$ 27,059         | \$ 18,267         | \$ 15,082   |
| Estimated interest portion of rent expense <sup>2</sup> | 61                | 60                | 63                | 64                | 63                | 171   |
| Fixed charges   | <u>29,097</u>     | <u>\$ 24,931</u>  | <u>\$ 39,274</u>  | <u>\$ 27,123</u>  | <u>\$ 18,330</u>  | <u>\$ 15,253</u>  |
| Ratio of earnings to fixed charges                      | <u>12.24</u>      | <u>17.12</u>      | <u>13.76</u>      | <u>20.55</u>      | <u>6.82</u>       | <u>11.07</u>  |

<sup>1</sup> Interest expense includes amortization of debt discount and expenses.

<sup>2</sup> Represents the estimated portion of operating lease rental expense that is considered by us to be representative of interest and amortization of discount related to indebtedness.

**CERTIFICATIONS**

I, John P. McLaughlin, Chief Executive Officer, of PDL BioPharma, Inc., certify that:

- (1) I have reviewed this Quarterly Report on Form 10-Q of PDL BioPharma, Inc.;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- (4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- (5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2017

/s/ John P. McLaughlin

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John P. McLaughlin

Chief Executive Officer

(Principal Executive Officer)

**CERTIFICATIONS**

I, Peter S. Garcia, Vice President and Chief Financial Officer, of PDL BioPharma, Inc., certify that:

- (1) I have reviewed this Quarterly Report on Form 10-Q of PDL BioPharma, Inc.;
- (2) Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
- (3) Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
- (4) The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
  - a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
  - b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
  - c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
  - d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
- (5) The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
  - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
  - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 13, 2017

/s/ Peter S. Garcia

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Peter S. Garcia

Vice President and Chief Financial Officer

(Principal Financial Officer)

**CERTIFICATION**

Pursuant to the requirement set forth in Rule 13a-14(b) of the Securities Exchange Act of 1934, as amended (the "Exchange Act"), and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. Section 1350), John P. McLaughlin, Chief Executive Officer of PDL BioPharma, Inc. (the "Company"), and Peter S. Garcia, Vice President and Chief Financial Officer of the Company, each hereby certifies that, to the best of their knowledge:

- (1) The Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2017, to which this Certification is attached as Exhibit 32.1 (the "Periodic Report"), fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, and
- (2) The information contained in the Periodic Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 13, 2017

By:

/s/ JOHN P. MCLAUGHLIN

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**John P. McLaughlin**  
**Chief Executive Officer**  
**(Principal Executive Officer)**

By:

/s/ PETER S. GARCIA

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**Peter S. Garcia**  
**Vice President and Chief Financial Officer**  
**(Principal Financial Officer)**

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(1) This certification accompanies the Quarterly Report on Form 10-Q to which it relates, is not deemed filed with the Securities and Exchange Commission and is not to be incorporated by reference into any filing of PDL BioPharma, Inc. under the Securities Act of 1933, as amended, or the Exchange Act (whether made before or after the date of the Form 10-Q), irrespective of any general incorporation language contained in such filing. A signed original of this written statement required by Section 906 of the Sarbanes-Oxley Act of 2002 has been provided to PDL BioPharma, Inc. and will be retained by PDL BioPharma, Inc. and furnished to the Securities and Exchange Commission or its staff upon request.

