UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934**
For the quarterly period ended June 30, 2012

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	**94-3023969**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification Number)**

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 x 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 x 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 x	*Accelerated filer ☐*	*Non-accelerated filer ☐*	*Smaller reporting company ☐*
	(Do not check if a smaller reporting company)		

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

As of July 27, 2012, there were 139,931,204 shares of the Registrant's Common Stock outstanding.

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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 June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Revenues:				
Royalties	$ 125,904	$ 122,127	$ 203,248	$ 195,463
License and other	-	-	-	10,000
Total revenues	125,904	122,127	203,248	205,463
Operating expenses:				
General and administrative	5,145	3,776	12,090	9,555
Operating income	120,759	118,351	191,158	195,908
Non-operating expense, net				
Loss on retirement or conversion of convertible notes	-	(766)	-	(766)
Interest and other income, net	428	157	518	332
Interest expense	(7,872)	(9,780)	(16,573)	(18,934)
Total non-operating expense, net	(7,444)	(10,389)	(16,055)	(19,368)
Income before income taxes	113,315	107,962	175,103	176,540
Income tax expense	39,813	37,976	61,417	62,009
Net income	$ 73,502	$ 69,986	$ 113,686	$ 114,531
Net income per share				
Basic	$ 0.53	$ 0.50	$ 0.81	$ 0.82
Diluted	$ 0.52	$ 0.38	$ 0.80	$ 0.63
Cash dividends declared per common share	$ -	$ -	$ 0.60	$ 0.60
Weighted average shares outstanding				
Basic	139,683	139,650	139,681	139,645
Diluted	142,213	186,060	142,890	186,055

See accompanying notes.

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

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	**2011**	**2012**	**2011**
Net income	$ 73,502	$ 69,986	$ 113,686	$ 114,531
Other comprehensive income (loss), net of tax				
Unrealized gains (losses) on investments in available-for-sale securities	(16)	71	13	47
Unrealized gain (losses) on cash flow hedges	8,950	(1,478)	2,273	(9,261)
Total other comprehensive income (loss), net of tax	8,934	(1,407)	2,286	(9,214)
Comprehensive income	$ 82,436	$ 68,579	$ 115,972	$ 105,317

See accompanying notes.

PDL BIOPHARMA, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS
(In thousands, except per share amounts)

	June 30, 2012	December 31, 2011
Assets	(unaudited)	(Note 1)
Current assets:		
Cash and cash equivalents	$ 184,506	$ 168,544
Short-term investments	43,812	42,301
Receivables from licensees	-	600
Deferred tax assets	5,162	10,054
Prepaid and other current assets	3,340	12,014
Total current assets	236,820	233,513
Property and equipment, net	33	22
Long-term investments	1,015	17,101
Note receivable	7,435	-
Long-term deferred tax assets	4,848	11,481
Other assets	9,678	7,354
Total assets	$ 259,829	$ 269,471
Liabilities and Stockholders' Deficit		
Current liabilities:		
Accounts payable	$ 155	$ 528
Accrued legal settlement	-	27,500
Accrued liabilities	51,006	11,609
Accrued income taxes	18,588	-
Current portion of non-recourse notes payable	22,738	93,370
Total current liabilities	92,487	133,007
Convertible notes payable	304,767	316,615
Other long-term liabilities	23,689	24,122
Total liabilities	420,943	473,744
Commitments and contingencies (Note 8)		
Stockholders' deficit:		
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, 250,000 shares authorized; 139,714 and 139,680 shares issued and outstanding at June 30, 2012 and December 31, 2011, respectively	1,397	1,397
Additional paid-in capital	(234,563)	(161,750)
Accumulated other comprehensive income (loss)	401	(1,885)
Retained earnings (Accumulated deficit)	71,651	(42,035)
Total stockholders' deficit	(161,114)	(204,273)
Total liabilities and stockholders' deficit	$ 259,829	$ 269,471

See accompanying notes.

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

	Six Months Ended June 30,	
	2012	**2011**
Cash flows from operating activities		
Net income	$ 113,686	$ 114,531
Adjustments to reconcile net income to net cash provided by operating activities:		
Discounts and deferred issuance costs	7,221	4,076
Other amortization, depreciation and accretion	586	669
Loss on retirement or conversion of convertible notes	-	766
Stock-based compensation expense	436	7
Excess tax benefit from stock-based compensation	(7)	-
Deferred taxes	4,543	19,423
Changes in assets and liabilities:		
Receivables from licensees	600	469
Prepaid and other current assets	6,580	7,207
Other assets	(1,167)	(5,759)
Accounts payable	(373)	(2,416)
Accrued legal settlement	(27,500)	(37,500)
Accrued liabilities	1,098	1,163
Accrued income taxes	18,588	12,575
Other long-term liabilities	(1,498)	(27,288)
Net cash provided by operating activities	122,793	87,923
Cash flows from investing activities		
Purchases of investments	(5,993)	(58,359)
Maturities of investments	20,000	26,146
Issuance of Note receivable	(7,425)	-
Purchase of intangible assets	-	(50)
Acquisition of property and equipment	(19)	-
Net cash provided by (used in) investing activities	6,563	(32,263)
Cash flows from financing activities		
Repurchase of convertible notes	-	(134,464)
Repayment of non-recourse notes	(70,632)	(62,570)
Payment of debt issuance costs	(845)	-
Net proceeds from the issuance of convertible notes	-	149,643
Purchase of call options	-	(20,765)
Proceeds from issue of warrants	-	10,868
Cash dividends paid	(41,924)	(41,924)
Excess tax benefit from stock-based compensation	7	-
Net cash used in financing activities	(113,394)	(99,212)
Net increase (decrease) in cash and cash equivalents	15,962	(43,552)
Cash and cash equivalents at beginning of the year	168,544	211,574
Cash and cash equivalents at end of period	$ 184,506	$ 168,022
Supplemental cash flow information		
Cash paid for income taxes	$ 30,000	$ 28,000
Cash paid for interest	$ 9,673	$ 13,786

See accompanying notes.

1. Summary of Significant Accounting Policies

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with U.S. generally accepted accounting principles (GAAP) for interim financial information. The financial statements include all adjustments (consisting only of normal recurring adjustments) the management of PDL BioPharma, Inc. (the Company, PDL, we, us or our) 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 Condensed Consolidated Financial Statements and related financial information should be read in conjunction with the audited Consolidated Financial Statements and the related notes thereto for the year ended December 31, 2011, included in our Annual Report on Form 10-K filed with the U.S. Securities and Exchange Commission. The Condensed Consolidated Balance Sheet at December 31, 2011, has been derived from the audited Consolidated Financial Statements at that date.

Principles of Consolidation

The Consolidated Financial Statements include the accounts of PDL and its wholly-owned subsidiaries. All material intercompany balances and transactions have been eliminated in consolidation.

Customer Concentration

The percentage of total revenue earned from our licensees' net product sales, which individually accounted for 10% or more of our total revenues, was:

		Three Months Ended June 30,		Six Months Ended June 30,	
Licensee	**Product Name**	**2012**	**2011**	**2012**	**2011**
Genentech, Inc. (Genentech)	*Avastin*®	33%	34%	32%	31%
	Herceptin®	35%	35%	35%	33%
	Lucentis®	22%	20%	19%	16%
Elan Corporation, Plc (Elan)	*Tysabri*®	10%	9%	12%	10%

Foreign Currency Hedging

We hedge certain Euro-denominated currency exposures related to our licensees' product sales with Euro forward contracts. In general, these contracts are intended to offset the underlying Euro market risk in our royalty revenues. We do not enter into speculative foreign currency transactions. We have designated the Euro forward contracts as cash flow hedges.

At the inception of the hedging relationship and on a quarterly basis, we assess hedge effectiveness. The fair value of the Euro forward contracts is estimated using pricing models with readily observable inputs from actively quoted markets and is disclosed on a gross basis. The aggregate unrealized gain or loss, net of tax, on the effective portion of the hedge is recorded in stockholders' deficit as accumulated other comprehensive income (loss). Gains or losses on cash flow hedges are recognized as an adjustment to royalty revenue in the same period that the hedged transaction impacts earnings as royalty revenue. In January 2012, we modified our existing Euro forward and option contracts related to our licensees' sales through December 2012 into Euro forward contracts with more favorable rates. Ineffectiveness, if any, resulting from either the modified 2012 hedge or lower than forecasted Euro-based royalties is reclassified from other comprehensive income (loss) and recorded as interest and other income, net, in the period it occurs.

Comprehensive Income

In the first quarter of 2012, we adopted Financial Accounting Standards Board (FASB) accounting standard update (ASU) 2011-05, and have presented the components of other comprehensive income (loss) in the Condensed Consolidated Statements of Comprehensive Income. Also in accordance with this ASU, we have applied this guidance retrospectively to all periods presented. The adoption of the guidance was a change to the presentation of other comprehensive income (loss) and had no effect on our condensed consolidated financial statements. See Note 14 for our discussion of accumulated other comprehensive income (loss).

Recent Accounting Pronouncements

In December 2011, the FASB issued ASU 2011-11 that requires new disclosures associated with offsetting financial instruments and derivative instruments on the balance sheet that will enable users to evaluate the effect on an entity's financial position. The ASU will be effective for our first quarter of 2013, but is not expected to have a material impact on our financial statements.

2. Net Income per Share

	Three Months Ended June 30,		Six Months Ended June 30,	
Net Income per Basic and Diluted Share:	**2012**	**2011**	**2012**	**2011**
	(In thousands, except per share amounts)			
Numerator				
Net income used to compute net income per basic share	$ 73,502	$ 69,986	$ 113,686	$ 114,531
Add back interest expense for convertible notes, net of estimated tax of $3,000 and $0.7 million for the three months ended June 30, 2012 and 2011, respectively and $18,000 and $1.4 million for the six months ended June 30, 2012 and 2011, respectively (see Note 9)	6	1,275	33	2,549
Income used to compute net income per diluted share	$ 73,508	$ 71,261	$ 113,719	$ 117,080
Denominator				
Total weighted-average shares used to compute net income per basic share	139,683	139,650	139,681	139,645
Restricted stock outstanding	100	26	84	27
Effect of dilutive stock options	15	14	15	13
Assumed conversion of Series 2012 Notes	2,252	-	2,189	-
Assumed conversion of 2012 Notes	-	19,743	-	19,743
Assumed conversion of February 2015 Notes	163	26,627	921	26,627
Weighted-average shares used to compute net income per diluted share	142,213	186,060	142,890	186,055
Net income per basic share	$ 0.53	$ 0.50	$ 0.81	$ 0.82
Net income per diluted share	$ 0.52	$ 0.38	$ 0.80	$ 0.63

We compute net income per basic share using the weighted-average number of shares of common stock outstanding during the period less the weighted-average number of restricted stock shares that are subject to repurchase.

We compute 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 under our stock options and restricted stock awards, our 2.875% Convertible Senior Notes due February 15, 2015 (February 2015 Notes), our 2.875% Series 2012 Convertible Notes due February 15, 2015 (Series 2012 Notes), our 3.75% Senior Convertible Notes due May 1, 2015 (May 2015 Notes) and, in 2011, our 2.00% Convertible Senior Notes due February 15, 2012 (2012 Notes), on a weighted average basis for the period that the notes were outstanding, including the effect of adding back interest expense, net of tax, and the underlying shares using the if-converted method. Our 2012 Notes were fully retired as of June 30, 2011, and $179.0 million aggregate principal amount of our February 2015 Notes was exchanged for our Series 2012 Notes in the first quarter of 2012.

The Series 2012 Notes are net share settled, with the principal amount settled in cash and the excess settled in our common stock. The weighted-average share adjustment related to our Series 2012 Notes includes the shares issuable in respect of such excess.

We excluded 22.1 million and 20.0 million shares of potential dilution for the May 2015 Notes and 18.8 million and 17.0 million shares of potential dilution for our warrants for the six months ended June 30, 2012 and 2011, respectively, because the conversion price of the Notes and exercise price of the warrants exceeded the average market price of our common stock and thus, for the periods presented, no stock was issuable upon conversion. These securities could be dilutive in future periods. In addition, we excluded 22.1 million and 20.0 million shares for our purchased call options for the six months ended June 30, 2012 and 2011, respectively because they will always be anti-dilutive and therefore, will have no effect on diluted net income per share. For further information related to our convertible notes, see Note 9.

We excluded 0.2 million shares underlying outstanding stock options, calculated on a weighted average, from our net income per diluted share calculations for each of the three and six months ended June 30, 2012 and June 30, 2011, because their effect was anti-dilutive.

3. Fair Value Measurements

The fair value of our financial instruments are estimates of the amounts that would be received if we were to sell an asset or we paid 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. As of June 30, 2012, and December 31, 2011, we had no Level 3 assets or liabilities.

Assets and Liabilities Recorded at Fair Value by Classification	**June 30, 2012**			**December 31, 2011**		
	Level 1	**Level 2**	**Total**	**Level 1**	**Level 2**	**Total**
(In thousands)						
Assets:						
Money market funds	$ 127,068	$ -	$ 127,068	$ 163,368	$ -	$ 163,368
Corporate debt securities	-	37,314	37,314	-	44,877	44,877
Commercial paper	-	-	-	-	8,996	8,996
U.S. government sponsored agency bonds	2,008	-	2,008	2,015	-	2,015
U.S. treasury securities	5,505	-	5,505	5,513	-	5,513
Foreign currency hedge contracts	-	2,675	2,675	-	6,838	6,838
Total	$ 134,581	$ 39,989	$ 174,570	$ 170,896	$ 60,711	$ 231,607
Liabilities:						
Foreign currency hedge contracts	$ -	$ 2,122	$ 2,122	$ -	$ 9,783	$ 9,783

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

The fair value of commercial paper is estimated based on observable inputs of the comparable securities.

The fair value of the foreign currency hedging contracts is estimated based on pricing models using readily observable inputs from actively quoted markets and is disclosed on a gross basis.

Assets and Liabilities Not Recorded at Fair Value by Classification Category	June 30, 2012		December 31, 2011	
	Carrying Value	Fair Value Level 2	Carrying Value	Fair Value Level 2
(In thousands)				
Assets:				
Note receivable	$ 7,435	$ 7,445	$ -	$ -
Liabilities:				
Series 2012 Notes	$ 162,626	$ 207,193	$ -	$ -
May 2015 Notes	141,152	168,640	138,952	156,123
February 2015 Notes	989	1,158	177,663	191,475
Non-recourse Notes	22,738	23,192	93,370	95,237
Total	$ 327,505	$ 400,183	$ 409,985	$ 442,835

The fair value of our note receivable was determined using discounted cash flows incorporating expected payments and the interest rate extended on the note.

The fair value of our convertible notes and our Non-recourse Notes, as defined herein, was based on quoted market pricing or dealer quotes of our then outstanding notes.

4. Cash Equivalents and Investments

As of June 30, 2012, and December 31, 2011, we had invested our excess cash balances primarily in money market funds, corporate debt securities, commercial paper, U.S. government sponsored agency bonds and U.S. treasury securities. Our securities are classified as available-for-sale and are carried at estimated fair value, with unrealized gains and losses, net of estimated taxes, reported in accumulated other comprehensive income (loss) in stockholders' deficit. See Note 3 for fair value measurement information. The cost of securities sold is based on the specific identification method. To date, we have not experienced credit losses on investments in these instruments and we do not require collateral for our investment activities.

Summary of Available-For-Sale Securities	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
(In thousands)				
June 30, 2012:				
Money market funds	$ 127,068	$ -	$ -	$ 127,068
Corporate debt securities	37,263	52	(1)	37,314
Commercial paper	-	-	-	-
U.S. government sponsored agency bonds	2,002	6	-	2,008
U.S. treasury securities	5,498	7	-	5,505
Total	$ 171,831	$ 65	$ (1)	$ 171,895
December 31, 2011:				
Money market funds	$ 163,368	$ -	$ -	$ 163,368
Corporate debt securities	44,863	57	(43)	44,877
Commercial paper	8,997	-	(1)	8,996
U.S. government sponsored agency bonds	2,003	12	-	2,015
U.S. treasury securities	5,494	19	-	5,513
Total	$ 224,725	$ 88	$ (44)	$ 224,769

Classification on Condensed Consolidated Balance Sheets:	June 30, 2012	December 31, 2011
(In thousands)		
Cash equivalents	$ 127,068	$ 165,367
Short-term investments	43,812	42,301
Long-term investments	1,015	17,101
Total	$ 171,895	$ 224,769

Available-For-Sale Debt Securities by Contractual Maturity	June 30, 2012		December 31, 2011	
	Amortized Cost	Fair Value	Amortized Cost	Fair Value
(In thousands)				
Less than one year	$ 43,754	$ 43,812	$ 44,262	$ 44,300
Greater than one year but less than five years	1,009	1,015	17,095	17,101
Total	$ 44,763	$ 44,827	$ 61,357	$ 61,401

We did not recognize any gains or losses on sales of available-for-sale securities for the three and six months ended June 30, 2012 and 2011. The net unrealized gain on investments included in other comprehensive income, net of tax, was approximately $42,000 as of June 30, 2012. No significant facts or circumstances have arisen to indicate that there has been any deterioration in the creditworthiness of the issuers of these securities. Based on our review of these securities, we believe we had no other-than-temporary impairments on these securities as of June 30, 2012. Our 2012 investments in a loss position at June 30, 2012, reflected unrealized losses of less than $1,000, net of tax.

5. Foreign Currency Hedging

In January 2012, we modified our existing Euro forward and option contracts related to our licensees' sales through December 2012 into Euro forward contracts with more favorable rates. Additionally, we entered into a series of Euro forward contracts covering the quarters in which our licensees' sales occur through December 2013.

The foreign currency exchange contracts used to hedge royalty revenues based on underlying Euro-denominated sales are designated as cash flow hedges. Euro forward contracts are presented on a net basis on our Condensed Consolidated Balance Sheets as we have entered into a netting arrangement with the counterparty.

The notional amounts, Euro exchange rates, fair values of our Euro forward contracts at June 30, 2012, and Euro forward and option contracts at December 31, 2011, designated as cash flow hedges were:

Euro Forward Contracts

Currency	Settlement Price ($ per Eurodollar)	Type	June 30, 2012 (In thousands) Notional Amount	June 30, 2012 (In thousands) Fair Value	December 31, 2011 (In thousands) Notional Amount	December 31, 2011 (In thousands) Fair Value
Euro	1.400	Sell Euro	$ -	$ -	$ 25,150	$ 1,837
Euro	1.200	Sell Euro	-	-	117,941	(9,783)
Euro	1.230	Sell Euro	85,494	(2,122)	-	-
Euro	1.300	Sell Euro	128,700	2,675	-	-
Total			$ 214,194	$ 553	$ 143,091	$ (7,946)

Euro Option Contracts

Currency	Strike Price ($ per Eurodollar)	Type	Notional Amount	Fair Value	Notional Amount	Fair Value
Euro	1.510	Purchased call option	$ -	$ -	$ 27,126	$ -
Euro	1.315	Purchased call option	-	-	129,244	5,001
Total			$ -	$ -	$ 156,370	$ 5,001

The location and fair values of our Euro contracts in our Condensed Consolidated Balance Sheets were:

Cash Flow Hedge	Location	June 30, 2012	December 31, 2011
(In thousands)			
Euro contracts	Prepaid and other current assets	$ 831	$ 1,837
Euro contracts	Other assets	1,844	-
Euro contracts	Accrued liabilities	2,122	4,134
Euro contracts	Other long-term liabilities	-	648

The effect of derivative instruments designated as cash flow hedges in our Condensed Consolidated Statements of Income and our Condensed Consolidated Statements of Comprehensive Income were:

	Three Months Ended June 30, 2012	Three Months Ended June 30, 2011	Six Months Ended June 30, 2012	Six Months Ended June 30, 2011
(In thousands)				
Net gain (loss) recognized in OCI, net of tax [1]	$ 7,086	$ (1,695)	$ 1,603	$ (8,675)
Gain (loss) reclassified from accumulated OCI into royalty revenue, net of tax [2]	(1,864)	(218)	(670)	586
Net gain (loss) recognized in interest and other income, net [3]	57	(19)	(27)	(19)
Amount excluded from effectiveness testing	-	-	-	-

[1] Net change in the fair value of the effective portion of cash flow hedges classified in other comprehensive income (loss) (OCI)
[2] Effective portion classified as royalty revenue
[3] Ineffective portion classified as interest and other income, net

For the three months ended June 30, 2012, we recognized a gain of approximately $57,000 associated with the ineffectiveness of the modified 2012 foreign exchange hedge. For the six months ended June 30, 2012, we recognized a loss, of approximately $27,000 associated with the ineffectiveness of the modified 2012 foreign exchange hedge. There was no ineffectiveness related to forecasted transactions for the three and six months ended June 30, 2012, and there was approximately $19,000 of ineffectiveness related to lower than forecasted Euro-based royalty transactions for the three and six months ended June 30, 2011. Approximately $0.8 million is expected to be reclassified from other comprehensive income (loss) against earnings in the next 12 months.

6. Note Receivable

In March 2012, the Company executed a $7.5 million two-year senior secured note receivable. In addition to interest, the note gives PDL certain rights to negotiate for certain royalty assets. The note was recorded net of origination fees that are accreted to the note receivable as interest income using the interest method. The note bears interest at 10% per annum, with interest due semi-annually and final interest due at maturity together with the principal. The Company has not assigned a risk grade to the receivable or recorded an allowance for credit loss as PDL anticipates all payments will be received in full when due. No impairment has been recorded as the payments on the note are current. For fair value information related to our note receivable, see Note 3.

7. Accrued Liabilities

	June 30, 2012	December 31, 2011
(In thousands)		
Compensation	$ 1,426	$ 1,341
Interest payable	3,029	3,351
Deferred revenue	-	1,713
Foreign currency hedge	2,122	4,134
Dividend payable	42,076	52
Other	2,353	1,018
Total	$ 51,006	$ 11,609

8. Commitments and Contingencies

Legal Proceedings

Communications with Genentech regarding European SPCs

In August 2010, we received a letter from Genentech, sent on behalf of F. Hoffmann-LaRoche Ltd. (Roche) and Novartis AG (Novartis), asserting that Avastin, Herceptin, Lucentis and Xolair® (the Genentech Products) do not infringe the supplementary protection certificates (SPCs) granted to PDL by various countries in Europe for each of the Genentech Products and seeking a response from PDL to these assertions. Genentech did not state what actions, if any, it intends to take with respect to its assertions. PDL's SPCs were granted by the relevant national patent offices in Europe and specifically cover the Genentech Products. The SPCs covering the Genentech Products effectively extend our European patent protection for the '216B Patent generally until December 2014, except that the SPCs for Herceptin will generally expire in July 2014.

Genentech's letter does not suggest that the Genentech Products do not infringe PDL's U.S. patents to the extent that such Genentech Products are made, used or sold in the United States (U.S.-based Sales). Genentech's quarterly royalty payments received after receipt of the letter included royalties generated on all worldwide sales of the Genentech Products.

If Genentech is successful in asserting this position, then under the terms of our license agreements with Genentech, it would not owe us royalties on sales of the Genentech Products that are both manufactured and sold outside of the United States. Royalties on sale of the Genentech Products that are made and sold outside of the United States (ex-U.S.-based Manufacturing and Sales) accounted for approximately 32% of our royalty revenues for the six months ended June 30, 2012. Based on announcements by Roche regarding moving more manufacturing outside of the United States, we expect this amount to increase in the future.

We believe that the SPCs are enforceable against the Genentech Products, that Genentech's letter violates the terms of the 2003 settlement agreement and that Genentech owes us royalties on sales of the Genentech Products on a worldwide basis. We intend to vigorously assert our SPC-based patent rights.

Nevada Litigation with Genentech, Roche and Novartis in Nevada State Court

In August 2010, we filed a complaint in the Second Judicial District of Nevada, Washoe County, naming Genentech, Roche and Novartis as defendants. We intend to enforce our rights under our 2003 settlement agreement with Genentech and are seeking an order from the court declaring that Genentech is obligated to pay royalties to us on ex-U.S.-based Manufacturing and Sales of the Genentech Products.

The 2003 settlement agreement was entered into as part of a definitive agreement resolving intellectual property disputes between the two companies at that time. The agreement limits Genentech's ability to challenge infringement of our patent rights and waives Genentech's right to challenge the validity of our patent rights. Certain breaches of the 2003 settlement agreement as alleged by our complaint require Genentech to pay us liquidated and other damages of potentially greater than one billion dollars. This amount includes a retroactive royalty rate of 3.75% on past U.S.-based Sales of the Genentech Products and interest, among other items. We may also be entitled to either terminate our license agreements with Genentech or be paid a flat royalty of 3.75% on future U.S.-based Sales of the Genentech Products.

In November 2010, Genentech and Roche filed a motion to dismiss our complaint against them in which we seek to enforce our rights under the 2003 settlement agreement with Genentech. Genentech and Roche's motions to dismiss under Nevada Rule of Civil Procedure 12(b)(5) alleged that all of our claims for relief relating to the 2003 settlement agreement should be dismissed because the 2003 settlement agreement applies only to our U.S. patents. In addition, Roche filed a separate motion to dismiss our complaint under Nevada Rule of Civil Procedure 12(b)(2) on the ground that the Nevada court lacks personal jurisdiction over Roche. On July 7, 2011, the Second Judicial District Court of Nevada ruled in favor of us on the two motions to dismiss filed by Genentech and Roche. The court denied Genentech and Roche's motion to dismiss four of our five claims for relief and, further, denied Roche's separate motion to dismiss for lack of personal jurisdiction. The court dismissed one of our claims that Genentech committed a bad-faith breach of the covenant of good faith and fair dealing stating that, based on the current state of the pleadings, no "special relationship" had been established between Genentech and us as required under Nevada law. On November 1, 2011, the Nevada court issued an order accepting Roche's stipulation of waiver to its personal jurisdiction defense. As a result of the order, Roche is foreclosed from reliance on lack of personal jurisdiction in defending against our claims.

On February 25, 2011, we reached a settlement with Novartis under which, among other things, we agreed to dismiss our claims against Novartis in the action in Nevada state court against Genentech, Roche and Novartis. Genentech and Roche continue to be parties to the Nevada suit.

The court has scheduled trial to commence on October 7, 2013. The outcome of this litigation is uncertain and we may not be successful in our allegations.

Lease Guarantee

In connection with the spin-off of Facet Biotech Corporation (Facet) in 2008, we entered into amendments to the leases for our former facilities in Redwood City, California, under which Facet was added as a co-tenant under the leases, 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. Should Facet default under its lease obligations, we would be held liable by the landlord as a co-tenant and, thus, we have in substance guaranteed the payments under the lease agreements for the Redwood City facilities. As of June 30, 2012, the total lease payments for the duration of the guarantee, which runs through December 2021, are approximately $105.6 million. We would also be responsible for lease-related costs including utilities, property taxes and common area maintenance which may be as much as the actual lease payments if Facet were to default. In April 2010, Abbott Laboratories acquired Facet and later renamed the company Abbott Biotherapeutics Corp.

As of June 30, 2012, and December 31, 2011, we had a liability of $10.7 million on our Condensed Consolidated Balance Sheets for the estimated fair value of this guarantee. In future periods, we may increase the recorded liability for this obligation if we conclude that a loss, which is larger than the amount recorded, is both probable and estimable.

9. Convertible Notes and Non-recourse Notes

Description	Maturity Date		Principal Balance Outstanding June 30, 2012	Carrying Value June 30, 2012	Carrying Value December 31, 2011
(In thousands)					
May 2015 Notes	May 1, 2015		$ 155,250	$ 141,152	$ 138,952
Series 2012 Notes	February 15, 2015		179,000	162,626	-
February 2015 Notes	February 15, 2015		1,000	989	177,663
Non-recourse Notes	September 15, 2012	(1)	22,738	22,738	93,370
Total carrying value of debt				$ 327,505	$ 409,985

(1) Anticipated repayment date

As of June 30, 2012, PDL was in compliance with all applicable debt covenants, and embedded features of all debt agreements were evaluated and did not need to be accounted for separately. For fair value information on our convertible notes and Non-recourse Notes, see Note 3.

Series 2012 Notes

In January 2012, we exchanged $169.0 million aggregate principal of our February 2015 Notes for an identical principal amount of new Series 2012 Notes, plus a cash payment of $5.00 for each $1,000 principal amount tendered for a total cash incentive payment of approximately $845,000. The cash incentive payment was allocated to deferred issue costs of $765,000, additional paid-in capital of $52,000 and deferred tax assets of $28,000. The deferred issue costs will be recognized over the life of the Series 2012 Notes as interest expense. In February 2012, we entered into separate privately negotiated exchange agreements under which we exchanged $10.0 million aggregate principal amount of our February 2015 Notes for an identical principal amount of our Series 2012 Notes.

The terms of the Series 2012 Notes are governed by the indenture dated as of January 5, 2012 (Indenture) and include a net share settlement feature, meaning that if a conversion occurs, the principal amount will be settled in cash and the excess, if any, will be settled in the Company's common stock. The Series 2012 Notes may not be redeemed by the Company prior to their stated maturity date. Our Series 2012 Notes are due February 15, 2015 and bear interest at a rate of 2.875% per annum, payable semiannually in arrears on February 15 and August 15 of each year. This is the same interest rate that we paid on the February 2015 Notes.

The initial conversion rate of the Series 2012 Notes was 155.396 shares of common stock per $1,000 principal amount, or approximately $6.44 per common share, subject to further adjustment upon certain events including dividend payments. Third party transaction costs of approximately $813,000 related to the exchange transactions have been recognized within general and administrative expense, of which $216,000 was recognized in the first quarter of 2012 and $597,000 was recognized during the year ended December 31, 2011.

Holders may convert their Series 2012 Notes at any time prior to the close of business on the second scheduled trading day immediately preceding the stated maturity date of the Series 2012 Notes under the following circumstances:

- During any fiscal quarter commencing after the fiscal quarter ending December 31, 2011, if the closing 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 Series 2012 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 the Series 2012 Notes for each trading day of that measurement period was less than 98% of the product of the closing price of the Company's common stock and the conversion rate for the Series 2012 Notes for that trading day;

- Upon the occurrence of certain corporate transactions as provided in the Indenture; or

- Anytime, at the holder's option, beginning on August 15, 2014.

Holders of our Series 2012 Notes who convert their Series 2012 Notes in connection with a fundamental change resulting in the reclassification, conversion, exchange or cancellation of our common stock may be entitled to a make-whole premium in the form of an increase in the conversion rate. Such fundamental change is generally defined to include a merger involving PDL, an acquisition of a majority of PDL's outstanding common stock and a change of a majority of PDL's board of directors without the approval of the board of directors.

We allocated $2.3 million of the remaining deferred February 2015 Notes original issue discount as of the date of the exchange to the Series 2012 Notes based on the percentage of the February 2015 Notes exchanged. In accordance with the accounting guidance for convertible debt instruments that may be settled in cash or other assets on conversion, we were 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, we separated the principal balance of the Series 2012 Notes, net of the allocated original issue discount, between the fair value of the debt component and the common stock conversion feature. Using an assumed borrowing rate of 7.3%, which represents the estimated market interest rate for a similar nonconvertible instrument available to us during the period of the exchange transactions, we recorded a total debt discount of $16.8 million, allocated $10.9 million to additional paid-in capital and $5.9 million to deferred tax liability. The discount is being amortized to interest expense over the term of the Series 2012 Notes and increases interest expense during the term of the Series 2012 Notes from the 2.875% cash coupon interest rate to an effective interest rate of 7.3%. The common stock conversion feature is recorded as a component of stockholders' deficit.

The principal amount, carrying value and unamortized discount of our Series 2012 Notes were:

	June 30, 2012
(In thousands)	
Principal amount of the Series 2012 Notes	$ 179,000
Unamortized discount of liability component	(16,374)
Net carrying value of the Series 2012 Notes	$ 162,626

Interest expense for our Series 2012 Notes on the Condensed Consolidated Statements of Income was:

	For the Three Months Ended June 30, 2012	For the Six Months Ended June 30, 2012
(In thousands)		
Contractual coupon interest	$ 1,287	$ 2,550
Amortization of debt issuance costs	277	548
Amortization of debt discount	1,415	2,780
Total	$ 2,979	$ 5,878

As of June 30, 2012, our Series 2012 Notes are convertible into 162.885 shares of the Company's common stock per $1,000 of principal amount, or approximately $6.14 per common share, subject to further adjustment upon certain events including dividend payments. As of June 30, 2012, the remaining discount amortization period was 2.6 years.

Our common stock price did not exceed the conversion threshold price of $8.17 per common share for at least 20 days during the 30 consecutive trading days ended March 31, 2012; accordingly the Series 2012 Notes were not convertible at the option of the holder during the quarter ended June 30, 2012. Our common stock did not exceed the conversion threshold price of $7.98 for at least 20 days during 30 consecutive trading days ended June 30, 2012; accordingly the Series 2012 Notes are not convertible at the option of the holder during the quarter ended September 30, 2012. At June 30, 2012, the if-converted value of our Series 2012 Notes exceeded their principal amount by approximately $14.3 million.

May 2015 Notes

As of June 30, 2012, our May 2015 Notes are convertible into 142.5217 shares of the Company's common stock per $1,000 of principal amount, or approximately $7.02 per common share, subject to further adjustment upon certain events including dividend payments. If a conversion occurs, to the extent that the conversion value exceeds the principal amount, the principal amount is due in cash and the difference between the conversion value and the principal amount is due in shares of the Company's common stock. As of June 30, 2012, the remaining discount amortization period was 2.8 years.

The principal amount, carrying value and unamortized discount of our May 2015 Notes were:

	June 30, 2012	December 31, 2011
(In thousands)		
Principal amount of the May 2015 Notes	$ 155,250	$ 155,250
Unamortized discount of liability component	(14,098)	(16,298)
Net carrying value of the May 2015 Notes	$ 141,152	$ 138,952

Interest expense for our May 2015 Notes on the Condensed Consolidated Statements of Income was:

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
(In thousands)				
Contractual coupon interest	$ 1,455	$ 728	$ 2,911	$ 728
Amortization of debt issuance costs	297	144	592	144
Amortization of debt discount	1,110	519	2,200	519
Total	$ 2,862	$ 1,391	$ 5,703	$ 1,391

As of June 30, 2012, the market price condition for convertibility of our May 2015 Notes was not met and there were no related purchased call options or warrants exercised.

Purchased Call Options

At June 30, 2012, the purchased call options cover, subject to anti-dilution and certain other customary adjustments substantially similar to those in our May 2015 Notes, approximately 22.1 million shares of our common stock at a strike price of approximately $7.02, which corresponds to the conversion price of our May 2015 Notes. We may exercise the purchased call options upon conversion of our May 2015 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.

Warrants

At June 30, 2012, the outstanding warrants of up to 27.5 million shares of common stock underlying our May 2015 Notes, have a current strike price of approximately $8.25 per share, subject to additional anti-dilution and certain other customary adjustments.

February 2015 Notes

As of June 30, 2012, our February 2015 Notes aggregate principal amount outstanding was $1.0 million, and were convertible into 162.885 shares of common stock per $1,000 principal amount or approximately $6.14 per common share. As of June 30, 2012, the remaining unamortized issuance costs of approximately $15,000 and the unamortized discount of approximately $11,000 are being amortized to interest expense over the term of our February 2015 Notes, with a remaining amortization period of approximately 2.6 years.

2012 Notes Retirement

Our 2012 Notes of $133.5 million aggregate principal were fully retired at June 30, 2011, at a redemption price of 100.29% of principal for aggregate consideration of $133.9 million plus interest of $1.0 million. We recorded a net loss of $0.8 million from the redemption of the debt in the second quarter of 2011.

Non-recourse Notes

As of June 30, 2012, the remaining principal balance of our Non-recourse Notes was $22.7 million. The remaining related unamortized issuance costs of $0.1 million were included as a component of Prepaid and other current assets on the Condensed Consolidated Balance Sheets. These issuance costs are being amortized to interest expense using the effective interest method with approximately 0.3 years remaining.

10. Other Long-Term Liabilities

Other long-term liabilities consisted of the following:

	June 30, 2012	December 31, 2011
(In thousands)		
Accrued lease liability	$ 10,700	$ 10,700
Uncertain tax position	12,761	12,774
Compensation	228	-
Foreign currency hedge	-	648
Total	$ 23,689	$ 24,122

11. Stock-Based Compensation

	For the Three Months Ended		For the Six Months Ended	
Stock-based Compensation	**June 30, 2012**	**June 30, 2011**	**June 30, 2012**	**June 30, 2011**
(In thousands)				
Employees and directors	$ 177	$ 74	$ 327	$ 124
Non-employees	55	-	109	-
Total	$ 232	$ 74	$ 436	$ 124

The Company issued approximately 59,000 shares of restricted stock in the first quarter of 2012 that will vest in December 2013, and approximately 56,000 shares of restricted stock in the second quarter of 2012, of which 32,000 will vest in June 2013 and 24,000 will vest in December 2013. The Company issued approximately 115,000 shares of restricted stock in the second quarter of 2011, of which, approximately 18,000 shares were forfeited in December 2011, 34,000 shares vested in June 2012 and the remaining 63,000 shares will vest in December 2012.

Additionally, the Company issued non-employees restricted stock in the second half of 2011, which vest both over time and upon the achievement of certain performance goals.

12. Cash Dividends

On January 18, 2012, our board of directors declared that the regular quarterly dividends to be paid to our stockholders in 2012 will be $0.15 per share of common stock, payable on March 14, June 14, September 14 and December 14 of 2012 to stockholders of record on March 7, June 7, September 7 and December 7 of 2012, the record dates for each of the dividend payments, respectively.

In connection with the June 14, 2012, dividend payment, the conversion rates for our convertible notes adjusted as follows:

Convertible Notes	Conversion Rate per $1,000 Principal Amount	Approximate Conversion Price Per Common Share	Effective Date
May 2015 Notes	142.5217	$ 7.02	June 5, 2012
Series 2012 Notes	162.885	$ 6.14	June 5, 2012
February 2015 Notes	162.885	$ 6.14	June 8, 2012

13. Income Taxes

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2012	**June 30, 2011**	**June 30, 2012**	**June 30, 2011**
(In thousands)				
Income Tax	$ 39,813	$ 37,976	$ 61,417	$ 62,009

For the three and six months ended June 30, 2012 and 2011, income tax expense was primarily derived by applying the federal statutory rate of 35% to operating income before income taxes.

In general, our income tax returns are subject to examination by tax authorities for tax years 1995 forward. In May 2012, PDL 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 California Franchise Tax Board (FTB) is currently examining the Company’s 2008 and 2009 tax returns. 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, we do not anticipate any material change to the amount of our unrecognized tax benefits over the next 12 months.

14. Accumulated Other Comprehensive Income (Loss)

Comprehensive income is comprised of net income and other comprehensive income (loss). We include unrealized net gains on investments held in our available-for-sale securities and unrealized gains (losses) on our cash flow hedges 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 (loss), net of tax, was as follows:

	Unrealized gains on available-for-sale securities	Unrealized gains (losses) on cash flow hedges	Total Accumulated Other Comprehensive Income (Loss)
(In thousands)			
Beginning Balance at December 31, 2011	$ 29	$ (1,914)	$ (1,885)
Activity for the six months ended June 30, 2012	13	2,273	2,286
Ending Balance at June 30, 2012	$ 42	$ 359	$ 401

15. Subsequent Event

In July 2012, PDL loaned $35 million to Merus Labs International, Inc. (Merus Labs) in connection with its acquisition of a commercial-stage pharmaceutical product and related assets (the Assets). In addition, PDL agreed to provide a $20 million letter of credit on behalf of Merus Labs that the seller of the Assets may draw upon to satisfy the remaining $20 million purchase price obligation on July 11, 2013 (Letter of Credit). Draws on the Letter of Credit will be funded from the proceeds of an additional loan to Merus Labs. Outstanding borrowings under the July 2012 loan bear interest at the rate of 13.5% per annum and outstanding borrowings as a result of draws on the Letter of Credit bear interest at the rate of 14.0% per annum. Merus Labs is required to make four periodic principal payments in respect of the July 2012 loan, with repayment of the remaining principal balance of all loans due on March 31, 2015. The borrowings are subject to mandatory prepayments upon certain asset dispositions or debt issuances upon the terms set forth in the credit agreement (Credit Agreement).

The Credit Agreement provides for a number of standard events of default, including payment, bankruptcy, covenant, judgment and cross-defaults.

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

This Quarterly Report 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. 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. 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, and actual results could differ materially from those projected or assumed in the forward-looking statements. Our future financial condition and results of operations, as well as any forward-looking statements, 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. All forward-looking statements and reasons why results may differ included in this Quarterly Report are made as of the date hereof, and we assume no obligation to update these forward-looking statements or reasons why actual results might differ.

OVERVIEW

PDL pioneered the humanization of monoclonal antibodies and, by doing so, enabled the discovery of a new generation of targeted treatments for cancer and immunologic diseases. Today, PDL is focused on intellectual property asset management, investing in new revenue generating assets and maximizing the value of its patent portfolio and related assets. We receive royalties based on sales of humanized antibody products marketed today and may also receive royalty payments on additional humanized antibody products that are manufactured or launched before final patent expiry in December 2014 or which are otherwise subject to a royalty for licensed know-how under our agreements. Under most of our licensing agreements, we are entitled to receive a flat-rate or tiered royalty based upon our licensees' net sales of covered antibodies.

We continuously evaluate alternatives to increase return for our stockholders, for example, purchasing new revenue generating assets, buying back or redeeming our convertible notes, repurchasing our common stock, paying dividends or selling the company. At the beginning of each fiscal year, our board of directors reviews the Company's total annual dividend payment for the prior year and determines whether to increase, maintain or decrease the quarterly dividend payments for that year. The board of directors evaluates the financial condition of the Company and considers the economic outlook, corporate cash flow, the Company's liquidity needs and the health and stability of credit markets when determining whether to maintain or change the dividend.

Recent Developments

June 14, 2012, Dividend Payment and Effect on Conversion Rates for the Convertible Notes

On January 18, 2012, our board of directors declared that the regular quarterly dividends to be paid to our stockholders in 2012 will be $0.15 per share of common stock, payable on March 14, June 14, September 14 and December 14 of 2012 to stockholders of record on March 7, June 7, September 7 and December 7 of 2012, the record dates for each of the dividend payments, respectively. On June 14, 2012, we paid the regular quarterly dividend to our stockholders totaling $21.0 million using earnings generated in the first six months of 2012.

In connection with the June 14, 2012, dividend payment, the conversion rates for our convertible notes adjusted as follows:

Convertible Notes	Conversion Rate per $1,000 Principal Amount	Approximate Conversion Price Per Common Share	Effective Date
May 2015 Notes	142.5217	$ 7.02	June 5, 2012
Series 2012 Notes	162.885	$ 6.14	June 5, 2012
February 2015 Notes	162.885	$ 6.14	June 8, 2012

In connection with a cash dividend, the conversion rates increase based on multiplying the previous conversion rate by a fraction, calculated as follows:

- for the May 2015 Notes, the numerator equals the average closing price of PDL's common stock for the ten consecutive trading days immediately preceding the ex-dividend date, and the denominator of which is such ten day average closing price less the per share dividend amount; and

- for the Series 2012 Notes and February 2015 Notes, the numerator equals the average closing price of PDL's common stock for the five consecutive trading days immediately preceding the ex-dividend date, and the denominator of which is such five day average closing price less the per share dividend amount.

Perjeta™

On June 8, 2012, Genentech announced that the U.S. Food and Drug Administration (FDA) approved Perjeta (pertuzumab). Perjeta is approved in combination with Herceptin® and docetaxel chemotherapy for the treatment of people with HER2-positive metastatic breast cancer who have not received prior anti-HER2 therapy or chemotherapy for metastatic disease.

Genentech notified PDL on June 18, 2012, that Perjeta is a licensed product. PDL will receive royalties on sales of Perjeta in the quarter following the first quarter of Perjeta sales in accordance with Genentech’s license agreements with PDL.

Subsequent Event

In July 2012, PDL loaned $35 million to Merus Labs International, Inc. (Merus Labs) in connection with its acquisition of a commercial-stage pharmaceutical product and related assets (the Assets). In addition, PDL agreed to provide a $20 million letter of credit on behalf of Merus Labs that the seller of the Assets may draw upon to satisfy the remaining $20 million purchase price obligation on July 11, 2013 (Letter of Credit). Draws on the Letter of Credit will be funded from the proceeds of an additional loan to Merus Labs. Outstanding borrowings under the July 2012 loan bear interest at the rate of 13.5% per annum and outstanding borrowings as a result of draws on the Letter of Credit bear interest at the rate of 14.0% per annum. Merus Labs is required to make four periodic principal payments in respect of the July 2012 loan, with repayment of the remaining principal balance of all loans due on March 31, 2015. The borrowings are subject to mandatory prepayments upon certain asset dispositions or debt issuances upon the terms set forth in the credit agreement (Credit Agreement).

The Credit Agreement provides for a number of standard events of default, including payment, bankruptcy, covenant, judgment and cross-defaults.

Intellectual Property

Patents

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 is in December 2014, cover, among other things, humanized antibodies, methods for humanizing antibodies, polynucleotide encoding in humanized antibodies and methods of producing humanized antibodies.

The following is a list of our U.S. patents within our Queen et al. patent portfolio:

Application Number	Filing Date	Patent Number	Issue Date	Expiration Date
08/477,728	06/07/95	5,585,089	12/17/96	06/25/13
08/474,040	06/07/95	5,693,761	12/02/97	12/02/14
08/487,200	06/07/95	5,693,762	12/02/97	06/25/13
08/484,537	06/07/95	6,180,370	01/30/01	06/25/13

Our U.S. Patent No. 5,693,761 patent (‘761 patent), which is the last to expire of our U.S. patents, covers 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 will typically extend to the use or sale of compositions made with those methods and/or materials.

The European Patent No. 0 451 216B (‘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. These SPCs effectively extend our patent protection with respect to these products generally until December 2014, except that most of our SPCs for Herceptin will expire in July 2014. Because SPCs are granted on a jurisdiction-by-jurisdiction basis, the duration of the extension varies slightly in certain jurisdictions. We may still be eligible for royalties notwithstanding the unavailability of SPC protection if the relevant royalty-bearing humanized antibody product is also made, used, sold or offered for sale in or imported from a jurisdiction in which we have an unexpired Queen et al. patent such as the United States.

Licensing Agreements

We have entered into licensing agreements with numerous entities that are independently developing or have developed humanized antibodies under which we have licensed certain rights under our Queen et al. patents to make, use, sell, offer for sale and import humanized antibodies. We receive royalties on net sales of products that are made, used or sold prior to patent expiry. 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 or tiered royalty based upon our licensees’ net sales of covered antibodies. Additionally, we receive minimal annual maintenance fees, as well as periodic milestone payments, from licensees of our Queen et al. patents prior to patent expiry. Total annual milestone payments in each of the last several years have been less than 1% of total revenue and we expect this trend will continue through the expiration of the Queen et al. patents.

Licensing Agreements for Marketed Products

In the six months ended June 30, 2012, we received royalties on sales of the seven humanized antibody products listed below, all of which are currently approved for use by the FDA and other regulatory agencies outside the United States.

Licensee	Product Names
Genentech, Inc. (Genentech)	Avastin®
	Herceptin®
	Xolair®
	Lucentis®
Elan Corporation, Plc (Elan)	Tysabri®
Wyeth Pharmaceuticals, Inc. (Wyeth)	Mylotarg®
Chugai Pharmaceutical Co., Ltd. (Chugai)	Actemra®

For the three months ended June 30, 2012 and 2011, we received royalty revenues under license agreements of $125.9 million and $122.1 million, respectively, and for the six months ended June 30, 2012 and 2011, we received royalty revenues under license agreements of $203.2 million and $195.4 million, respectively.

In June 2010, after results from a clinical trial raised concerns about the efficacy and safety of Mylotarg®, Pfizer Inc. (Pfizer), the parent company of Wyeth, announced that it will be discontinuing commercial availability of Mylotarg. For the three and six months ended June 30, 2012 and 2011, our royalties for sales of Mylotarg were insignificant.

Genentech

We entered into a master patent license agreement, effective September 25, 1998, under which we granted Genentech a license under our Queen et al. patents to make, use and sell certain antibody products. Our master patent license agreement with Genentech provides for a tiered royalty structure under which the royalty rate Genentech must pay on royalty-bearing products sold in the United States or manufactured in the United States and used or sold anywhere in the world (U.S.-based Sales) in a given calendar year decreases on incremental U.S.-based Sales above certain sales thresholds based on 95% of the underlying gross U.S.-based Sales. The net sales thresholds and the applicable royalty rates are outlined below:

Genentech Products Made or Sold in the U.S.	**Royalty Rate**
Net sales up to $1.5 billion	3.0%
Net sales between $1.5 billion and $2.5 billion	2.5%
Net sales between $2.5 billion and $4.0 billion	2.0%
Net sales exceeding $4.0 billion	1.0%
Genentech Products Made and Sold ex-U.S.	
Net sales	3.0%

As a result of the tiered royalty structure, Genentech's average annual royalty rate for a given year will decline as Genentech's U.S.-based Sales increase during that year. Because we receive royalties one quarter in arrears, the average royalty rates for the payments we receive from Genentech for U.S.-based Sales in the second calendar quarter for Genentech's sales from the first calendar quarter have been and are expected to continue to be higher than the average royalty rates for following quarters. The average royalty rates for payments we receive from Genentech are generally lowest in the fourth and first calendar quarters for Genentech's sales from the third and fourth calendar quarters when more of Genentech's U.S.-based Sales bear royalties at the 1% royalty rate.

With respect to royalty-bearing products that are both manufactured and sold outside of the United States (ex-U.S.-based Manufacturing and Sales), the royalty rate that we receive from Genentech is a fixed rate of 3.0% based on 95% of the underlying gross ex-U.S.-based Manufacturing and Sales. The mix of U.S.-based Sales and ex-U.S.-based Manufacturing and Sales has fluctuated in the past and may continue to fluctuate in future periods, particularly in light of the 2009 acquisition of Genentech by Roche. The percentage of net global sales that were generated outside of the United States and the percentage of net global sales that were ex-U.S.-based Manufacturing and Sales are outlined in the following table:

Manufacturing Split

	Three Months Ended June 30,		**Six Months Ended June 30,**	
	2012	**2011**	**2012**	**2011**
Avastin				
Ex-U.S.-based Sales	54%	55%	55%	55%
Ex-U.S.-based Manufacturing and Sales	20%	20%	23%	20%
Herceptin				
Ex-U.S.-based Sales	69%	72%	70%	71%
Ex-U.S.-based Manufacturing and Sales	41%	30%	38%	35%
Lucentis				
Ex-U.S.-based Sales	62%	57%	61%	57%
Ex-U.S.-based Manufacturing and Sales	0%	0%	0%	0%
Xolair				
Ex-U.S.-based Sales	38%	40%	39%	39%
Ex-U.S.-based Manufacturing and Sales	38%	40%	39%	39%

The information in the table above is based on information provided to us by Genentech. We were not provided the reasons for the shift in the manufacturing split between U.S.-based Sales and ex-U.S.-based Manufacturing and Sales.

In the six months ended June 30, 2012 and 2011, PDL received royalties generated from three of Genentech's licensed products that were ex-U.S.-based manufactured and sold: Herceptin, Avastin and Xolair. Roche has announced that there are new plants in Singapore for the production of Avastin and Lucentis. The plants were registered by the FDA to produce bulk Avastin and Lucentis for use in the United States in 2010 and Roche expects the plants to be registered to produce bulk Avastin and Lucentis for use in Europe. Roche has also expanded its Penzberg, Germany plant that currently manufactures Herceptin. The master patent license agreement continues until the expiration of the last to expire of our Queen et al. patents but may be terminated (i) by Genentech prior to such expiration upon sixty days written notice, (ii) by either party upon a material breach by the other party or (iii) upon the occurrence of certain bankruptcy-related events. Our licensing agreements with Genentech entitle us to royalties following the expiration of our patents with respect to sales of products manufactured prior to patent expiry in jurisdictions providing patent protection.

Elan

We entered into a patent license agreement, effective April 24, 1998, under which we granted to Elan a license under our Queen et al. patents to make, use and sell antibodies that bind to the cellular adhesion molecule a4 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. The agreement continues until the expiration of the last to expire of our Queen et al. patents but may be terminated (i) by Elan prior to such expiration upon sixty days written notice, (ii) by either party upon a material breach by the other party or (iii) upon the occurrence of certain bankruptcy-related events.

Wyeth

We entered into a patent license agreement, effective September 1, 1999, under which we granted to Wyeth a license under our Queen et al. patents to make, use and sell antibodies that bind to CD33, an antigen that is found in about 80% of patients with acute myeloid leukemia, and conjugated to a cytotoxic agent. Under the agreement, we are entitled to receive a flat royalty rate in the low single digits based on Wyeth's net sales of the Mylotarg product. The agreement continues until the expiration of the last to expire of our Queen et al. patents but may be terminated (i) by Wyeth prior to such expiration upon sixty days written notice, (ii) by either party upon a material breach by the other party or (iii) upon the occurrence of certain bankruptcy-related events. In June 2010, after results from a recent clinical trial raised concerns about the efficacy and safety of Mylotarg, Pfizer, the parent company of Wyeth, announced that it will be discontinuing commercial availability of Mylotarg.

Chugai

We entered into a patent license agreement, effective May 18, 2000, with Chugai, a majority owned subsidiary of Roche, under which we granted to Chugai a license under our Queen et al. patents to make, use and sell antibodies that bind to interleukin-6 receptors to prevent inflammatory cascades involving multiple cell types for the treatment of rheumatoid arthritis. Under the agreement, we are entitled to receive a flat royalty rate in the low single digits based on net sales of the Actemra® product manufactured in the U.S. The agreement continues until the expiration of the last to expire of our Queen et al. patents but may be terminated (i) by Chugai prior to such expiration upon sixty days written notice, (ii) by either party upon a material breach by the other party or (iii) upon the occurrence of certain bankruptcy-related events.

Licensing Agreements for Non-Marketed Products

We have also entered into licensing agreements under which we have licensed certain rights under our Queen et al. patents to make, use and sell certain products in development that have not yet reached commercialization. Certain of these development-stage products are currently in Phase 3 clinical trials. With respect to these agreements, we may receive payments based on certain development milestones and annual maintenance fees. We may also receive royalty payments if the licensed products receive marketing approval and are manufactured or generate sales before the expiration of our Queen et al. patents. For example, trastuzumab-DM1 (T-DM1) which is an experimental, antibody-drug conjugate that links Herceptin to a cytotoxic, or cell killing agent, DM1, is being developed by Genentech. This approach is designed to increase the already significant tumor fighting ability of Herceptin by coupling it with an additional cell killing agent that is efficiently and simultaneously delivered to the targeted cancer cells by the antibody. Two additional examples are the Eli Lilly and Company (Lilly) and Pfizer (in conjunction with Johnson & Johnson) licensed antibodies for the treatment of Alzheimer's disease that are currently in Phase 3 clinical trials. If Lilly's antibody for Alzheimer's disease is approved, we would also be entitled to receive a royalty based on a "know-how" license for technology provided in the design of this antibody. Unlike the royalty for the patent license, the 2% royalty payable for "know-how" runs for 12.5 years after the product's initial commercialization.

Economic and Industry-wide Factors

Various economic and industry-wide factors are relevant to us and could affect 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" section of this quarterly report for additional factors that may impact our business and results of operations.

Critical Accounting Policies and Uses of Estimates

During the six months ended June 30, 2012, there have been no significant changes to our critical accounting policies since those presented in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2011, except for the foreign currency hedging presented below.

Foreign Currency Hedging

We hedge certain Euro-denominated currency exposures related to our licensees' product sales with Euro forward contracts. In general, these contracts are intended to offset the underlying Euro market risk in our royalty revenues. We do not enter into speculative foreign currency transactions. We have designated the Euro forward contracts as cash flow hedges.

At the inception of the hedging relationship and on a quarterly basis, we assess hedge effectiveness. The fair value of the Euro forward contracts is estimated using pricing models with readily observable inputs from actively quoted markets and are disclosed on a gross basis. The aggregate unrealized gain or loss, net of tax, on the effective portion of the hedge is recorded in stockholders' deficit as accumulated other comprehensive income (loss). Gains or losses on cash flow hedges are recognized as an adjustment to royalty revenue in the same period that the hedged transaction impacts earnings as royalty revenue. Ineffectiveness, if any, resulting from the change in fair value of the modified 2012 hedge or lower than forecasted Euro-based royalties is reclassified from other comprehensive income (loss) and recorded as interest and other income, net, in the period it occurs.

Operating Results

Revenues

	Three Months Ended June 30,		Change from Prior Year %	Six Months Ended June 30,		Change from Prior Year %
	2012	2011		2012	2011	
(Dollars in thousands)						
Revenues						
Royalties	$ 125,904	$ 122,127	3%	$ 203,248	$ 195,463	4%
License and other	-	-	N/A	-	10,000	-100%
Total revenues	$ 125,904	$ 122,127	3%	$ 203,248	$ 205,463	-1%

Three Months Ended June 30, 2012, compared to June 30, 2011

Total royalty revenues were $125.9 million and $122.1 million for the three months ended June 30, 2012 and 2011, respectively, and consisted of royalties and maintenance fees earned on sales of products under license agreements associated with our Queen et al. patents. Royalty revenue is net of the payments made under our February 2011 settlement agreement with Novartis, which is based on a portion of the royalties that the company receives from Lucentis sales made by Novartis outside the United States. The amount paid is less than we receive in royalties on such sales.

Royalty revenues increased 3% for the three months ended June 30, 2012, when compared to the same period in 2011. The growth is primarily driven by increased net sales in the first quarter of 2012 of Herceptin, Lucentis, Xolair and Tysabri by our licensees. Net sales of Herceptin, Lucentis, Xolair and Avastin, are subject to a tiered royalty rate for product that is U.S.-based Sales and a flat royalty rate of 3% for product that is ex-U.S.-based Manufacturing and Sales.

Reported worldwide sales of Herceptin increased 4% in the first quarter of 2012 when compared to the same period in 2011. Roche reported that in 2012, Herceptin global sales growth was driven by expanded access in developing countries, increased and improved HER2 testing and continued uptake in HER2-positive stomach cancer. Additionally, Roche reported that sustained double-digit increases were recorded internationally, with strong demand in Latin America and the Asia-Pacific region. Ex-U.S. manufactured and sold Herceptin sales represented 41% of total Herceptin sales in the first quarter of 2012 as compared with 30% in the first quarter of 2011.

Reported worldwide sales for Lucentis increased 15% in the first quarter of 2012 when compared to the same period in 2011. Lucentis is approved for the treatment of age-related macular degeneration (AMD) in the U.S. and Europe. Lucentis received approval for the treatment of macular edema following retinal vein occlusion (RVO) in June 2010 in the U.S. and in June 2011 in Europe. In January 2011, Lucentis was approved in Europe for the treatment of visual impairment due to diabetic macular edema. All sales of Lucentis were from inventory produced in the U.S.

Reported worldwide sales for Avastin decreased 1% in the first quarter of 2012 when compared to the same period in 2011. Roche has reported that a significant portion of the decline in sales in the U.S. was due to reimbursement uncertainty regarding the metastatic breast cancer indication, which was revoked by the U.S. Food and Drug Administration in November 2011, and that U.S. market share for all other indications remained stable. In Europe, austerity measures along with lower use of Avastin for breast cancer led to lower sales, but market penetration in colorectal cancer remained stable.

Reported worldwide sales for Tysabri increased 13% in the first quarter of 2012 compared to the same period in 2011. Tysabri royalties are determined at a flat rate as a percentage of sales regardless of location of manufacture or sale.

The sales information presented above is based on information provided by PDL's licensees in their quarterly reports to the Company as well as from public disclosures made by PDL's licensees.

Six months ended June 30, 2012, compared to June 30, 2011

Total revenues were $203.2 million and $205.5 million for the six months ended June 30, 2012 and 2011, respectively, and consist of royalty revenues as well as license and other revenues including, for the six months ended June 30, 2011, a one-time $10.0 million payment from our legal settlement with UCB Pharma, S.A. (UCB) resolving all legal disputes between the two companies, including those relating the UCB's pegylated humanized antibody fragment, Cimzia®, and PDL's patents known as the Queen et al. patents.

The following table summarizes the percentage of our total revenues earned from our licensees' net product sales, which individually accounted for 10% or more of our total revenues:

		Three Months Ended June 30,		Six Months Ended June 30,	
Licensee	**Product Name**	**2012**	**2011**	**2012**	**2011**
Genentech	*Avastin*	33%	34%	32%	31%
	Herceptin	35%	35%	35%	33%
	Lucentis	22%	20%	19%	16%
Elan	*Tysabri*	10%	9%	12%	10%

Foreign currency exchange rates also impact our revenue results. More than 50% of our licensees' product sales are in currencies other than U.S. dollars; as such, 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 would have been had the U.S. dollar not weakened. For example, in a quarter in which we generate $70 million in royalty revenues, approximately $35 million is based on sales in currencies other than U.S. dollar. If the U.S. dollar strengthens across all currencies by ten percent during the conversion 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 $3.5 million less in the current quarter than in the prior year quarter. The impact on full year revenue is greatest in the second quarter when we receive the largest amount of royalties because the Genentech tiered royalties are at their highest rate for first quarter sales.

As a result of our Euro forward contracts, royalty revenues recognized decreased $2.9 million and $0.3 million, for the three months ended June 30, 2012 and 2011, respectively, and for the six months ended June 30, 2012 and 2011, royalty revenues recognized increased (decreased) $(1.0) million and $0.9 million, respectively.

Operating Expenses

	Three Months Ended June 30,		Change from Prior Year %	Six Months Ended June 30,		Change from Prior Year %
	2012	2011		2012	2011	
(Dollars in thousands)						
Operating expenses						
General and administrative	$ 5,145	$ 3,776	36%	$ 12,090	$ 9,555	27%

For the three and six months ended June 30, 2012, compared to June 30, 2011

The increase in operating expenses was primarily driven by expenses related to efforts to acquire new revenue generating assets and compensation related expenses.

Individual components of operating expenses comprise:

	Three Months Ended June 30,		Change from Prior Year %	Six Months Ended June 30,		Change from Prior Year %
	2012	2011		2012	2011	
(Dollars in thousands)						
Operating expenses:						
General and administrative						
Compensation and benefits	$ 1,198	$ 970	24%	$ 2,323	$ 1,912	21%
Legal fees	1,876	1,404	34%	5,405	4,898	10%
Professional services	1,128	623	81%	2,157	1,191	81%
Stock-based compensation	232	74	214%	436	124	252%
All other	711	705	1%	1,769	1,430	24%
Total general and administrative	$ 5,145	$ 3,776	36%	$ 12,090	$ 9,555	27%

Non-operating Expense, Net

A summary of our non-operating expense, net, is presented below:

	Three Months Ended June 30,		Change from Prior	Six Months Ended June 30,		Change from Prior
	2012	2011	Year %	2012	2011	Year %
(Dollars in thousands)						
Loss on retirement or conversion of convertible notes	$ -	$ (766)	-100%	$ -	$ (766)	-100%
Interest and other income, net	428	157	173%	518	332	56%
Interest expense	(7,872)	(9,780)	-20%	(16,573)	(18,934)	-12%
Total non-operating expense, net	$ (7,444)	$ (10,389)	-28%	$ (16,055)	$ (19,368)	-17%

For the three months ended June 30, 2012, compared to June 30, 2011, non-operating expense, net, decreased primarily due to lower interest expense as a result of our $119.0 million reduction in the principal balance of our Non-recourse Notes at June 30, 2012, compared to June 30, 2011, offset, in part, by increased interest expense on our May 2015 Notes and our Series 2012 Notes. This increase in interest expense consisted primarily of $2.5 million related to non-cash interest expense as we were required to compute interest expense using similar non-convertible instruments in accordance with the accounting guidance for convertible debt instruments that may be settled in cash or other assets on conversion.

Income Taxes

	For the Three Months Ended		For the Six Months Ended	
	June 30, 2012	June 30, 2011	June 30, 2012	June 30, 2011
(In thousands)				
Income Tax	$ 39,813	$ 37,976	$ 61,417	$ 62,009

Income tax expense was primarily derived by applying the federal statutory income tax rate of 35% to operating income before income taxes.

Net Income per Share

Net income per share for the three and six months ended June 30, 2012 and 2011, was:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
Net income per basic share	$ 0.53	$ 0.50	$ 0.81	$ 0.82
Net income per diluted share	$ 0.52	$ 0.38	$ 0.80	$ 0.63

Net income for the second quarter of 2012 was $73.5 million, or $0.52 per diluted share, as compared with net income of $70 million, or $0.38 per diluted share, for the same period of 2011. Second quarter net income per diluted share is higher in 2012 primarily because we eliminated 44.0 million potentially dilutive shares from the diluted earnings per share calculation by restructuring two of our convertible notes in 2011 and early 2012 to "net share settle."

Non-GAAP Net Income per Share

We are presenting net income per share in conformance with GAAP and also on a non-GAAP basis for the three and six months ended June 30, 2012 and 2011, because management believes that presenting this non-GAAP information enhances investors' understanding of how management assesses the performance of the Company's business. For example, our Series 2012 Notes and our May 2015 Notes include non-cash interest expense due to the required accounting treatment for the net share settlement feature of convertible debt that affects comparability between the quarters presented. We believe this exclusion facilitates comparison to PDL's cash operating results. We do not use these non-GAAP measures for compensation determinations. Non-GAAP financial information is not prepared under a comprehensive set of accounting rules and should only be used to supplement an understanding of the Company's net income as reported under GAAP. For the three and six months ended June 30, 2012, the effect of the non-GAAP adjustments, increased net income per diluted share from $0.52 to $0.53, and from $0.80 to $0.82, respectively. For the three months ended June 30, 2011, the effect of the non-GAAP adjustments, increased net income per diluted share from $0.38 to $0.39 per share and there was no change for the six months ended June 30, 2011.

The adjustments comprise:

During the first quarter of 2012, to limit the potential dilution from our February 2015 Notes, we exchanged $179.0 million in aggregate principal of our February 2015 Notes, for an identical amount of Series 2012 Notes with a net settlement feature. Due to the Series 2012 Notes net settlement feature, we were required to separately account for the fair value of the liability component of the instrument in a manner that reflects the market interest rate for a similar nonconvertible instrument during the period of the exchange, which was estimated at 7.3%. As a result, the additional non-cash interest expense was $1.4 million, or $0.9 million, net of tax, for the three months ended June 30, 2012, and $2.8 million, or $1.8 million, net of tax, for the six months ended June 30, 2012.

During the second quarter of 2011, we issued our May 2015 Notes that included a net settlement feature. Due to the May 2015 Notes net settlement feature, we were required to separately account for the fair value of 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, which was estimated at 7.5%. As a result, the additional non-cash interest was $1.1 million or $0.7 million, net of tax, for the three months ended June 30, 2012, and $2.2 million or $1.4 million, net of tax, for the six months ended June 30, 2012. The additional non-cash interest for the three and six months ended June 30, 2011, was $0.5 million, or $0.3 million, net of tax. We used the proceeds from the issuance of our May 2015 Notes to redeem the remaining $133.5 million in aggregate principal of our 2012 Notes. The redemption transaction resulted in a charge to non-operating expense of $0.8 million, or $0.5 million net of tax, for the three and six months ended June 30, 2011.

Excluding the loss on the redemption of our 2012 Notes, the non-cash interest expense of our Series 2012 Notes and May 2015 Notes and the tax effect of these transactions, non-GAAP net income per diluted share was:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2012	2011	2012	2011
(In thousands, except per share amounts)				
Numerator				
Net income	$ 73,502	$ 69,986	$ 113,686	$ 114,531
Add back:				
Loss on repurchase of convertible debt, net of estimated taxes	-	498	-	498
Amortization of debt discount on Series 2012 Notes and May 2015 Notes, net of estimated taxes	1,642	337	3,238	337
Non-GAAP net income	75,144	70,821	116,924	115,366
Add back interest expense for convertible notes, net of estimated tax	6	1,275	33	2,549
Non-GAAP income used to compute non-GAAP net income per diluted share	$ 75,150	$ 72,096	$ 116,957	$ 117,915
Denominator				
Shares used to compute net income per diluted share	142,213	186,060	142,890	186,055
Non-GAAP net income per diluted share	$ 0.53	$ 0.39	$ 0.82	$ 0.63

Liquidity and Capital Resources

We finance our operations primarily through royalty and other license related revenues and public and private placements of debt and equity securities. We currently have fewer than ten employees managing our intellectual property, our licensing operations 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 investments of $229.3 million and $227.9 million at June 30, 2012, and December 31, 2011, respectively. The $1.4 million increase was primarily attributable to net cash provided by operating activities of $122.8 million and maturities of investments of $20.0 million, offset, in part, by principal repayment on our Non-recourse Notes of $70.6 million, payment of dividends of $41.9 million, cash advanced on a note receivable of $7.4 million, purchase of investments of $6.0 million and the $0.8 million incentive payment on our Series 2012 Notes exchange transaction. We believe that cash from future royalty revenues, 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. The last of our Queen et al. patents expires in December 2014, with the obligation to pay royalties under various license agreements expiring sometime thereafter, and we do not expect to receive any meaningful revenue from the inventories produced prior to the expiration of our Queen et al. patents beyond the first quarter of 2016. As such, we are pursuing the acquisition of new revenue generating assets if we believe we can acquire such assets on terms that allow us to generate a profitable return to our stockholders.

We continuously evaluate alternatives to increase return for our stockholders, for example, purchasing revenue generating assets, buying back our convertible notes, repurchasing our common stock, paying dividends or selling the Company. On January 18, 2012, our board of directors declared regular quarterly dividends of $0.15 per share of common stock, payable on March 14, June 14, September 14 and December 14 of 2012 to stockholders of record on March 7, June 7, September 7 and December 7 of 2012, the record dates for each of the dividend payments, respectively. The second of such dividends was paid on June 14, 2012. As of June 30, 2012, we have accrued $42.1 million for the remaining 2012 dividend payments.

Convertible Notes

Series 2012 Notes

In January 2012, we completed a debt exchange transaction where we exchanged $169.0 million aggregate principal amount of our February 2015 Notes, for an identical principal amount of new Series 2012 Notes, plus a cash payment of $5.00 for each $1,000 principal amount tendered for a total cash incentive payment of approximately $0.8 million. Additionally, in February 2012, we entered into separate privately negotiated exchange agreements under which we exchanged an additional $10.0 million aggregate principal amount of our February 2015 Notes for an identical principal amount of our Series 2012 Notes. Like our May 2015 Notes, our Series 2012 Notes net share settle. At the time of the exchange, the effect of issuing $179.0 million aggregate principal of our Series 2012 Notes with the net share settle feature in exchange for our February 2015 Notes reduced 27.8 million shares of potential dilution to our stockholders.

Our Series 2012 Notes bear interest at a rate of 2.875% per annum, payable semiannually in arrears on February 15 and August 15 of each year, beginning on February 15, 2012 and is the same interest rate payable for the February 2015 Notes. The Series 2012 Notes mature on February 15, 2015, unless earlier repurchased or converted. The Company may not redeem the Series 2012 Notes prior to their stated maturity date. Our Series 2012 Notes are not puttable by the note holders other than in the context of a fundamental change resulting in the reclassification, conversion, exchange or cancellation of our common stock. Such repurchase event or fundamental change is generally defined to include a merger involving PDL, an acquisition of a majority of PDL's outstanding common stock and a change of a majority of PDL's board of directors without the approval of the board of directors.

Holders may convert their Series 2012 Notes at any time prior to the close of business on the second scheduled trading day immediately preceding the stated maturity date of the Series 2012 Notes under the following circumstances:

- During any fiscal quarter commencing after the fiscal quarter ending December 31, 2011, if the closing 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 Series 2012 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 the Series 2012 Notes for each trading day of that measurement period was less than 98% of the product of the closing price of the Company's common stock and the conversion rate for the Series 2012 Notes for that trading day;

- Upon the occurrence of certain corporate transactions as provided in the Indenture; or

- Anytime, at the holder's option, beginning on August 15, 2014.

Upon conversion of Series 2012 Notes, the Company will be required to pay cash and, if applicable, deliver shares of the Company's common stock. Our Series 2012 Notes are convertible into 162.885 shares of the Company's common stock per $1,000 of principal amount or approximately $6.14 per share of our common stock, subject to further adjustment upon certain events including dividend payments. As of June 30, 2012, $179.0 million of our Series 2012 Notes were outstanding and the if-converted value exceeded the principal amount by approximately $14.3 million. However, the stock price at June 30, 2012 did not exceed the threshold price of $7.98 per common share.

May 2015 Notes

Our May 2015 Notes are due May 1, 2015, and are convertible into 142.5217 shares of the Company's common stock per $1,000 of principal amount, or approximately $7.02 per share of our common stock, subject to further adjustment upon certain events including dividend payments. Our May 2015 Notes bear interest at a rate of 3.75% per annum, payable semiannually in arrears on May 1 and November 1 of each year, beginning November 1, 2011. Upon the occurrence of a fundamental change, as defined in the indenture, holders have the option to require PDL to repurchase their May 2015 Notes at a purchase price equal to 100% of the principal, plus accrued interest. Our May 2015 Notes are convertible under any of the following circumstances:

- During any fiscal quarter ending after the quarter ending June 30, 2011, if the last reported sale price of our 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, which we refer 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 our 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 November 1, 2014.

If a conversion occurs, to the extent that the conversion value exceeds the principal amount, the principal amount is due in cash and the difference between the conversion value and the principal amount is due in shares of the Company's common stock. As of June 30, 2012, $155.3 million of our May 2015 Notes were outstanding.

Our purchased call option transactions with two hedge counterparties entitle the Company to purchase up to 22.1 million shares of the Company's common stock, subject to adjustment. In addition, the warrants we sold to the hedge counterparties are exercisable, on a cashless basis, for up to 27.5 million shares of the Company's common stock. The purchased call option transactions and warrant sales effectively serve to reduce the potential dilution associated with conversion of our May 2015 Notes. The strike prices, subject to further adjustment upon certain events including dividends, are approximately $7.02 and $8.25, for the purchased call options and warrants, respectively.

If the share price is above $7.02, upon conversion of our May 2015 Notes, the purchased call options will offset the share dilution, because the Company will receive shares on exercise of the purchased call options equal to the shares that the Company must deliver to the note holders. If the share price is above $8.25, upon exercise of the warrants, the Company will deliver shares to the counterparties in an amount equal to the excess of the share price over $8.25. For example, a 10% increase in the share price above $8.25 would result in the issuance of 2.0 million incremental shares upon exercise of the warrants. If our share price increases, additional dilution would occur.

While the purchased call options are expected to reduce the potential equity dilution upon conversion of our May 2015 Notes, prior to conversion or exercise, our May 2015 Notes and the warrants could have a dilutive effect on the Company's earnings per share to the extent that the price of the Company's common stock during a given measurement period exceeds the respective exercise prices of those instruments. As of June 30, 2012, the if-converted amount of our May 2015 Notes was less than the principal amount. The purchased call options and warrants are considered indexed to PDL stock, require net-share settlement, and met all criteria for equity classification at inception and at June 30, 2012.

February 2015 Notes

As of June 30, 2012, $1.0 million of our February 2015 Notes were outstanding and met the criteria for conversion into shares of our common stock. In January and February 2012, we exchanged $179.0 million of our February 2015 Notes for an identical amount of our new Series 2012 Notes. Our February 2015 Notes are due February 15, 2015, and are convertible at any time, at the holders' option, into our common stock at a conversion price of 162.885 shares of common stock per $1,000 principal amount or $6.14 per share of common stock, subject to further adjustment upon certain events including dividend payments. Our February 2015 Notes bear interest at a rate of 2.875% per annum, payable semiannually in arrears on February 15 and August 15 of each year. Our February 2015 Notes are senior unsecured debt and are redeemable by us in whole or in part on or after August 15, 2014, at 100% of principal amount. Our February 2015 Notes are not puttable by the note holders other than in the context of a fundamental change resulting in the reclassification, conversion, exchange or cancellation of our common stock. Such repurchase event or fundamental change is generally defined to include a merger involving PDL, an acquisition of a majority of PDL's outstanding common stock and a change of a majority of PDL's board of directors without the approval of the board of directors. The issuance of our February 2015 Notes was not registered under the Securities Act of 1933, as amended, in reliance on exemption from registration thereunder.

Non-recourse Notes

In November 2009, we completed a $300 million securitization transaction whereby we monetized 60% of the net present value of the estimated future five year royalties (the Genentech Royalties) from sales of Avastin, Herceptin, Lucentis, Xolair (the Genentech Products) and future products, if any, under which Genentech may take a license under our related agreements with Genentech. Our Non-recourse Notes due March 15, 2015 (Non-recourse Notes), bear interest at 10.25% per annum, payable quarterly in arrears, and were issued in a non-registered offering by QHP, a Delaware limited liability company, and newly formed, wholly-owned subsidiary of PDL. The Genentech Royalties and other payments, if any, that QHP is entitled to receive under the agreements with Genentech, together with any funds made available from certain accounts of QHP, are the sole source of payment of principal and interest on our Non-recourse Notes, which are secured by a continuing security interest granted by QHP in its rights to receive the Genentech Royalties. Our Non-recourse Notes may be redeemed at any time prior to maturity, in whole or in part, at the option of QHP at a make-whole redemption price. The amount of quarterly repayment of the principal of our Non-recourse Notes will vary based upon the amount of future quarterly Genentech Royalties received. As of June 30, 2012, $22.7 million in aggregate principal of our Non-recourse Notes was outstanding. The anticipated final repayment date of our Non-recourse Notes is September 2012.

Contractual Obligations

As of June 30, 2012, our contractual obligations consisted primarily of our Series 2012, our May 2015 Notes, our February 2015 Notes and our Non-recourse Notes, which in the aggregate totaled $358.0 million in principal. Our Series 2012 Notes and our May 2015 Notes are not puttable by the note holders other than in the context of a fundamental change as discussed above.

We expect that our debt service obligations over the next several years will consist of interest payments and repayment of our Series 2012 Notes, our May 2015 Notes and our February 2015 Notes. Also our debt service obligations in 2012 include our Non-recourse-Notes, which we expect will be fully retired in the third quarter of 2012. 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 are available on favorable terms.

Note Receivable

In March 2012, we provided cash of approximately $7.4 million through a senior secured note receivable with a two-year term. In addition to interest, the note gives PDL certain rights to negotiate for certain royalty assets. The note was recorded net of origination fees that are accreted to the note receivable as interest income using the interest method. The note bears interest at 10% per annum, with interest due semi-annually and the final interest due at maturity together with the principal. The Company has not assigned a risk grade to the receivable or recorded an allowance for credit loss as PDL anticipates all payments will be received in full when due. No impairment has been recorded as the payments on the note are current.

Lease Guarantee

In connection with the spin-off of Facet Biotech Corporation (Facet) in 2008, 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. Should Facet default under its lease obligations, we could be held liable by the landlord as a co-tenant and, thus, we have in substance guaranteed the payments under the lease agreements for the Redwood City facilities. As of June 30, 2012, the total lease payments for the duration of the guarantee, which runs through December 2021, are approximately $105.6 million. If Facet were to default, we could also be responsible for lease related costs including utilities, property taxes and common area maintenance which may be as much as the actual lease payments. In April 2010, Abbott Laboratories acquired Facet and later renamed the company Abbott Biotherapeutics Corp. We have recorded a liability of $10.7 million on our Condensed Consolidated Balance Sheets as of June 30, 2012, and December 31, 2011, related to this guarantee.

Credit Agreement

In July 2012, we loaned $35 million to Merus Labs International, Inc. (Merus Labs) in connection with its acquisition of a commercial-stage pharmaceutical product and related assets (the Assets). In addition, we agreed to provide a $20 million letter of credit on behalf of Merus Labs that the seller of the Assets may draw upon to satisfy the remaining $20 million purchase price obligation on July 11, 2013 (Letter of Credit). Draws on the Letter of Credit will be funded from the proceeds of an additional loan to Merus Labs. Outstanding borrowings under the July 2012 loan bear interest at the rate of 13.5% per annum and outstanding borrowings as a result of draws on the Letter of Credit bear interest at the rate of 14.0% per annum. Merus Labs is required to make four periodic principal payments in respect of the July 2012 loan, with repayment of the remaining principal balance of all loans due on March 31, 2015. The borrowings are subject to mandatory prepayments upon certain asset dispositions or debt issuances under the terms set forth in the credit agreement (Credit Agreement).

The Credit Agreement provides for a number of standard events of default, including payment, bankruptcy, covenant, judgment and cross-defaults.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

Foreign Currency Risk

The underlying sales of our licensees' products are conducted in multiple countries and in multiple currencies throughout the world. 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 in relation to other currencies, the converted amount is greater than it would have been had the U.S. dollar not weakened. More than 50% of our licensees' product sales are in currencies other than U.S. dollars; as such, our revenues may fluctuate due to changes in foreign currency exchange rates and is subject to foreign currency exchange risk. For example, in a quarter in which we generate $70 million in royalty revenues, approximately $35 million is based on sales in currencies other than the U.S. dollar. If the U.S. dollar strengthens across all currencies by 10% during the conversion 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 $3.5 million less in that current quarter sales, assuming that the currency risk in such forecasted sales was not hedged.

We hedge Euro-denominated risk exposures related to our licensees' product sales with Euro forward contracts. In general, these contracts are intended to offset the underlying Euro market risk in our royalty revenues. In January 2012, we modified our existing Euro forward and option contracts related to our licensees' sales through December 2012 into Euro forward contracts with more favorable rates than the rate that was insured by the previous contracts. Additionally, we entered into a series of Euro forward contracts covering the quarters in which our licensees' sales occur through December 2013. We have designated the Euro forward contracts as cash flow hedges. At the inception of the hedging relationship and on a quarterly basis, we assess hedge effectiveness. The aggregate unrealized gain or loss, net of tax, on the effective component of the hedge, is recorded in stockholders' deficit as accumulated other comprehensive income (loss).

Gains or losses on cash flow hedges are recognized in the same period that the hedged transaction impacts earnings as an adjustment to royalty revenue. Ineffectiveness, if any, resulting from the change in fair value of the modified 2012 hedge or lower than forecasted Euro-based royalties is reclassified from other comprehensive income (loss) and recorded as interest and other income, net, in the period it occurs. For the three months ended June 30, 2012, we recognized a gain of approximately $57,000 associated with the ineffectiveness of the modified 2012 foreign exchange hedge. For the six months ended June 30, 2012, we recognized a loss, of approximately $27,000 associated with the ineffectiveness of the modified 2012 foreign exchange hedge. There was no ineffectiveness related to forecasted transactions for the three and six months ended June 30, 2012, and there was approximately $19,000 of ineffectiveness related to lower than forecasted Euro-based royalty transactions for the three and six months ended June 30, 2011.

Interest Rate Risk

Our investment portfolio was approximately $171.9 million at June 30, 2012, and $224.8 million at December 31, 2011, and consisted of investments in Rule 2a-7 money market funds, corporate debt securities, commercial paper, U.S. government sponsored agency bonds and U.S. treasury securities. If market interest rates were to have increased by 1%, there would have been no material impact on the fair value of our portfolio.

The fair value of our convertible notes is subject to interest rate risk, market risk and other factors due to the convertible feature. Generally, the fair value of our convertible notes will increase as interest rates fall and/or our common stock price increases, and decrease as interest rates rise and/or our common stock price decreases. The interest and market value changes affect the fair value of our convertible notes, but do not impact our financial position, cash flows, or results of operations due to the fixed nature of the debt obligations. We do not carry our convertible notes at fair value, but present the fair value of the principal amount of our convertible notes for disclosure purposes only. At June 30, 2012, our convertible notes consisted of our May 2015 Notes at a fixed interest rate of 3.75%, our Series 2012 Notes at a fixed rate of 2.875% and our February 2015 Notes at a fixed interest rate of 2.875%. At December 31, 2011, our convertible notes consisted of our May 2015 Notes at a fixed interest rate of 3.75% and our February 2015 Notes at a fixed interest rate of 2.875%.

The fair value of our convertible notes was $377.0 million at June 30, 2012, and $347.6 million at December 31, 2011. The fair value was based on quoted market pricing and dealer quotes. The principal amount of our convertible notes, which consists of the combined debt and equity components, was $335.3 million at June 30, 2012, and December 31, 2011.

The fair value of our Non-recourse Notes was estimated to be $23.2 million at June 30, 2012, and $95.2 million at December 31, 2011, based on available pricing information. Our Non-recourse Notes bear interest at a fixed rate of 10.25% per annum. This obligation is subject to interest rate risk because the fixed interest rates under this obligation exceed current interest rates.

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 the end of the period covered by this report. Based on this evaluation, our Chief Executive Officer and Chief Financial have concluded that, as of June 30, 2012, our disclosure controls and procedures were effective to ensure the information required to be disclosed by us in the reports that we file or submit under the Securities Exchange Act of 1934, as amended, is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms.

Changes in Internal Controls

There were no changes in our internal controls over financial reporting during the quarter ended June 30, 2012, that have materially affected, or are 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, 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

Genentech / Roche Matter

Communications with Genentech regarding European SPCs

In August 2010, we received a letter from Genentech, sent on behalf of F. Hoffmann-LaRoche, Ltd. Roche and Novartis AG (Novartis), asserting that the Avastin, Herceptin, Lucentis and Xolair (the Genentech Products) do not infringe the supplementary protection certificates (SPCs) granted to PDL by various countries in Europe for each of the Genentech Products and seeking a response from PDL to these assertions. Genentech did not state what actions, if any, it intends to take with respect to its assertions. PDL's SPCs were granted by the relevant national patent offices in Europe and specifically cover the Genentech Products. The SPCs covering the Genentech Products effectively extend our European patent protection for the European Patent No. 0 451 216B ('216B Patent) generally until December 2014, except that the SPCs for Herceptin will generally expire in July 2014.

Genentech's letter does not suggest that the Genentech Products do not infringe PDL's U.S. patents to the extent that such Genentech Products are U.S.-based Sales. Genentech's quarterly royalty payments received after receipt of the letter have included royalties generated on all worldwide sales of the Genentech Products.

If Genentech is successful in asserting this position, then under the terms of our license agreements with Genentech, it would not owe us royalties on sales of the Genentech Products that are both manufactured and sold outside of the United States. Royalties on sales of the Genentech Products that are ex-U.S.-based Manufacturing and Sales accounted for approximately 32% of our royalty revenues for the six months ended June 30, 2012. Based on announcements by Roche regarding moving more manufacturing outside of the United States, we expect this amount to increase in the future.

We believe that the SPCs are enforceable against the Genentech Products, that Genentech's letter violates the terms of the 2003 settlement agreement and that Genentech owes us royalties on sales of the Genentech Products on a worldwide basis. We intend to vigorously assert our SPC-based patent rights.

Nevada Litigation with Genentech, Roche and Novartis in Nevada State Court

In August 2010, we filed a complaint in the Second Judicial District of Nevada, Washoe County, naming Genentech, Roche and Novartis as defendants. We intend to enforce our rights under our 2003 settlement agreement with Genentech and are seeking an order from the court declaring that Genentech is obligated to pay royalties to us on ex-U.S.-based Manufacturing and Sales of the Genentech Products.

The 2003 settlement agreement was entered into as part of a definitive agreement resolving intellectual property disputes between the two companies at that time. The agreement limits Genentech's ability to challenge infringement of our patent rights and waives Genentech's right to challenge the validity of our patent rights. Certain breaches of the 2003 settlement agreement as alleged by our complaint require Genentech to pay us liquidated and other damages of potentially greater than one billion dollars. This amount includes a retroactive royalty rate of 3.75% on past U.S.-based Sales of the Genentech Products and interest, among other items. We may also be entitled to either terminate our license agreements with Genentech or be paid a flat royalty of 3.75% on future U.S.-based Sales of the Genentech Products.

In November 2010, Genentech and Roche filed a motion to dismiss our complaint against them in which we seek to enforce our rights under the 2003 settlement agreement with Genentech. Genentech and Roche's motions to dismiss under Nevada Rule of Civil Procedure 12(b)(5) alleged that all of our claims for relief relating to the 2003 settlement agreement should be dismissed because the 2003 settlement agreement applies only to our U.S. patents. In addition, Roche filed a separate motion to dismiss our complaint under Nevada Rule of Civil Procedure 12(b)(2) on the ground that the Nevada court lacks personal jurisdiction over Roche. On July 7, 2011, the Second Judicial District Court of Nevada ruled in favor of us on the two motions to dismiss filed by Genentech and Roche. The court denied Genentech and Roche's motion to dismiss four of our five claims for relief and, further, denied Roche's separate motion to dismiss for lack of personal jurisdiction. The court dismissed one of our claims that Genentech committed a bad-faith breach of the covenant of good faith and fair dealing stating that, based on the current state of the pleadings, no "special relationship" had been established between Genentech and us as required under Nevada law. On November 1, 2011, the Nevada court issued an order accepting Roche’s stipulation of waiver to its personal jurisdiction defense. As a result of the order, Roche is foreclosed from reliance on lack of personal jurisdiction in defending against our claims.

On February 25, 2011, we reached a settlement with Novartis under which, among other things, we agreed to dismiss our claims against Novartis in the action in Nevada state court against Genentech, Roche and Novartis. Genentech and Roche continue to be parties to the Nevada suit.

The court has scheduled trial to commence on October 7, 2013. The outcome of this litigation is uncertain and we may not be successful in our allegations.

Other Legal Proceedings

In addition, from time to time, we are subject to various other legal proceedings and claims that arise in the ordinary course of business and which we do not expect to materially impact our financial statements.

ITEM 1A. RISK FACTORS

Except as set forth below, during the six months ended June 30, 2012, there were no material changes to the risk factors included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2011. Please carefully consider the information set forth in this Quarterly Report on Form 10-Q and the risk factors discussed in Part I, "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the year ended December 31, 2011, which could materially affect our business, financial condition or future results. The risks described in our Annual Report on Form 10-K, as well as other risks and uncertainties, could materially and adversely affect our business, results of operations and financial condition, which in turn could materially and adversely affect the trading price of shares of our common stock. Additional risks not currently known or currently material to us may also harm our business.

Our common stock may lose value, our common stock could be delisted from NASDAQ and our business may be liquidated due to several factors, including the expiration of our Queen et al. patents, the failure to acquire other sources of revenue, the payment of dividends or distributions to our stockholders and failure to meet analyst expectations.

Our revenues consist almost entirely of royalties from licensees of our Queen et al. patents, which finally expire in December of 2014. The continued payment of dividends or distributions to our stockholders without other revenue sources and the approaching patent expiration will likely reduce the price of our common stock. If the price of our common stock were to fall below NASDAQ listing standards, our common stock may be delisted. If our common stock were delisted, market liquidity for our common stock could be severely affected and our stockholders' ability to sell securities in the secondary market could be limited. Delisting from NASDAQ would negatively affect the value of our common stock. Delisting could also have other negative results, including, but not limited to, the potential loss of confidence by employees, the loss of institutional investor interest and fewer business development opportunities.

Unless we are able to acquire patents or other sources of revenue on commercially reasonable terms, we will no longer generate revenues sufficient to sustain an ongoing public company once our licensees have sold all their inventory of licensed product that was manufactured before the expiration of the Queen et al. patents. If we are unsuccessful in acquiring new sources of revenue sufficient to sustain our business, we will likely liquidate our business.

If we fail to meet the expectations of securities analysts or investors, or if adverse conditions prevail or are perceived to prevail with respect to our business, the price of the common stock would likely drop significantly.

Our current and future acquisitions or other material revenue generating asset transactions may not produce the anticipated revenues.

We are engaged in a continual review of opportunities to acquire revenue generating assets, whether royalty based or otherwise, or to acquire companies that hold royalty assets. We currently, and generally at any time, have acquisition opportunities in various stages of active review, including, for example, our engagement of consultants and advisors to analyze particular opportunities, technical, financial and other confidential information, submission of indications of interest and involvement as a bidder in competitive auctions. Many potential acquisition targets do not meet our criteria, and for those that do, we may face significant competition for these acquisitions from other royalty buyers and enterprises. Competition for future asset acquisition opportunities in our markets could increase the price we pay for such assets and could reduce the number of potential acquisition targets. The success of our revenue generating asset acquisitions is based on our ability to make accurate assumptions regarding the valuation, timing and amount of payments. The failure of any of these acquisitions to produce anticipated revenues may materially and adversely affect our financial condition and results of operations.

ITEM 6. EXHIBITS

10.1*	Credit Agreement between the Company and Merus Labs International, Inc., dated July 10, 2012†
10.2#	Offer Letter between the Company and Bruce Tomlinson, dated April 20, 2012 (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed April 27, 2012)
12.1*	Ratio of Earnings to Fixed Charges
31.1*	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
31.2*	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
32.1**	Certification by the Principal Executive Officer, as required by Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934, as amended, and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350)
32.2**	Certification by the Principal Financial Officer, as required by Rule 13a-14(b) or Rule 15d-14(b) of the Securities Exchange Act of 1934, as amended, and Section 1350 of Chapter 63 of Title 18 of the United States Code (18 U.S.C. 1350)
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.

** This certification accompanies the 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 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 Form 10-Q), irrespective of any general incorporation language contained in such filing.

† Certain information in this exhibit has been omitted and filed separately with the Securities and Exchange Commission pursuant to a confidential treatment request under 17 C.F.R. Sections 200.80(b)(4) and 24b-2.

# Indicates a management contract or compensatory plan or arrangement, as required by Item 15(a)3

SIGNATURES

Pursuant to the requirements of Section 13 or 15(d) 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: August 2, 2012
PDL BIOPHARMA, INC. (REGISTRANT)

/s/ John P. McLaughlin

John P. McLaughlin
President and Chief Executive Officer
(Principal Executive Officer)

/s/ Bruce Tomlinson

Bruce Tomlinson
Vice President and Chief Financial Officer
(Principal Financial Officer)

/s/ Caroline Krumel

Caroline Krumel
Vice President Finance
(Principal Accounting Officer)

Exhibit 10.1

Pursuant to 17 CFR 240.24b-2, confidential information has been omitted in places marked "* * *" and has been filed separately with the Securitites and Exchange Commission pursuant to a Confidential Treatment Application filed with the Commission.

CREDIT AGREEMENT

dated as of July 10**,** 2012

among

MERUS LABS INTERNATIONAL INC.,

as Borrower,

MERUS LABS LUXCO S.À R.L,

MERUS LABS INC.,

ECG HOLDINGS INC.,

and

MERUS LABS NETHERLANDS B.V.

as Loan Parties,

PDL BIOPHARMA, INC.,

as Lender,

and

PDL BIOPHARMA, INC.,

as Agent

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CREDIT AGREEMENT

This Credit Agreement dated as of July 10**,** 2012, (as amended, restated or otherwise modified from time to time, this "Agreement") is made among MERUS LABS INTERNATIONAL INC., a corporation organized under the laws of British Columbia ("Borrower"), the Loan Parties named herein, PDL BIOPHARMA, INC. (the "Lender"), and PDL BIOPHARMA, INC., not individually, but as Agent (as defined below).

Borrower and the other Loan Parties have agreed to enter into this Agreement with the Lender and Agent evidencing their agreement to incur the Loans, and in connection therewith, to make the representations and warranties, covenants and undertakings as hereinafter set forth.

Section 1. Definitions; Interpretation.

1.1. Definitions. When used herein the following terms shall have the following meanings:

"Acceleration Event" means the occurrence of any of the following: (i) an Event of Default under Section 8.1.3; (ii) an Event of Default under Section 8.1.1 and the termination of the Commitments pursuant to Section 8.2; or (iii) any other Event of Default under Section 8.1 and the election by the Lender to declare the Obligations to be due and payable pursuant to Section 8.2.

"Acquired Person" has the meaning set forth in Section 1.4.

"Acquisition" means any transaction or series of related transactions for the purpose of or resulting, directly or indirectly, in (a) the acquisition of all or a substantial portion of the assets of a Person, or of all or a substantial portion of any business or division of a Person, (b) the acquisition of in excess of 50% of the Stock of any Person, or otherwise causing any Person to become a Subsidiary, (c) a merger, consolidation, amalgamation or any other combination with another Person (other than a combination between two Persons that prior to the merger, consolidation, amalgamation or combination were already Loan Parties) and (d) the acquisition of a brand, line of business, division, branch, product line, marketing rights with respect to a product line, operating division or other unit operation of any Person.

"Additional Commitment" means, as to the Lender, the Lender's commitment to provide the Additional Loan pursuant to Section 2.1.2. The amount of the Additional Commitment shall be set forth on Annex I.

"Additional Loan" has the meaning given in the definition of "Loans".

"Affiliate" of any Person means (a) any other Person which, directly or indirectly, controls or is controlled by or is under common control with such Person and (b) any officer or director of such Person. A Person shall be deemed to be "controlled by" any other Person if such Person possesses, directly or indirectly, power to vote 10% or more of the securities (on a fully diluted basis) having ordinary voting power for the election of directors or managers or power to direct or cause the direction of the management and policies of such Person whether by contract or otherwise. Unless expressly stated otherwise herein, neither Agent nor the Lender shall be deemed an Affiliate of any Group Member.

"Agent" means PDL BioPharma, Inc. in its capacity as administrative agent for the Lender hereunder and any successor thereto in such capacity.

"Agreement" has the meaning set forth in the Preamble.

"AML Legislation" has the meaning set forth in Section 10.8.

"Asset Purchase" means the purchase of the "Transferred Assets" (as defined in the Asset Purchase Agreement) pursuant to the Asset Purchase Agreement.

"Asset Purchase Agreement" means the Asset Purchase Agreement dated as of July 11, 2012 between Novartis and Merus Labs Luxco S.à r.l.

"Asset Purchase Documents" means the Asset Purchase Agreement and the other material documents, agreements and instruments executed and delivered in connection therewith, including, without limitation, the License Agreement, the Supply Agreement, the TM Assignment Documents, the Patent Assignment Documents and the Domain Name Assignment Documents (in each case as defined in the Asset Purchase Agreement).

"Asset Purchase Transactions" means the transactions contemplated by the Asset Purchase Documents.

"Asset Purchaser" means Merus Labs Luxco S.à r.l.

"Board Observer" has the meaning as set forth in Section 6.11.

"Board Meeting" has the meaning as set forth in Section 6.11.

"Borrower" has the meaning set forth in the Preamble.

"Business Day" means any day on which commercial banks are open for commercial banking business in New York, New York, and on which dealings are carried on in the London interbank eurodollar market.

"Canadian Dollars" and "CDN$" each mean lawful currency of Canada.

"Canadian Employee" means any employee or former employee of a Canadian Loan Party.

"Canadian Employee Benefits Legislation" means the Canada Pension Plan (Canada), the Pension Benefits Standards Act (British Columbia), and any Canadian federal, provincial or local counterparts or equivalents, in each case, as applicable and as amended from time to time.

"Canadian Employee Plan" means any employee benefit, health, welfare, supplemental unemployment benefit, bonus, pension, supplemental pension, profit sharing, retiring allowance, severance, deferred compensation, stock compensation, stock purchase, retirement, life, hospitalization insurance, medical, dental, disability or other employee group or similar benefit or employment plans or supplemental arrangements applicable to the Canadian Employees.

"Canadian Guarantee and Collateral Agreement" means the Guarantee and Collateral Agreement, dated as of the Closing Date, made by each Loan Party (other than Merus Labs Luxco S.à r.l) and other grantor or pledgor signatory thereto in favor of Agent, and governed by the laws of British Columbia, as amended, restated or otherwise modified from time to time in accordance with the terms hereof and thereof.

"Canadian Loan Parties" means each Loan Party organized under the laws of Canada or a province thereof, including, for greater certainty, the Borrower and Merus Labs Inc.

"Canadian Pension Plan" means any pension plan required to be registered under the Income Tax Act (Canada) or any Canadian federal or provincial law and or contributed to by a Canadian Loan Party for its Canadian Employees or former Canadian Employees, including any pension benefit plan within the meaning of the Pension Benefits Standards Act (British Columbia), but does not include the Canada Pension Plan maintained by the Government of Canada or the Quebec Pension Plan maintained by the Province of Quebec.

"Capital Lease" means, with respect to any Person, any lease of (or other agreement conveying the right to use) any real or personal property by such Person that, in conformity with IFRS, is accounted for as a capital lease on the balance sheet of such Person.

"Cash Equivalent Investment" means, at any time, (a) any evidence of Debt, maturing not more than one year after such time, issued or guaranteed by the Canadian or the United States Government or any agency thereof, (b) commercial paper, or corporate demand notes, in each case rated at least A-l by Standard & Poor's Ratings Group or P-l by Moody's Investors Service, Inc., (c) any certificate of deposit (or time deposit represented by a certificate of deposit) or banker's acceptance maturing not more than one year after such time, or any overnight Federal Funds transaction that is issued or sold by a commercial banking institution that is a member of the Federal Reserve System and has a combined capital and surplus and undivided profits of not less than $500,000,000, (d) any repurchase agreement entered into with any commercial banking institution of the nature referred to in clause (c) above which (i) is secured by a fully perfected security interest in any obligation of the type described in any of clauses (a) through (c) above and (ii) has a market value at the time such repurchase agreement is entered into of not less than 100% of the repurchase obligation of such commercial banking institution thereunder, (e) money market accounts or mutual funds which invest predominantly in assets satisfying the foregoing requirements and (f) other short term liquid investments approved in writing by Agent.

"Change of Control" means an event or series of events by which:

(a) any "person" or "group" (as such terms are used in Section 13(d) and 14(d) of the Securities Exchange Act of 1934, but excluding any employee benefit plan of such person or its subsidiaries, and any person or entity acting in its capacity as trustee, agent or other fiduciary or administrator of any such plan) becomes the "beneficial owner" (as defined in Rules 13-d and 13d-5 under the Securities Exchange Act of 1934, except that a person or group shall be deemed to have "beneficial ownership" of all Stock that such person or group has the right to acquire (such right, an "option right"), whether such right is exercisable immediately or only after the passage of time), directly or indirectly, of fifty percent (50%) or more of the Stock and Stock Equivalents of the Borrower entitled to vote for members of the board of directors or equivalent governing body of the Borrower on a fully diluted basis (and taking into account all such securities that such person or group has the right acquire pursuant to any option right); or

(b) individuals who on the Closing Date constituted the board of directors or similar governing body of the Borrower (together with any new directors whose election or appointment by such board of directors or similar governing body or whose nomination for election by the shareholders of the Borrower was approved by a vote of a majority of the directors of the Borrower then still in office who were either directors on the Closing Date or whose election or nomination for election was previously so approved) cease for any reason to constitute a majority of the board of directors or similar governing body of the Borrower then in office.

"Closing Date" means the date on which the conditions set forth in Section 4.1 have been satisfied or waived by the Lender.

"Closing Date Commitment" means, as to the Lender, the Lender's commitment to provide the Initial Loan pursuant to Section 2.1.1. The amount of the Closing Date Commitment shall be set forth on Annex I.

"Collateral" means all property and interests in property and proceeds thereof now owned or hereafter acquired by any Loan Party and any other Person who has granted a Lien to the Agent, in or upon which a Lien now or hereafter exists in favor of the Lender or the Agent for the benefit of the Agent and the Lender, whether under this Agreement or under any other documents executed by any such Persons and delivered to the Agent.

"Collateral Access Agreement" means an agreement in form and substance satisfactory to Agent in its reasonable discretion pursuant to which a mortgagee or lessor of real property on which Collateral is stored or otherwise located, or a warehouseman, processor or other bailee of Inventory or other property owned by any Loan Party, acknowledges the Liens of Agent and waives (or, if approved by Agent, subordinates) any Liens held by such Person on such property, and, in the case of any such agreement with a mortgagee or lessor, permits Agent reasonable access to and use of such real property during the continuance of an Event of Default to assemble, complete and sell any Collateral stored or otherwise located thereon.

"Collateral Documents" means, collectively, the Guarantee and Collateral Agreements, each Mortgage, the Luxembourg Collateral Documents, the Netherlands Collateral Documents and each other agreement or instrument pursuant to or in connection with which any Loan Party or any other Person grants a security interest in any Collateral to Agent for the benefit of the Lender or pursuant to which any such security interest in Collateral is perfected, each as amended, restated or otherwise modified from time to time in accordance with the terms hereof and thereof.

"Commitment" means the Closing Date Commitment and/or the Additional Commitment, as applicable.

"Compliance Certificate" means a certificate substantially in the form of Exhibit A.

"Computation Period" means each period of two consecutive Fiscal Quarters ending on the last day of a Fiscal Quarter.

"Consideration" means the value of all cash, Cash Equivalent Investments, Stock (which in the case of Qualified Preferred Stock is the aggregate liquidation preference of such Qualified Preferred Stock), Stock Equivalents, securities and "earn-outs" and other similar agreements representing purchase consideration paid or payable for any Permitted Acquisition, whether payable at or prior to the consummation of such Permitted Acquisition or deferred for payment at any future time, whether or not any such future payment is subject to the occurrence of any contingency, and includes any and all payments representing the purchase price and any assumptions of Debt, with "earn-outs" and other similar agreements valued at the maximum amount reasonably anticipated to be paid therefor.

"Consolidated Net Income" means, with respect to Borrower and its Subsidiaries for any period, the consolidated net income (or loss) of Borrower and its Subsidiaries for such period, excluding (i) consolidated net income of any Person for any period prior to such Person becoming a Subsidiary, (ii) any gains or losses from dispositions of any assets, (iii) any extraordinary gains or extraordinary losses, (iv) any net income of any Subsidiary to the extent that such Subsidiary is unable, by virtue of any legal or contractual prohibition, from distributing such net income to the Borrower, and (iv) any gains or losses from discontinued operations.

"Contingent Obligation" means any agreement, undertaking or arrangement by which any Person guarantees, endorses or otherwise becomes or is contingently liable upon (by direct or indirect agreement, contingent or otherwise, to provide funds for payment, to supply funds to or otherwise to invest in a debtor, to provide security for the obligations of a debtor or otherwise to assure a creditor against loss) any indebtedness, obligation or other liability of any other Person (other than by endorsements of instruments in the course of collection), or guarantees the payment of dividends or other distributions upon the Stock of any other Person. The amount of any Person's obligation in respect of any Contingent Obligation shall (subject to any limitation set forth therein) be deemed to be the principal amount of the indebtedness, obligation or other liability supported thereby or the amount of the dividends or distributions guaranteed, as applicable.

"Control Agreement" means a tri-party deposit account, securities account or commodities account Control Agreement by and among the applicable Loan Party, Agent and the depository, securities intermediary or commodities intermediary, and each in form and substance satisfactory in all respects to Agent in its reasonable discretion and in any event providing to Agent either (i) "control" of such deposit account, securities or commodities account within the meaning of Articles 8 and 9 of the UCC or (ii) "control" of such securities account within the meaning of the PPSA. For certainty for any Canadian deposit account, such term shall also refer to a "blocked account agreement" with respect to such deposit account, notwithstanding that the execution and delivery of such agreement is not a perfection requirement.

"Copyrights" means all rights, title and interests (and all related IP Ancillary Rights) arising under any requirement of law in copyrights and all mask work, database and design rights, whether or not registered or published, all registrations and recordations thereof and all applications in connection therewith.

"Curable Default" has the meaning set forth in Section 8.3.

"Current Ratio" means, as of any date of determination, the ratio of (a) cash to (b) current accounts payable (as determined in accordance with IFRS).

"DCC" means the Dutch Civil Code (Burgerlijk Wetboek).

"Dutch Loan Party" means a Loan Party incorporated under Dutch law, including, for greater certainty, Merus Labs Netherlands B.V., with corporate seat in Amsterdam, the Netherlands.

"Debt" of any Person means, without duplication, (a) all indebtedness of such Person for borrowed money, (b) all indebtedness evidenced by bonds, debentures, notes or similar instruments, (c) all obligations of such Person as lessee under Capital Leases which have been or should be recorded as liabilities on a balance sheet of such Person in accordance with IFRS, (d) all obligations of such Person to pay the deferred purchase price of property or services (excluding trade accounts payable in the ordinary course of business), (e) all indebtedness secured by a Lien on the property of such Person, whether or not such indebtedness shall have been assumed by such Person (with the amount thereof being measured as the fair market value of such property), (f) all obligations, contingent or otherwise, with respect to letters of credit (whether or not drawn), banker's acceptances and surety bonds issued for the account of such Person, (g) all Hedging Obligations of such Person, (h) all Contingent Obligations of such Person, (i) all non-compete payment obligations and earn-out, purchase price adjustment and similar obligations, (j) all obligations of such Person in respect of Disqualified Capital Stock issued by such Person, (k) all indebtedness of the types listed in (a) through (j) and (l) of any partnership of which such Person is a general partner and (l) all obligations of such Person under any synthetic lease transaction, where such obligations are considered borrowed money indebtedness for tax purposes but the transaction is classified as an operating lease in accordance with IFRS.

"Default" means any event that, if it continues uncured, will, with the lapse of time or the giving of notice or both, constitute an Event of Default.

"Default Rate" has the meaning set forth in Section 2.3.1.

"Defined Benefit Plan" means any Canadian Pension Plan which contains a "defined benefit provision" as defined in subsection 147.1(1) of the Income Tax Act (Canada).

"Disposition" means, as to any asset or right of any Group Member, (a) any sale, lease, assignment or other transfer pursuant to Section 7.5(b)(ii), (b) any loss, destruction or damage of property or (c) any condemnation, confiscation, requisition, seizure or taking of property.

"Disqualified Capital Stock" means any Stock which, by its terms (or by the terms of any security into which it is convertible or for which it is exchangeable), or upon the happening of any event, (a) matures (excluding any maturity as the result of an optional redemption by the issuer thereof) or is mandatorily redeemable, pursuant to a sinking fund obligation or otherwise, or is redeemable at the option of the holder thereof, in whole or in part, on or prior to the 365th day after the Maturity Date, (b) is convertible into or exchangeable (unless at the sole option of the issuer thereof) for (i) debt securities or (ii) any Stock referred to in (a) above, in each case at any time on or prior to the 365th day after the Maturity Date, or (c) contains any repurchase obligation which may come into effect prior to the Obligations being Paid in Full; provided that any Stock that would not constitute Disqualified Capital Stock but for provisions thereof giving holders thereof (or the holders of any security into or for which such Stock is convertible, exchangeable or exercisable) the right to require the issuer thereof to redeem or repurchase such Stock upon the occurrence of a change in control or an asset sale occurring prior to the 365th day after the Maturity Date shall not constitute Disqualified Capital Stock if such Stock provides that the issuer thereof will not redeem or repurchase any such Stock pursuant to such provisions prior to the repayment in full of the Obligations.

"Dollar" and "$" mean lawful currency of the United States of America.

"Domain Name Assignment Documents" has the meaning set forth in the Asset Purchase Agreement.

"EBITDA" means, for any period, Consolidated Net Income for such period plus, to the extent deducted in determining such Consolidated Net Income for such period, without duplication, (i) Interest Expense, (ii) income tax expense, (iii) depreciation and amortization, (iv) transaction expenses incurred in connection with the Asset Sale and the financing contemplated by this Agreement, (v) non-cash stock compensation expense, (vi) any non-cash non-recurring charges or expenses, and (vii) any extraordinary or non-recurring charges or expenses approved in writing by the Agent minus, to the extent included in determining Consolidated Net Income for such period, all non-cash gains for such period.

"Environmental Claims" means all claims, however asserted, by any governmental, regulatory or judicial authority or other Person alleging potential liability or responsibility under or for violation of any Environmental Law, or for release or injury to the environment or any Person or property or natural resources.

"Environmental Laws" means all present or future federal, state, provincial or local laws, statutes, common law duties, rules, regulations, ordinances and codes, including all amendments, together with all administrative orders, directed duties, requests, licenses, authorizations and permits of, and agreements with, any Governmental Authority, in each case relating to any matter arising out of or relating to health and safety, or pollution or protection of the environment, natural resources or workplace, including any of the foregoing relating to the presence, use, production, recycling, reclamation, generation, handling, transport, treatment, storage, disposal, distribution, discharge, release, emission, control, cleanup or investigation or management of any Hazardous Substance.

"Equivalent Amount" means, on any date of determination, with respect to obligations or valuations denominated in one currency (the "first currency"), the amount of another currency (the "second currency") which would result from the Agent converting the first currency into the second currency at approximately 12:00 noon (New York time) in a commercially reasonable manner.

"ERISA" means the Employee Retirement Income Security Act of 1974, as amended.

"Event of Default" means any of the events described in Section 8.1.

"Excess Cash" means, as of any date of determination, Unrestricted Cash in excess of the amount of Unrestricted Cash that would be required to maintain a Current Ratio of 1.2 to 1.0.

"Excluded Taxes" has the meaning set forth in Section 3.1(a).

"Fee Letter" means the Fee Letter, dated as of or before the Closing Date, signed by the Lender and Agent, accepted and agreed to by the Borrower, and governed by the laws of New York.

"Fiscal Quarter" means a fiscal quarter of a Fiscal Year.

"Fiscal Year" means the fiscal year of Borrower and its Subsidiaries, which period shall be the 12-month period ending on September 30 of each year.

"Fixed Charges" means, for any period, and with respect to the Borrower and its Subsidiaries determined on a consolidated basis in accordance with IFRS, the sum, without duplication, of (a) Interest Expense accrued (other than interest paid-in-kind, amortization of financing fees, and other non-cash Interest Expense) during such period, (b) principal payments in respect of Debt that are required to be paid during such period, (c) all federal, state, and local income taxes paid in cash with respect to such period and (d) all Restricted Payments paid (whether in cash or other property, other than common Stock) during such period.

"Fixed Charges Coverage Ratio" means, for any Computation Period, the ratio of (a) the total for such Computation Period of EBITDA to (b) the total for such Computation Period of Fixed Charges.

"Fixed Charges Coverage Ratio Requirement" means, for any Computation Period, the applicable Fixed Charges Coverage Ratio set forth below at the end of each such Computation Period:

Computation Period	Amount
September 30, 2012	2.3:1.0
December 31, 2012	2.3:1.0
March 31, 2013	2.3:1.0
June 30, 2013	2.3:1.0
September 30, 2013	2.3:1.0
December 31, 2013	2.3:1.0
March 31, 2014	2.3:1.0
June 30, 2014	2.3:1.0
September 30, 2014	2.3:1.0
December 31, 2014	2.3:1.0
March 31, 2015	2.3:1.0

"Foreign Lender" means the Lender to the extent that it is not resident in Canada for purposes of the Tax Act.

"FRB" means the Board of Governors of the Federal Reserve System or any successor thereto.

"Governmental Authority" means any nation or government, any state, province, municipality or other political subdivision thereof, any central bank (or similar monetary or regulatory authority) thereof, any entity exercising executive, legislative, judicial, regulatory or administrative functions of or pertaining to government (including any supra-national bodies such as the European Union or the European Central Bank), and any corporation or other entity owned or controlled, through stock or capital ownership or otherwise, by any of the foregoing.

"Gross Sales" means, with respect to the Products for any Computation Period, the gross revenue from the sale of such Products as shown or as would be shown in the consolidated financial statements of the Loan Parties prepared for such period in accordance with IFRS applied on a consistent basis. For the avoidance of doubt, no Disposition shall be included in Gross Sales.

"Group Member" means Borrower and each Subsidiary of Borrower.

"Guarantee and Collateral Agreements" means the U.S. Guarantee and Collateral Agreement and the Canadian Guarantee and Collateral Agreement.

"Hazardous Substances" means any waste, chemical, substance, or material listed, defined, classified, or regulated as a hazardous waste, hazardous substance, pollutant, contaminant, toxic substance, or hazardous, dangerous or radioactive material, chemical or waste or otherwise regulated by any Environmental Law, including, without limitation, any petroleum or any derivative, waste, or byproduct thereof, radon, asbestos, and polychlorinated biphenyls, and any other substance, the storage, manufacture, disposal, treatment, generation, use, transportation, remediation, release into or concentration in the environment of which is prohibited, controlled, regulated or licensed by any governmental authority under any Environmental Law.

"Hedging Obligation" means, with respect to any Person, any liability of such Person under any interest rate, currency or commodity swap agreement, cap agreement or collar agreement, and any other agreement or arrangement designed to protect a Person against fluctuations in interest rates, currency exchange rates or commodity prices. The amount of any Person's obligation in respect of any Hedging Obligation shall be deemed to be the incremental obligation that would be reflected in the financial statements of such Person in accordance with IFRS.

"IFRS" means the International Financial Reporting Standards and applicable accounting requirements set by the International Accounting Standards Board or any successor thereto (or the Financial Accounting Standards Board, the Accounting Principles Board of the American Institute of Certified Public Accountants, the Canadian Accounting Standards Board, or any successor to any such Board, or the Securities and Exchange Commission, as the case may be), as in effect from time to time.

"Inactive Subsidiaries" means the following Subsidiaries: ECG Properties Inc., Envoy Securities Corp., and Orbis Pharma Inc.

"Indemnified Liabilities" has the meaning set forth in Section 10.5.

"Initial Loan" has the meaning given in the definition of "Loans".

"Insolvency Regulation" means the Council Regulation (EC) n°1346/2000 of 29 May 2000 on insolvency proceedings.

"Intellectual Property" means all rights, title and interests in intellectual property arising under any Requirement of Law and all IP Ancillary Rights relating thereto, including all Copyrights, Patents, Trademarks, Internet Domain Names, Trade Secrets, industrial designs, integrated circuit topographies, plant breeders' rights and rights under IP Licenses.

"Interest Expense" means for any period the consolidated interest expense of Borrower and its Subsidiaries for such period (including all imputed interest on Capital Leases).

"Internet Domain Name" means all right, title and interest (and all related IP Ancillary Rights) arising under any requirement of law in internet domain names.

"Inventory" means all the "inventory" (as such term is defined in the UCC or the PPSA, as applicable) of the Borrower and its Subsidiaries, including, but not limited to, all merchandise, raw materials, parts, supplies, work-in-process and finished goods intended for sale, together with all the containers, packing, packaging, shipping and similar materials related thereto, and including such inventory as is temporarily out of the Borrower's or such Subsidiary's custody or possession, including inventory on the premises of others and items in transit.

"Investment" means, with respect to any Person, (a) the purchase of any debt or equity security of any other Person, (b) the making of any loan or advance to any other Person, (c) becoming obligated with respect to a Contingent Obligation in respect of obligations of any other Person or (d) the making of an Acquisition.

"IP Ancillary Rights" means, with respect to an item of Intellectual Property all foreign counterparts to, and all divisionals, reversions, continuations, continuations-in-part, reissues, reexaminations, renewals and extensions of, such Intellectual Property and all income, royalties, proceeds and liabilities at any time due or payable or asserted under or with respect to any of the foregoing or otherwise with respect to such Intellectual Property, including all rights to sue or recover at law or in equity for any past, present or future infringement, misappropriation, dilution, violation or other impairment thereof, and, in each case, all rights to obtain any other IP Ancillary Right.

"IP License" means all contractual obligations (and all related IP Ancillary Rights), whether written or oral, granting any right, title and interest in any Intellectual Property.

"IRC" means the Internal Revenue Code of 1986, as amended.

"Issuing Bank" means Wells Fargo Bank, N.A., the issuing bank of the Novartis Letter of Credit.

"Legal Costs" means, with respect to any Person, (a) all reasonable fees and charges of any counsel, accountants, auditors, appraisers, consultants and other professionals to such Person, (b) the reasonable allocable cost of internal legal services of such Person and all reasonable disbursements of such internal counsel and (c) all court costs and similar legal expenses.

"Lender Party" has the meaning set forth in Section 10.5.

"Lender" has the meaning set forth in the Preamble.

"License Agreement" has the meaning set forth in the Asset Purchase Agreement.

"Lien" means, with respect to any Person, any interest granted by such Person in any real or personal property, asset or other right owned or being purchased or acquired by such Person which secures payment or performance of any obligation and shall include any mortgage, lien, encumbrance, charge or other security interest of any kind, whether arising by contract, as a matter of law, by judicial process or otherwise.

"Loan Documents" means this Agreement, the Notes, the Collateral Documents, the Fee Letter, and all other documents, instruments and agreements delivered in connection with the foregoing, all as amended, restated or otherwise modified from time to time in accordance with the terms hereof and thereof.

"Loan Party" means Borrower and each Subsidiary of Borrower that is not an Inactive Subsidiary.

"Loan Party Subsidiary" means each Subsidiary of Borrower that is not an Inactive Subsidiary.

"Loans" means the term loan from the Lender in a principal amount equal to the Closing Date Commitment (subject to the terms and conditions herein) made to Borrower on the Closing Date pursuant to Section 2.1.1 (such term loan, the "Initial Loan") and the additional term loan from the Lender in a principal amount equal to the Additional Commitment (subject to the terms and conditions herein) made to the Borrower pursuant to Section 2.1.2 in order to satisfy the obligations of the Borrower to reimburse the Lender for amounts drawn under the Novartis Letter of Credit pursuant to the last sentence of Section 4 (such term loan, the "Additional Loan").

"Luxembourg Collateral Documents" means the Luxembourg law governed share pledge agreement, in favor of the Agent over the shares of Merus Labs Luxco S.à r.l., and the Luxembourg law governed first demand guarantee agreement, whereby Merus Labs Luxco S.à r.l. provides a guarantee in favor of the Agent.

"Margin Stock" means any "margin stock" as defined in Regulation T, U or X of the FRB.

"Material Adverse Effect" means (a) a material adverse change in, or a material adverse effect upon, the operations, assets, business, prospects, properties or condition (financial or otherwise) of Loan Parties taken as a whole, (b) a material impairment of the ability of any Loan Party to perform in any material respect any of its Obligations under any Loan Document to which it is a party or (c) a material adverse effect upon the legality, validity, binding effect or enforceability against any Loan Party of any Loan Document to which it is a party.

"Maturity Date" means March 31, 2015.

"Maximum Total Leverage Ratio" means, for any Computation Period, the ratio of (a) the total Debt outstanding less the amount of Unrestricted Cash that is Excess Cash, in each case as of the last date of such Computation Period to (b) the total for such Computation Period of EBITDA.

"Mortgage" means a mortgage, deed of trust, leasehold mortgage or similar instrument granting Agent a Lien on a real property interest of any Loan Party, each as amended, restated or otherwise modified from time to time in accordance with the terms hereof and thereof.

"Net Cash Proceeds" means:

(a) with respect to any Disposition, the aggregate cash proceeds (including cash proceeds received pursuant to policies of insurance and by way of deferred payment of principal pursuant to a note, installment receivable or otherwise, but only as and when received) received by any Group Member pursuant to such Disposition net of (i) the reasonable direct costs relating to such Disposition (including sales commissions and legal, accounting and investment banking fees, commissions and expenses), (ii) any portion of such proceeds deposited in an escrow account pursuant to the documentation relating to such Disposition (provided that such amounts shall be treated as Net Cash Proceeds upon their release from such escrow account to the applicable Group Member), (iii) taxes paid or reasonably estimated by Borrower to be payable as a result thereof (after taking into account any available tax credits or deductions and any tax sharing arrangements), (iv) amounts required to be applied to the repayment of any Debt secured by a Lien (permitted hereunder) prior to the Lien of Agent on the asset subject to such Disposition, and (v) so long as no Event of Default exists (or if an Event of Default exists, only with the prior written consent of the Lender) (A) with respect to any Disposition described in clause (a) of the definition thereof, all money actually applied within 180 days, or within 360 days pursuant to a binding agreement executed within 180 days, to replace such assets with assets performing the same or similar functions, and (B) with respect to any Disposition described in clause (b) or (c) of the definition thereof, all money actually applied within 180 days, or within 360 days pursuant to a binding agreement executed within 180 days, to repair, replace or reconstruct damaged property or property affected by loss, destruction, damage, condemnation, confiscation, requisition, seizure or taking; and

(b) with respect to any issuance or incurrence of Debt, the aggregate cash proceeds received by Borrower or any Subsidiary of Borrower pursuant to such issuance or incurrence, net of the reasonable direct costs relating to such issuance or incurrence.

"Netherlands Collateral Documents" means the Dutch law governed share pledge agreement, in favor of the Agent over the shares of Merus Labs Netherlands B.V.

"Net Sales" means, with respect to any Computation Period, Gross Sales minus Net Sales Deductions.

"Net Sales Deductions" means, with respect to the Products for any Computation Period, the sum of all applicable (i) freight, insurance and other transportation and shipping charges, in each case included in the gross invoice price for such Products; (ii) sales, use, value-added, excise taxes and duties, in each case included in the gross invoice price for such Products; (iii) billbacks, chargebacks, customer adjustments (including payment discounts and customer pricing), performance allowances, promotional monies, trade, quantity, cash discounts, volume incentives, off invoice discounts, government and other third-party rebates, and product service fees; (iv) allowances or credits, including those in respect of rejection, defects, damaged item credits, sales returns, retroactive price reduction, shipping charges, shipment shortages, shelf-stock adjustments, invoice errors, and replacement costs; (v) bad debt; and (vi) such other discounts and other deductions customary in the trade, each as accrued or required to be accrued by the Borrower with respect to such Products for such period in accordance with IFRS consistently applied.

"Non-Excluded Taxes" has the meaning set forth in Section 3.1(a).

"Note" means a promissory note substantially in the form of Exhibit B, as the same may be replaced, substituted, amended, restated or otherwise modified from time to time.

"Novartis" means Novartis Pharma AG, a company organized under the laws of Switzerland, and its successors and assigns under the Novartis Letter of Credit.

"Novartis Letter of Credit" means the Irrevocable Standby Letter of Credit, dated as of or before the Closing Date, identifying Novartis as the beneficiary, issued by the Issuing Bank, in the amount of $20 million.

"Obligations" means all liabilities, indebtedness and obligations (monetary (including interest accrued at the rate provided in the applicable Loan Document after the commencement of a bankruptcy proceeding whether or not a claim for such interest is allowed) or otherwise) of any Group Member under this Agreement, any other Loan Document, any Collateral Document or any other document or instrument executed in connection herewith or therewith, in each case howsoever created, arising or evidenced, whether direct or indirect, absolute or contingent, now or hereafter existing, or due or to become due.

"OFAC" has the meaning set forth in Section 5.21.1.

"Other Taxes" means all present or future stamp, court or documentary, intangible, recording, filing or similar Taxes that arise from any payment made under, from the execution, delivery, performance, enforcement or registration of, from the receipt or perfection of a security interest under, or otherwise with respect to, any Loan Document.

"Paid in Full" or "Payment in Full" means, with respect to any Obligations, the payment in full in cash and performance of all such Obligations.

"Patent Assignment Documents" has the meaning set forth in the Asset Purchase Agreement.

"Patents" means all rights, title and interests (and all related IP Ancillary Rights) arising under any requirement of law in or relating to letters patent and applications therefor.

"Permitted Acquisition" means any Acquisition, in each case to the extent that each of the conditions precedent set forth below shall have been satisfied in a manner reasonably satisfactory to the Agent:

(a) * * *

(b) * * *

(c) * * *

(d) * * *

(e) * * *

(f) * * *

(g) * * *

(h) * * *

(i) * * *

"Permitted Joint Venture" * * *

"Permitted Lien" means any Lien expressly permitted by Section 7.2.

"Permitted Refinancing" * * *

"Permitted Seller Debt" * * *

"Person" means any natural person, corporation, partnership, trust, limited liability company, association, Governmental Authority or unit, or any other entity, whether acting in an individual, fiduciary or other capacity.

"PPSA" means the Personal Property Security Act (British Columbia) and the Regulations thereunder, as from time to time in effect, provided, however, if attachment, perfection or priority of the Agent's security interests in any Collateral is governed by the personal property security laws of any jurisdiction other than British Columbia, PPSA shall mean those personal property security laws in such other jurisdiction for the purposes of the provisions hereof relating to such attachment, perfection or priority and for the definitions related to such provisions (including the Civil Code of Quebec).

"Pro Forma Basis" means, with respect to compliance with any test or covenant or calculation of any financial ratio hereunder, the determination or calculation of such test, covenant or ratio (including in connection with Specified Transactions) in accordance with Section 1.4.

"Product" means Enablex, Factive, Vancomycin, Collacare, and any other product sold by the Loan Parties in the ordinary course of business that (x) constitutes a brand, line of business, division, branch, product line, marketing rights with respect to a product line, operating division or other unit operation of any Person acquired by the Loan Parties in a Permitted Acquisition, and (y) is elected by the Borrower to be a "Product" for purposes of this Agreement, by written notice to the Agent.

"Proposed Acquisition Target" means any Person or any brand, product, marketing rights with respect to a product, line of business, division, branch, operating division or other unit operation of any Person.

"Public Record" means the public filings made by the Borrower pursuant to requirements of law, in each case as available on SEDAR.

"Qualified Capital Stock" of any person shall mean any Stock of such person that is not Disqualified Capital Stock.

"Reference Computation Period" has the meaning set forth in Section 7.13.4.

"Required Deposit Date" has the meaning set forth in Section 7.13.4.

"Restricted Payment" has the meaning set forth in Section 7.4.

"Retroactive Effect Deposit" has the meaning set forth in Section 7.13.4.

"Seller" means Novartis Pharma AG.

"Sinking Fund Account" * * *

"Sinking Fund Deposit Cure Notice" * * *

"Specified Transaction" has the meaning set forth in Section 1.4.

"Stock" means all shares of capital stock (whether denominated as common stock or preferred stock), equity interests, beneficial, partnership or membership interests, joint venture interests, participations or other ownership or profit interests in, or equivalents (regardless of how designated) of, a Person (other than an individual), whether voting or non-voting.

"Stock Equivalents" means all securities convertible into or exchangeable for Stock or any other Stock Equivalent and all warrants, options or other rights to purchase, subscribe for or otherwise acquire any Stock or any other Stock Equivalent, whether or not presently convertible, exchangeable or exercisable.

"Subsidiary" means, with respect to any Person, a corporation, partnership, limited liability company or other entity of which such Person owns, directly or indirectly, such number of outstanding shares of voting Stock or Stock Equivalents as to have more than 50% of the ordinary voting power for the election of directors or other managers of such corporation, partnership, limited liability company or other entity. Unless the context otherwise requires, each reference to Subsidiaries herein shall be a reference to Subsidiaries of Borrower.

"Supply Agreement" has the meaning set forth in the Asset Purchase Agreement.

"Tax Act" means the Income Tax Act (Canada), as amended.

"Taxes" has the meaning set forth in Section 3.1(a).

"Tax Returns" has the meaning set forth in Section 5.12.

"TM Assignment Documents" has the meaning set forth in the Asset Purchase Agreement.

"Trade Secrets" means all right, title and interest (and all related IP Ancillary Rights) arising under any requirement of law in or relating to trade secrets.

"Trademark" means all rights, title and interests (and all related IP Ancillary Rights) arising under any requirement of law in trademarks, trade names, corporate names, company names, business names, fictitious business names, trade styles, service marks, logos and other source or business identifiers and, in each case, all goodwill associated therewith, all registrations and recordations thereof and all applications in connection therewith.

"UCC" means the Uniform Commercial Code as in effect in from time to time in the State of New York, provided that where the context so requires any term defined by reference to "UCC" shall also have any extended, alternative or analogous meaning given to such term in applicable Canadian personal property security and other laws (including without limitation, the PPSA of each applicable province of Canada, the *Civil Code of Quebec*, the *Bills and Exchange Act* (Canada) and the *Depository Bills and Notes Act* (Canada), in each case for the extension, preservation or betterment of the security and rights of the Agent and the Lender under the Loan Documents.

"Unrestricted Cash" means, as of any date of determination, the aggregate amount of cash credited as of such date to all deposit accounts of the Loan Parties that are subject to Control Agreements in favor of the Agent, which cash is subject to no restriction on its use, transfer or distribution pursuant to any requirement of law or contractual obligation (other than this Agreement, the Collateral Documents and the applicable Control Agreement) and is subject to no Liens other than Liens securing obligations under the Loan Documents, and shall include, for the avoidance of doubt, the amount of cash credited as of such date to the Sinking Fund Account, if any.

"U.S. Guarantee and Collateral Agreement" means the Guarantee and Collateral Agreement, dated as of the Closing Date, made by each Loan Party and other grantor or pledgor signatory thereto in favor of Agent, and governed by the laws of New York, as amended, restated or otherwise modified from time to time in accordance with the terms hereof and thereof.

"Wholly-Owned Subsidiary" means, as to any Subsidiary, all of the Stock and Stock Equivalents of which (except directors' qualifying shares) are at the time directly or indirectly owned by Borrower and/or another Wholly-Owned Subsidiary of Borrower.

1.2. Interpretation. In the case of this Agreement and each other Loan Document, (a) the meanings of defined terms are equally applicable to the singular and plural forms of the defined terms; (b) Annex, Exhibit, Schedule and Section references in each Loan Document are to the particular Annex, Exhibit, Schedule and Section of such Loan Document unless otherwise specified; (c) the term "including" is not limiting and means "including but not limited to"; (d) in the computation of periods of time from a specified date to a later specified date, the word "from" means "from and including"; the words "to" and "until" each mean "to but excluding", and the word "through" means "to and including"; (e) unless otherwise expressly provided in such Loan Document, (i) references to agreements and other contractual instruments shall be deemed to include all subsequent amendments and other modifications thereto, but only to the extent such amendments and other modifications are not prohibited by the terms of any Loan Document, and (ii) references to any statute or regulation shall be construed as including all statutory and regulatory provisions amending, replacing, supplementing or interpreting such statute or regulation; (f) this Agreement and the other Loan Documents may use several different limitations, tests or measurements to regulate the same or similar matters, all of which are cumulative and each shall be performed in accordance with its terms; and (g) this Agreement and the other Loan Documents are the result of negotiations among and have been reviewed by counsel to Agent, Borrower, Lender and the other parties hereto and thereto and are the products of all parties; accordingly, they shall not be construed against Agent or the Lender merely because of Agent's or the Lender's involvement in their preparation. Any reference in any Loan Document to a Permitted Lien is not intended to subordinate or postpone, and shall not be interpreted as subordinating or postponing, or as any agreement to subordinate or postpone, any Lien created by any of the Loan Documents to any Permitted Lien.

1.3. UCC References; Dutch Terms. Notwithstanding the foregoing, and where the context so requires, (i) any term defined in this Agreement by reference to the "Code", the "UCC" or the "Uniform Commercial Code" shall also have any extended, alternative or analogous meaning given to such term in applicable Canadian personal property security and other laws (including, without limitation, the Personal Property Security Act of each applicable province of Canada, the *Civil Code of Quebec*, the *Bills and Exchange Act* (Canada) and the Depository Bills and Notes Act (Canada)), in all cases for the extension, preservation or betterment of the security and rights of the Collateral, (ii) all references in this Agreement to "Article 8" shall be deemed to refer also to applicable Canadian securities transfer laws (including, without limitation, the Securities Transfer Act (British Columbia), (iii) all references in this Agreement to a financing statement, continuation statement, amendment or termination statement shall be deemed to refer also to the analogous documents used under applicable Canadian personal property security laws, (v) all references to the United States of America, or to any subdivision, department, agency or instrumentality thereof shall be deemed to refer also to Canada, or to any subdivision, department, agency or instrumentality thereof, and (vi) all references to federal or state securities law of the United States shall be deemed to refer also to analogous federal and provincial securities laws in Canada. In this Agreement , where it relates to a Dutch entity, a reference to: (a) unless a contrary indication appears, a "**director**", in relation to a Dutch Loan Party, means a managing director (*bestuurder*) and "board of directors" means its managing board (*bestuur*); (b) a "**necessary action to authorise**" where applicable, includes without limitation: (i) any action required to comply with the Dutch Works Councils Act (W*et op de ondernemingsraden*); and (ii) obtaining an unconditional positive advice (*advies*) from the competent works council(s); (c) "**financial assistance**" means any act contemplated by: (i) (for a *besloten vennootschap met beperkte aansprakelijkheid*) section 2:207(c) DCC; or (ii) (for a *naamloze vennootschap*) Article 2:98(c) DCC; (d) "**Security**" includes any mortgage (*hypotheek*), pledge (*pandrecht*), right of retention (*recht van retentie*), and, in general, any right in rem (*beperkt recht*), created for the purpose of granting security (*goederenrechtelijk zekerheidsrecht*); (e) (i) a "**winding-up**", "**administration**" or "**dissolution**" includes a Dutch entity being declared bankrupt (*failliet verklaard*) or dissolved (*ontbonden*); (ii) a "**moratorium**" includes *surseance van betaling* and *noodregeling* and "**a moratorium is declared**" or "**occurs**" includes *surseance verleend* and *noodregeling uitgesproken*; (iii) any "**step**" or "**procedure**" taken in connection with insolvency proceedings includes a Dutch entity having filed a notice under Section 36 of the Dutch 1990 Tax Collection Act (*Invorderingswet 1990*) (whether or not pursuant to section 60 of the Act on the Financing of Social Insurances (W*et financiering sociale verzekeringen*); (iv) a "**trustee in bankruptcy**" includes a *curator*; (v) an "**administrator**" includes a b*ewindvoerde*r; and (vi) an "**attachment**" includes a *beslag*.

1.4. Pro Forma Calculation. * * *

Section 2. Credit Facilities.

2.1. Loans.

2.1.1. Initial Loan. On the terms and subject to the conditions of this Agreement, the Lender agrees to lend to Borrower on the Closing Date the entire amount of its Closing Date Commitment, after which the Closing Date Commitment shall terminate.

2.1.2. Additional Loan. On the terms and subject to the conditions of this Agreement, upon a draw by the Seller under the Novartis Letter of Credit (which draw cannot be made until one year after the Closing Date pursuant to the terms of the Asset Purchase Agreement) to satisfy the remaining purchase price obligations of the Asset Purchaser under Section 9.2 of the Asset Purchase Agreement, the Lender agrees to lend to Borrower the entire amount of its Additional Commitment. The Borrower agrees that the Additional Loan shall be made on behalf of Borrower but the proceeds of the Additional Loan shall be funded directly to the Issuing Bank to reimburse the Issuing Bank for the Seller's draw under the Novartis Letter of Credit, if any. The Additional Commitment shall immediately terminate upon the funding of the Additional Loan. If the Additional Loan is not funded on the first anniversary of the Closing Date, the Additional Commitment shall immediately terminate. The Agent shall provide written notice to the Borrower of the funding of the Additional Loan within one Business Day of such funding.

2.1.3. General. No portion of the Loans may be re-borrowed once repaid. The proceeds of the Loans shall be used to finance the consummation of the Asset Purchase.

2.2. Loan Accounting.

2.2.1. Recordkeeping. Agent, on behalf of the Lender, shall record in its records the date and amount of the share of the Loans made by the Lender and each repayment thereof. The aggregate unpaid principal amount so recorded shall be rebuttably presumptive evidence of the principal amount of the Loans owing and unpaid. The failure to so record any such amount or any error in so recording any such amount shall not, however, limit or otherwise affect the Obligations of Borrower hereunder or under any Note to repay the principal amount of the Loans hereunder, together with all interest accruing thereon.

2.2.2. Notes. At the request of the Lender, the Loans shall be evidenced by one or more Notes, with appropriate insertions, payable to the order of the Lender in a face principal amount equal to the Loans and payable in such amounts and on such dates as are set forth herein.

2.3. Interest.

2.3.1. Interest Rate. Borrower promises to pay interest on the unpaid principal amount of the Initial Loan for the period commencing on the Closing Date until the Initial Loan is Paid in Full at a rate per annum equal to 13.50% simple interest per annum. Borrower promises to pay interest on the unpaid principal amount of the Additional Loan for the period commencing on the date that the Lender advances the Additional Loan to or on behalf of the Borrower until the Additional Loan is Paid in Full at a rate per annum equal to 14.00% simple interest per annum. The foregoing notwithstanding, (i) at any time an Event of Default exists, if requested by the Agent or the Lender, the interest rate then applicable to the Initial Loan and the Additional Loan shall be increased by two percent (2.00%) simple interest per annum (and, in the case of Obligations other than the Loans, such Obligations shall bear interest at two percentage points per annum in excess of their contract interest rate) (any such increased rate, the "Default Rate"), (ii) any such increase may thereafter be rescinded by the Lender, and (iii) upon the occurrence of an Event of Default under Section 8.1.1 or 8.1.3, any such increase described in the foregoing clause (i) shall occur automatically. In no event shall interest payable on the Loans by Borrower to the Lender hereunder exceed the maximum rate permitted under applicable law, and if any such provision of this Agreement is in contravention of any such law, such provision shall be deemed modified to limit such interest to the maximum rate permitted under such law.

2.3.2. Interest Payments. Interest accrued on the Loans during the period from the Closing Date until the Maturity Date shall be paid on a monthly basis, in cash, in arrears, on the last day of each calendar month, and, to the extent not paid in advance, upon a prepayment of the Loans in accordance with Section 2.4 and at maturity, in each case, in cash. After maturity and at any time an Event of Default exists, all accrued interest on the Loans shall be payable in cash on demand at the rates specified in Section 2.3.1.

2.3.3. Computation of Interest. Interest shall be computed for the actual number of days elapsed on the basis of a year of 360 days consisting of twelve 30-day months.

2.3.4. Interest Act (Canada). For the purposes of *Interest Act* (Canada) and disclosure thereunder, whenever any interest or any fee to be paid hereunder or in connection herewith is to be calculated on the basis of a 360-day or 365-day year, the yearly rate of interest to which the rate used in such calculation is equivalent is the rate so used multiplied by the actual number of days in the calendar year in which the same is to be ascertained and divided by 360 or 365, as applicable. The rates of interest under this Agreement are nominal rates, and not effective rates or yields. The principle of deemed reinvestment of interest does not apply to any interest calculation under this Agreement.

2.3.5. Maximum Lawful Rate. If any provision of this Agreement would oblige a Canadian Loan Party to make any payment of interest or other amount payable to the Agent in an amount or calculated at a rate which would be prohibited by law or would result in a receipt by the Agent of "interest" at a "criminal rate" (as such terms are construed under the *Criminal Code* (Canada)), then, notwithstanding such provision, such amount or rate shall be deemed to have been adjusted with retroactive effect to the maximum amount or rate of interest, as the case may be, as would not be so prohibited by applicable law or so result in a receipt by the Agent of "interest" at a "criminal rate", such adjustment to be effected, to the extent necessary (but only to the extent necessary), as follows:

(A) first, by reducing the amount or rate of interest; and

(B) thereafter, by reducing any fees, commissions, costs, expenses, premiums and other amounts required to be paid which would constitute interest for purposes of section 347 of the *Criminal Code* (Canada).

Any provision of this Agreement that would oblige a Canadian Loan Party to pay any fine, penalty or rate of interest on any arrears of principal or interest secured by a mortgage on real property or hypothec on immovables that has the effect of increasing the charge on arrears beyond the rate of interest payable on principal money not in arrears shall not apply to such Canadian Loan Party, which shall be required to pay interest on money in arrears at the same rate of interest payable on principal money not in arrears.

2.4. Prepayment. * * *

2.5. Scheduled Repayment. * * *

2.6. Payment.

2.6.1. Making of Payments. All payments of principal of or interest on the Loans, and of all fees, shall be made by Borrower to Agent without setoff, recoupment or counterclaim and in immediately available funds, in the currency required by Section 2.6.5, at the deposit account of Agent in New York, New York set forth on Annex II or at such other deposit account specified by Agent, in any case, not later than 1:00 p.m. New York City time on the date due, and funds received after that hour shall be deemed to have been received by Agent on the following Business Day. Agent shall promptly remit to the Lender all principal, interest and fee payments received in collected funds by Agent for the account of such Lender.

2.6.2. Application of Payments and Proceeds.

(a) Except as set forth in Section 2.4.3, and subject to the provisions of Section 2.6.2(b) below, each payment by Borrower hereunder shall be applied to such Obligations as Borrower shall direct by notice to be received by Agent on or before the date of such payment or, in the absence of such notice, as Agent shall determine in its sole discretion. Concurrently with each remittance to the Lender of its share of any such payment, Agent shall advise such Lender as to the application of such payment.

(b) If an Event of Default or an Acceleration Event shall have occurred and be continuing, notwithstanding anything herein or in any other Loan Document to the contrary, Agent shall apply all or any part of payments in respect of the Obligations and proceeds of Collateral, in each case as received by Agent, to the payment of the Obligations in the following order:

(i) FIRST, to (A) the payment of all fees, costs, expenses and indemnities due and owing to Agent under this Agreement or any other Loan Document, and (B) any other Obligations owing to Agent in respect of sums advanced by Agent to preserve or protect the Collateral or to preserve or protect its security interest in the Collateral (whether or not such Obligations are then due and owing to Agent), until Paid in Full;

(ii) SECOND, to the payment of all fees, costs, expenses and indemnities due and owing to the Lender until Paid in Full;

(iii) THIRD, to the payment of all accrued and unpaid interest due and owing to the Lender in respect of the Loans (on a pro rata basis in respect of the Initial Loan and the Additional Loan) until Paid in Full;

(iv) FOURTH, to the payment of all principal then owing in respect of the Loans (on a pro rata basis in respect of the Initial Loan and the Additional Loan) until Paid in Full;

(v) FIFTH, to the payment of all other Obligations owing to the Lender until Paid in Full; and

(vi) SIXTH, the balance to the Borrower or such other Person as may be lawfully entitled thereto.

2.6.3. Payment Dates. If any payment of principal of or interest on a Loan, or of any fees, falls due on a day which is not a Business Day, then such due date shall be extended to the immediately following Business Day (unless such immediately following Business Day is the first Business Day of a calendar month, in which case such due date shall be the immediately preceding Business Day) and, in the case of principal, additional interest shall accrue and be payable for the period of any such extension.

2.6.4. Set-off. Borrower agrees that Agent and the Lender and its Affiliates have all rights of set-off and bankers' lien provided by applicable law, and in addition thereto, Borrower agrees that at any time an Event of Default has occurred and is continuing, Agent and the Lender may apply to the payment of any Obligations of Borrower hereunder, whether or not then due, any and all balances, credits, deposits, accounts or moneys of Borrower then or thereafter maintained with Agent or such Lender.

2.6.5. Currency Matters. Principal, interest, reimbursement obligations, cash collateral for reimbursement obligations, fees, and all other amounts payable under this Agreement and the other Loan Documents to the Agent and the Lender shall be payable (except as otherwise specifically provided herein) in Dollars. Unless stated otherwise, all calculations, comparisons, measurements or determinations under this Agreement shall be made in Canadian Dollars. If the Agent receives a payment in one currency for application to Obligations denominated in another currency (whether as proceeds of Collateral, proceeds of a judgment, or the exercise of control under a Control Agreement or otherwise), the Agent shall convert (or will be deemed to have converted) the payment to the Equivalent Amount thereof in the currency in which the Obligations are due.

Section 3. Yield Protection.

3.1. Taxes.

(a) Except as otherwise provided in this Section 3.1, all payments of principal and interest on the Loans and all other amounts payable under any Loan Document shall be made free and clear of and without deduction or withholding for any present or future income, excise, stamp, documentary, property or franchise taxes or other taxes, fees, duties, levies, withholdings or other charges of any nature whatsoever imposed by any taxing authority, including any interest, additions to tax or penalties applicable thereto ("Taxes"), excluding (i) taxes imposed on or measured by the Lender's net income by the jurisdiction under which the Lender is organized or conducts business (other than business arising from the Lender having executed, delivered, become a party to, performed its obligations under, received payments under, received or perfected a security interest under, engaged in any other transaction with respect to the Loans or pursuant to or enforced any Loan Document), (ii) any branch profit taxes imposed by Canada, or any similar tax imposed by any other jurisdiction, in each case to the extent the applicable Lender is organized or has its applicable lending office in such jurisdiction, and (iii) in the case of any Foreign Lender, any Canadian withholding tax that would not have been imposed but for such Foreign Lender's failure (other than as a result of a change in law, rule, regulation or treaty or in the administration, interpretation or application thereof by any Governmental Authority) to provide any form or other certificate or other information required by the Borrower for the purpose of reducing or eliminating the withholding or imposition of the Tax, provided, that such Lender is legally entitled to complete, execute and deliver such documentation and in such Lender's judgment such completion, execution or submission would not materially prejudice the legal position of such Lender or otherwise impose a material burden on it (collectively, "Excluded Taxes" and all such non-Excluded Taxes, "Non-Excluded Taxes"). If any withholding or deduction from any payment to be made by Borrower hereunder is required in respect of any Taxes pursuant to any applicable law (as determined in the good faith reasonable discretion of the Borrower or Agent), rule or regulation, then Borrower shall: (i) timely pay directly to the relevant taxing authority the full amount required to be so withheld or deducted; (ii) within thirty (30) days after the date of any such payment of Taxes, forward to Agent an official receipt or other documentation satisfactory to Agent evidencing such payment to such authority; and (iii) in the case of Non-Excluded Taxes, pay to Agent for the account of the Lender such additional amount or amounts as is necessary to ensure that the net amount actually received by the Lender will equal the full amount the Lender would have received had no such withholding or deduction (including withholdings and deductions applicable to any additional sums payable under this Section 3.1) been required.

(b) Borrower shall timely pay to the relevant Governmental Authority in accordance with applicable law, or at the option of the Agent timely reimburse it for the payment of, any Other Taxes.

(c) The Borrower shall reimburse and indemnify, within 10 days after receipt of demand therefor (with copy to the Agent), Agent and the Lender for all Non-Excluded Taxes and Other Taxes (including any additional Taxes imposed by any jurisdiction on amounts payable under this Section 3.1) paid by the Agent or the Lender, or required to be withheld or deducted from a payment to the Agent or the Lender, and any liabilities arising therefrom or with respect thereto (including any penalty, interest or expense), whether or not such Taxes were correctly or legally asserted. A certificate of the Agent or the Lender (or of the Agent on behalf of the Lender) claiming any compensation under this clause (c), setting forth the amounts to be paid thereunder and delivered to the Borrower with copy to the Agent, shall be conclusive, binding and final for all purposes, absent manifest error.

(d) [Reserved.]

The provisions of this Section 3.1 shall survive the termination of this Agreement and repayment of all Obligations.

3.2. Increased Cost.

(a) If, after the Closing Date, the adoption or taking effect of, or any change in, any applicable law, rule, regulation or treaty, or any change in the interpretation or administration of any applicable law, rule, regulation or treaty by any Governmental Authority, central bank or comparable agency charged with the interpretation or administration thereof, or compliance by the Lender with any request, rule, guideline or directive (whether or not having the force of law) of any such authority, central bank or comparable agency: (i) shall impose, modify or deem applicable any reserve (including any reserve imposed by the FRB), special deposit or similar requirement against assets of, deposits with or for the account of, or credit extended by the Lender; (ii) subject the Lender or Agent to any Taxes (other than Taxes indemnified pursuant to Section 3.1); or (iii) shall impose on the Lender any other condition affecting its Loan, its Note or its obligation to make the Loan; and the result of anything described in clauses (i) through (iii) above is to increase the cost to (or to impose a cost on) such Lender of making or maintaining its Loan, or to reduce the amount of any sum received or receivable by such Lender under this Agreement or under its Note with respect thereto, then, upon demand by such Lender (which demand shall be accompanied by a statement setting forth the basis for such demand and a calculation of the amount thereof in reasonable detail, a copy of which shall be furnished to Agent), Borrower shall pay directly to the Lender such additional amount as will compensate the Lender for such increased cost or such reduction.

(b) If the Lender shall reasonably determine that any change in, or the adoption or phase-in of, any applicable law, rule or regulation regarding capital adequacy, or any change in the interpretation or administration thereof by any Governmental Authority, central bank or comparable agency charged with the interpretation or administration thereof, or the compliance by the Lender or any Person controlling the Lender with any request or directive regarding capital adequacy (whether or not having the force of law) of any such authority, central bank or comparable agency, has or would have the effect of reducing the rate of return on the Lender's or such controlling Person's capital as a consequence of such Lender's Commitments hereunder to a level below that which the Lender or such controlling Person could have achieved but for such change, adoption, phase-in or compliance (taking into consideration the Lender's or such controlling Person's policies with respect to capital adequacy) by an amount deemed by the Lender or such controlling Person to be material, then from time to time, upon demand by the Lender (which demand shall be accompanied by a statement setting forth the basis for such demand and a calculation of the amount thereof in reasonable detail, a copy of which shall be furnished to Agent), Borrower shall pay to the Lender such additional amount as will compensate the Lender or such controlling Person for such reduction.

(c) Notwithstanding anything herein to the contrary, (i) all requests, rules, guidelines, requirements and directives promulgated by the Bank for International Settlements, the Basel Committee on Banking Supervision (or any successor or similar authority) or by United States or foreign regulatory authorities, in each case pursuant to Basel III, and (ii) the Dodd-Frank Wall Street Reform and Consumer Protection Act and all requests, rules, guidelines, requirements and directives thereunder or issued in connection therewith or in implementation thereof, shall in each case be deemed to be a change in law, regardless of the date enacted, adopted, issued or implemented.

3.3. Mitigation of Circumstances. The Lender shall promptly notify Borrower and Agent of any event of which it has knowledge which will result in, and will use reasonable commercial efforts available to it (and not, in such Lender's sole judgment, otherwise disadvantageous to such Lender) to mitigate or avoid, any obligation by Borrower to pay any amount pursuant to Section 3.1 or 3.2. Borrower hereby agrees to pay all reasonable costs and expenses incurred by Lender in connection with this Section 3.3.

3.4. Conclusiveness of Statements; Survival. Determinations and statements of the Lender pursuant to Sections 3.1 or 3.2 shall be conclusive absent demonstrable error provided that the Lender or the Agent provides Borrower with written notification of such determinations and statements. The Lender may use reasonable averaging and attribution methods in determining compensation under Sections 3.1 or 3.2 and the provisions of such Sections shall survive repayment of the Loans, cancellation of the Notes and termination of this Agreement.

Section 4. Conditions Precedent.

4.1. Initial Loan. The obligation of the Lender to make the Initial Loan on the Closing Date is subject to the following conditions precedent, each of which shall be satisfactory in all respects to Agent and the Lender:

4.1.1. Consummation of Purchase. Each of the following shall have occurred:

(a) The Agent shall have received a complete and correct copy of each of the Asset Purchase Agreement, the Supply Agreement, and the License Agreement, in each case including all schedules, exhibits, amendments, supplements, modifications, assignments and all other material documents delivered pursuant thereto or in connection therewith, and all such documentation shall be satisfactory to the Agent; provided that the Agent agrees that the executed versions of each of the Asset Purchase Agreement, the Supply Agreement, and the License Agreement (together with all exhibits and schedules thereto) in the form delivered to it on July 9, 2012, is satisfactory to it.

(b) The Asset Purchase and the other transactions contemplated by the Asset Purchase Documents shall have been, or simultaneously with the making of the Initial Loan hereunder shall be, consummated in accordance with applicable law and on the terms described in the Asset Purchase Documents, without material waiver or amendment thereof (or consent thereunder) unless consented to by the Agent (it being understood and agreed that any increase or decrease in the Purchase Price of more than 10% shall be deemed a material amendment).

4.1.2. Delivery of Loan Documents. Borrower shall have delivered the following documents in form and substance satisfactory to Agent (and, as applicable, duly executed by all Persons named as parties thereto and dated the Closing Date or an earlier date satisfactory to Agent):

(a) Agreement. This Agreement.

(b) Notes. A Note in respect of the Initial Loan.

(c) Collateral Documents. The Guarantee and Collateral Agreements, all other Collateral Documents, and all instruments, documents, certificates and agreements executed or delivered pursuant thereto (including Intellectual Property assignments and pledged equity and limited liability company interests in the Borrower and the Borrower's Subsidiaries, with undated irrevocable transfer powers executed in blank), in each case, executed and delivered by each Loan Party and each other Person named as a party thereto.

(d) Financing Statements. Properly completed Uniform Commercial Code financing statements, PPSA filings, and other filings and documents required by law or the Loan Documents to provide Agent perfected Liens (subject only to Permitted Liens) in the Collateral.

(e) Lien Searches. Copies of Uniform Commercial Code and PPSA search reports listing all effective financing statements or equivalent filings filed against any Loan Party, with copies of such financing statements and filings; and copies of Patent, Trademark, Copyright and Internet Domain Name search reports in material jurisdictions listing all effective collateral assignments in respect of such Intellectual Property filed with respect to any Loan Party, with copies of such collateral assignment documentation.

(f) Authorization Documents. For each Loan Party, such Person's (i) charter (or similar formation document), certified by the appropriate Governmental Authority (as applicable) in its jurisdiction of incorporation (or formation) (including, in relation to a Dutch Loan Party, a recent extract from the Dutch Trade Register (*handelsregister*) relating to it), (ii) good standing certificates in its jurisdiction of incorporation (or formation) and in each other jurisdiction requested by Agent or the Lender, (iii) limited liability company agreement, partnership agreement, bylaws (and similar governing document) (as applicable), (iv) (a) resolutions of its board of directors (or similar governing body) approving and authorizing such Person's execution, delivery and performance of the Loan Documents to which it is party and the transactions contemplated thereby, (b) in respect of a Dutch Loan Party: (1) a copy of a resolution of its board of supervisory directors (if any) approving its execution and the terms of, and the transactions contemplated by, the Loan Documents to which it is a party; (2) a copy of a resolution of its general meeting of shareholders approving its execution and the terms of, and the transactions contemplated by, the Loan Documents to which it is a party; and (3) if it is required by law or any arrangement binding on it to obtain works council advice in respect of its or any other person's entry into the Loan Documents, a copy of an unconditional positive advice from its (central) works council; and (v) signature and incumbency certificates of its directors and/or officers executing any of the Loan Documents, all certified by its secretary or an assistant secretary (or similar officer) as being in full force and effect without modification.

(g) Opinions of Counsel. Opinions of New York counsel for each Loan Party, of British Columbia counsel for each Loan Party formed in Canada, of Dutch Counsel for the Dutch Loan Party, and of Luxembourg counsel for each Loan Party formed in Luxembourg, each in form and substance requested by Agent.

(h) Insurance. Certificates or other evidence of insurance in effect as required by Section 6.3(b), with endorsements naming Agent as lenders' loss payee and/or additional insured, as applicable.

(i) Other Documents. Such other certificates, documents and agreements that may be listed on the closing checklist provided by Agent to the Borrower or as Agent or the Lender may request.

4.1.3. Payment of Fees and Expenses. The Borrower shall have paid, on or prior to the Closing Date, all fees and expenses owing and payable to Agent and the Lender as of the Closing Date (including the fees payable pursuant to the Fee Letter as of the Closing Date) and, subject to Section 10.4 and without duplication, all fees, expenses and other amounts payable set forth herein and costs and expenses incurred by Agent and the Lender in connection with the transactions contemplated hereby which are required to be paid by the Borrower.

4.1.4. Representations and Warranties. Each representation and warranty by each Loan Party contained herein or in any other Loan Document shall be true and correct in all material respects (without duplication of any materiality qualifier contained therein) as of the Closing Date.

4.1.5. No Default. No Default or Event of Default shall have occurred and be continuing.

4.1.6. No Material Adverse Change. Except as set forth in Schedule 4.1.6 hereto, since September 30, 2011, there has been no event or occurrence that has or could reasonably be expected to result in a Material Adverse Effect.

Section 5. Representations and Warranties.

To induce Agent and the Lender to enter into this Agreement and to induce the Lender to advance the Loans hereunder, Borrower represents and warrants to Agent and the Lender that each of the following are, and after giving effect to the Asset Purchase Transactions, will be, true, correct and complete:

5.1. Organization. Borrower is a corporation validly existing and in good standing under the laws of British Columbia; each other Loan Party is validly existing and in good standing (as applicable) under the laws of the jurisdiction of its organization; and each Loan Party is duly qualified to do business in each jurisdiction where, because of the nature of its activities or properties, such qualification is required, except for such jurisdictions where the failure to so qualify could not reasonably be expected to have a Material Adverse Effect. The "centre of main interests" (as that term is used in the Insolvency Regulation) of Merus Labs Luxco S.à r.l. is in Luxembourg, and Merus Labs Luxco S.à r.l has no "establishment" (as that term is used in the Insolvency Regulation) outside Luxembourg.

5.2. Authorization; No Conflict. Each of Borrower and each other Loan Party is duly authorized to execute and deliver each Loan Document and each Asset Purchase Document to which it is a party, Borrower is duly authorized to borrow monies hereunder, the granting of the security interests pursuant to the Collateral Documents is within the corporate purposes of Borrower and each other Loan Party, and each of Borrower and each other Loan Party is duly authorized to perform its Obligations under each Loan Document to which it is a party and its obligations under each Asset Purchase Document to which it is a party. The execution, delivery and performance by Borrower of this Agreement and by each of Borrower and each Loan Party of each Loan Document to which it is a party and each Asset Purchase Document to which it is a party, and the borrowings by Borrower hereunder, do not and will not (a) require any consent or approval of any governmental agency or authority (other than (i) any consent or approval which has been obtained and is in full force and effect, (ii) recordings and filings in connection with the Liens granted to the Agent under the Collateral Documents and (iii) with respect to Marketing Authorizations (as defined in the Asset Purchase Agreement) to be obtained after the Closing Date in accordance with the terms of the Asset Purchase Agreement), (b) conflict with (i) any provision of applicable law, (ii) the charter, by-laws, limited liability company agreement, partnership agreement or other organizational documents of any Group Member or (iii) any agreement, indenture, instrument or other document, or any judgment, order or decree, which is binding upon any Group Member or any of their respective properties or (c) require, or result in, the creation or imposition of any Lien on any asset of Borrower or any other Group Member (other than Liens in favor of Agent created pursuant to the Collateral Documents).

5.3. Validity; Binding Nature. Each of this Agreement, each other Loan Document to which Borrower or any other Loan Party is a party and each Asset Purchase Document to which any Loan Party is a party is the legal, valid and binding obligation of such Person, enforceable against such Person in accordance with its terms, subject to bankruptcy, insolvency and similar laws affecting the enforceability of creditors' rights generally and to general principles of equity.

5.4. Financial Condition.

(a) The audited consolidated financial statements of Borrower and its Subsidiaries (presented on a consolidated basis) as at September 30, 2011, together with the unaudited consolidated financial statements of Borrower and its Subsidiaries (presented on a consolidated basis) as at March 31, 2012, copies of each of which have been delivered pursuant hereto, were prepared in accordance with IFRS (or, in the case of the audited financial statements for the periods ending on or prior to September 30, 2011, Canadian GAAP) (subject, in the case of such unaudited statements, to the absence of footnotes and to normal year-end adjustments) and present fairly the consolidated financial condition of such Persons as at such dates and the results of their operations for the periods then ended.

(b) The consolidated financial projections (including an operating budget and a cash flow budget) of Borrower and its Subsidiaries for the period commencing June 30, 2012 through March 31, 2015 delivered to Agent and the Lender on or prior to the Closing Date and attached as Schedule 5.4 were: (i) prepared by Borrower in good faith; (ii) based upon current expectations regarding future events; and (iii) prepared in accordance with assumptions for which Borrower has a reasonable basis to believe as of the Closing Date, and the accompanying consolidated pro forma balance sheets of Borrower and its Subsidiaries as at the Closing Date, adjusted to give effect to the consummation of the financing contemplated hereby as if such transactions had occurred on such date, is consistent in all material respects with such projections; with the recognition, however, that projections are inherently subject to varying degrees of uncertainty and their achievability, despite the reasonableness upon which they were prepared, depend upon the timing and probability of occurrence of a complex series of future events, both internal and external, certain of which are beyond Borrower's control, and which may result in future costs, results of operations or outcomes that may be materially different from the projections attached as Schedule 5.4.

5.5. No Material Adverse Change. Except as set forth in Schedule 4.1.6, since September 30, 2011, there has been no event or occurrence that has or could reasonably be expected to result in a Material Adverse Effect.

5.6. Litigation. No litigation (including derivative actions), arbitration proceeding or governmental investigation or proceeding is pending or, to any Loan Party's knowledge, threatened, against any Loan Party or any of their respective properties which (i) purport to affect or pertain to this Agreement, any other Loan Document, any Asset Purchase Document or any of the transactions contemplated hereby or thereby or (ii) except as set forth in Schedule 5.6(a), could reasonably be expected to have, either individually or in the aggregate, a Material Adverse Effect. No injunction, writ, temporary restraining order or any order of any nature has been issued by any court or other Governmental Authority purporting to enjoin or restrain the execution, delivery or performance of this Agreement, any other Loan Document or any Asset Purchase Document, or directing that the transactions provided for herein or therein not be consummated as herein or therein provided. As of the Closing Date, except as specifically disclosed in Schedule 5.6(b), no Group Member is the subject of an audit or, to each Group Member's knowledge, any review or investigation by any Governmental Authority (excluding the IRS and other taxing authorities) concerning the violation or possible violation of any requirement of law.

5.7. Ownership of Properties; Liens. As of the date hereof, there are no Liens on the Collateral other than those granted in favor of the Agent to secure the Obligations and Permitted Liens. Each of Borrower and each other Loan Party owns good and, in the case of real property, marketable, title to all of its properties and assets, real and personal, tangible and intangible, of any nature whatsoever (including patents, trademarks, trade names, service marks and copyrights), free and clear of all Liens, charges and claims (including infringement claims with respect to Intellectual Property), except as permitted by Section 7.2. As of the Closing Date, Schedule 5.7 lists all of the real property owned, leased, subleased or otherwise owned or occupied by any Group Member.

5.8. Capitalization; Subsidiaries.

(a) Equity Interests. Schedule 5.8 sets forth a list, as of the Closing Date, of (i) all the Subsidiaries of Borrower and their jurisdictions of organization and (ii) the number of each class of its Stock and Stock Equivalents outstanding. All Stock and Stock Equivalents of each Group Member are duly and validly issued and, in the case of each entity that is a corporation, are fully paid and non-assessable, and, other than the Stock and Stock Equivalents of Borrower, are owned by Borrower, directly or indirectly through Wholly-Owned Subsidiaries. Each Loan Party is the record and beneficial owner of, and has good and marketable title to, the Stock and Stock Equivalents pledged by it to the Agent under the Collateral Documents, free of any and all Liens, rights or claims of other persons, except the security interest created by the Collateral Documents, and there are no outstanding warrants, options or other rights to purchase, or shareholder, voting trust or similar agreements outstanding with respect to, or property that is convertible into, or that requires the issuance or sale of, any such Stock and Stock Equivalents. Other than the the security interest created by the Collateral Documents, there is no floating charge (*gage sur fonds de commerce*) or similar security in existence on the business of the Borrower or Merus Labs Luxco S.à r.l, nor any mandate with a view to the creation thereof. Except as set forth on Schedule 5.8, as of the Closing Date no Group Member is engaged in any joint venture with any other Person.

(b) No Consent of Third Parties Required. No consent of any person including any other general or limited partner, any other member of a limited liability company, any other shareholder or any other trust beneficiary is necessary or reasonably desirable (from the perspective of a secured party) in connection with the creation, perfection or first priority status of the security interest of the Agent in any Stock and Stock Equivalents pledged to the Agent for the benefit of the Lender under the Collateral Documents or the exercise by the Agent of the voting or other rights provided for in the Collateral Documents or the exercise of remedies in respect thereof.

5.9. Pension Plans.

(a) U.S. Pension Plans. No Loan Parties have any liability under ERISA and no Loan Party sponsors any "pension plan" or has any liability subject to Title IV of ERISA.

(b) Canadian Employees.

(i) Except as set forth on Schedule 5.9(b) (as updated from time to time) and as of the date hereof, no Canadian Loan Party maintains or contributes to any plan other than statutory plans required by applicable law.

(ii) Except as set forth in Schedule 5.9(b) and as of the date hereof, no Canadian Loan Party has or is subject to any present or future obligation or liability under any Canadian Employee Plan and any overtime pay, vacation pay, premiums for unemployment insurance, health and welfare insurance premiums, accrued wages, salaries and commissions, severance pay and employee benefit plan payments have been fully paid by each Canadian Loan Party or, in the case of accrued unpaid overtime pay or accrued unpaid vacation pay for Canadian Employees, has been accurately accounted for in the books and records of each Canadian Loan Party or has been reported pursuant to the collateral reporting obligation pursuant to Section 5.9(b).

(iii) Schedule 5.9(b) (as updated from time to time) lists all the Canadian Pension Plans and Canadian Employee Plans applicable to the Canadian Employees of each Canadian Loan Party in respect of employment in Canada and which are currently maintained or sponsored by each Canadian Loan Party or to which each Canadian Loan Party contributes or has an obligation to contribute, except, for greater certainty, any statutory plans to which each Canadian Loan Party is obligated to contribute to or comply with under applicable law.

(iv) No improvements to any Canadian Pension Plan or any Canadian Employee Plan have been promised, except such improvements as are described in the collective bargaining agreements listed in Schedule 5.9(b) (as updated from time to time), and no amendments or improvements to a Canadian Employee Plan will be made or promised by any Canadian Loan Party before the Closing Date.

(v) Except as disclosed in Schedule 5.9(b) (as updated from time to time), no Canadian Loan Party provides benefits to retired Canadian Employees or to beneficiaries or dependents of retired Canadian Employees.

(vi) All obligations regarding the Canadian Pension Plans and the Canadian Employee Plans (including current service contributions) have been satisfied, there are no outstanding defaults or violations by any party to any Canadian Pension Plan and any Canadian Employee Plan and no taxes, penalties or fees are owing or exigible under any of the Canadian Employee Plans, except which could not reasonably be expected to result in a Material Adverse Effect. Except as disclosed in Schedule 5.9(b), as of the date hereof, each Canadian Pension Plan and each Canadian Employee Plan is fully funded or fully insured pursuant to the actuarial assumptions and methodology set out in Schedule 5.9(b) (as updated from time to time) and, in the case of a Canadian Pension Plan, as required under the most recent actuarial valuation filed with the applicable governmental authority pursuant to generally accepted actuarial practices and principles. To the best knowledge of each Canadian Loan Party, no fact or circumstance exists that could adversely affect the tax-exempt status of a Canadian Pension Plan or Canadian Employee Plan.

(vii) All contributions, assessments, premiums, fees, taxes, penalties or fines in relation to the Canadian Employees have been duly paid and there is no outstanding liability of any kind in relation to the employment of the Canadian Employees or the termination of employment of any Canadian Employee.

(viii) Each Canadian Loan Party is in compliance with all requirements of Canadian Employee Benefits Legislation and health and safety, workers compensation, employment standards, labor relations, health insurance, employment insurance, protection of personal information, human rights laws and any Canadian federal, provincial or local counterparts or equivalents in each case, as applicable to the Canadian Employees and as amended from time to time.

5.10. Compliance with Law; Investment Company Act; Other Regulated Entities. Except as set out in Schedule 5.10, Borrower and each other Group Member possesses all necessary authorizations, permits, licenses and approvals from all Governmental Authorities in order to conduct their respective businesses as presently conducted. All business and operations of the Borrower and each other Group Member complies with all applicable federal, state and local laws and regulations, except where the failure so to comply could not reasonably be expected to result in a Material Adverse Effect. Neither the Borrower nor any other Group Member is operating any aspect of its business under any agreement, settlement, order or other arrangement with any Governmental Authority. Neither Borrower nor any other Group Member is an “investment company” or a company “controlled” by an “investment company” or a “subsidiary” of an “investment company”, within the meaning of the Investment Company Act of 1940. None of any Group Member, any Person controlling any Group Member, or any Subsidiary of any Group Member, is subject to regulation under the Federal Power Act, the Interstate Commerce Act, any state public utilities code, or any other Federal or state statute, rule or regulation limiting its ability to incur Debt, pledge its assets or perform its Obligations under the Loan Documents.

5.11. Margin Stock. Neither Borrower nor any Group Member is engaged principally, or as one of its important activities, in the business of extending credit for the purpose of purchasing or carrying Margin Stock. No portion of the Obligations is secured directly or indirectly by Margin Stock.

5.12. Taxes. Except as disclosed in Schedule 5.12, each of Borrower and each other Group Member has filed all federal, state, provincial, local and foreign income, sales, goods and services, harmonized sales and franchise and other material tax returns, reports and statements (collectively, the "Tax Returns") with the appropriate Governmental Authorities in all jurisdictions in which such Tax Returns are or were required to be filed. All such Tax Returns are true and correct in all material respects. All Taxes, charges and other impositions reflected therein or otherwise due and payable have been paid prior to the date on which any liability may be added thereto for non-payment thereof, except for those contested in good faith by appropriate proceedings diligently conducted and for which adequate reserves are maintained on the books of the appropriate Group Member, as applicable, in accordance with IFRS. Except as specifically disclosed in Schedule 5.12, no Tax Return is under audit or examination by any Governmental Authority and no notice of such an audit or examination or any assertion of any claim for Taxes has been given or made by any Governmental Authority. Proper and accurate amounts have been withheld by each Group Member, as applicable, from their respective employees for all periods in full and complete compliance with the tax, social security and unemployment withholding provisions of applicable requirements of law and such withholdings have been timely paid to the respective Governmental Authorities. No Group Member has been a member of an affiliated, combined or unitary group other than the group of which a Group Member is the common parent or has liability for Taxes of any other person. Except as otherwise permitted under the Agreement or as set out in Schedule 5.12, each Group Member has withheld and remitted all required amounts within the prescribed periods to the appropriate governmental authorities, and in particular has deducted, remitted and paid all Canada Pension Plan contributions, Quebec Pension Plan contributions, workers compensation assessments, employment insurance premiums, employee health premiums, and real estate taxes within the prescribed periods to the appropriate governmental authorities. Borrower is resident in Canada for purposes of the Tax Act, is not resident in any other country, and no other country has asserted residency with respect to Borrower for purposes of the other country's Tax Laws.

5.13. Solvency. Both immediately before and after giving effect to (a) the Loans made on or prior to the date this representation and warranty is made or remade, (b) the disbursement of proceeds of such Loans, (c) the consummation of the transactions contemplated by the Asset Purchase Documents and (d) the payment and accrual of all transaction costs in connection with the foregoing, with respect to the Borrower and each other Loan Party, on a consolidated basis, (i) the fair value of its assets is greater than the amount of its liabilities (including disputed, contingent and unliquidated liabilities) as such value is established and liabilities evaluated, (ii) the present fair saleable value of its assets is not less than the amount that will be required to pay the probable liability on its debts as they become absolute and matured, (iii) it is able to realize upon its assets and pay its debts and other liabilities (including disputed, contingent and unliquidated liabilities) as they mature in the normal course of business, (iv) it does not intend to, and does not believe that it will, incur debts or liabilities beyond its ability to pay as such debts and liabilities mature and (v) it is not engaged in business or a transaction, and is not about to engage in business or a transaction, for which its property would constitute unreasonably small capital. None of Merus Labs Luxco S.à r.l.'s managers has taken any resolution to effect, and to the best of each such manager's knowledge no party has initiated, any of the following proceedings against Merus Labs Luxco S.à r.l.: (i) insolvency proceedings (*faillite*), or (ii) proceedings for voluntary arrangement with its creditors (*concordat préventif de faillite*), (iii) controlled management (*gestion contrôlée*) or (iv) suspension of payments (*sursis de paiement*) or (v) voluntary dissolution or liquidation (*dissolution ou liquidation volontaire*) or (vi) any similar foreign law proceedings having similar effects.

5.14. Environmental Matters. The on-going operations of Borrower and each other Group Member comply in all respects with all Environmental Laws, except such non-compliance which could not (if enforced in accordance with applicable law) reasonably be expected to result in a Material Adverse Effect. Borrower and each other Group Member have obtained, and maintained in good standing, all licenses, permits, authorizations and registrations required under any Environmental Law and necessary for their respective ordinary course operations, and Borrower and each other Group Member are in compliance with all material terms and conditions thereof, except where the failure to do so could not reasonably be expected to result in material liability to Borrower or any other Group Member and could not reasonably be expected to result in a Material Adverse Effect. Except as set forth on Schedule 5.14, none of Borrower, any other Group Member or any of their respective properties or operations is subject to any outstanding written order from or agreement with any federal, state or local Governmental Authority, nor subject to any judicial or docketed administrative proceeding, nor subject to any indemnification agreement or other contractual obligation, respecting any Environmental Law, Environmental Claim or Hazardous Substance. There are no Hazardous Substances or other conditions or circumstances existing with respect to any property, or arising from operations prior to the Closing Date, of Borrower or any other Group Member that could reasonably be expected to result in a Material Adverse Effect. Neither Borrower nor any other Group Member has any underground or above ground storage tanks that are not properly registered or permitted under applicable Environmental Laws or that are leaking or disposing of Hazardous Substances.

5.15. Insurance. Borrower and each other Group Member and their respective properties are insured with financially sound and reputable insurance companies which are not Affiliates of Borrower, in such amounts, with such deductibles and covering such risks as are customarily carried by companies engaged in similar businesses and owning similar properties in localities where Borrower or such other Group Member operates. A true and complete listing of such insurance as of the Closing Date, including issuers, coverages and deductibles, is set forth on Schedule 5.15.

5.16. Information. All information heretofore or contemporaneously herewith furnished in writing by Borrower or any other Loan Party to Agent or the Lender for purposes of or in connection with this Agreement and the transactions contemplated hereby is, and all written information hereafter furnished by or on behalf of Borrower or any Loan Party to Agent or the Lender pursuant hereto or in connection herewith will be, true and accurate in every material respect on the date as of which such information is dated or certified, and none of such information is or will be incomplete by omitting to state any material fact necessary to make such information not misleading in light of the circumstances under which made (it being recognized by Agent and the Lender that any projections and forecasts provided by Borrower are based on good faith estimates and assumptions believed by Borrower to be reasonable as of the date of the applicable projections or assumptions and that actual results during the period or periods covered by any such projections and forecasts may differ from projected or forecasted results).

5.17. Intellectual Property. Each Group Member owns, or is licensed or otherwise has the right to use, all Intellectual Property necessary to conduct its business as currently conducted except for such Intellectual Property the failure of which to own or have a license or other right to use would not reasonably be expected to have, either individually or in the aggregate, a Material Adverse Effect. To the knowledge of each Group Member, (a) the conduct and operations of the businesses of each Group Member do not infringe, misappropriate, dilute or violate any Intellectual Property owned by any other Person and (b) no other Person has contested any right, title or interest of any Group Member in any Intellectual Property, other than, in each case, as cannot reasonably be expected to have, individually or in the aggregate, a Material Adverse Effect.

5.18. Labor Matters. Except as set forth on Schedule 5.18, neither Borrower nor any other Group Member is subject to any labor or collective bargaining agreement. There are no existing or threatened strikes, lockouts or other labor disputes involving Borrower or any other Group Member that singly or in the aggregate could reasonably be expected to have a Material Adverse Effect. Hours worked by and payment made to employees of Borrower and the other Group Members are not in violation of the Fair Labor Standards Act or any other applicable law, rule or regulation dealing with such matters.

5.19. Canadian Labour Matters

(a) Except as disclosed in Schedule 5.19,

(i) No Canadian Loan Party is a party to any application, complaint, grievance, arbitration, or other proceeding under any statute or under any collective agreement related to any Canadian Employee or the termination of any Canadian Employee and there is no complaint, inquiry or other investigation by any regulatory or other administrative authority or agency with regard to or in relation to any Canadian Employee or the termination of any Canadian Employee; and

(ii) No Canadian Loan Party has engaged in any unfair labor practice, nor is any Canadian Loan Party aware of any pending or threatened complaint regarding any alleged unfair labor practices.

5.20. No Default. No Default or Event of Default exists or would result from the incurring of any Obligations by any Loan Party or the grant or perfection of the Agent's Liens on the Collateral or the consummation of the transactions contemplated by the Asset Purchase Documents. No Group Member is in default under or with respect to any contractual obligation in any respect which, individually or together with all such defaults, would reasonably be expected to have a Material Adverse Effect.

5.21. Foreign Assets Control Regulations and Anti-Money Laundering.

5.21.1. OFAC. Each Group Member is and will remain in compliance in all material respects with all U.S. and Canadian economic sanctions laws, Executive Orders and implementing regulations as promulgated by the U.S. Treasury Department's Office of Foreign Assets Control ("OFAC"), the *Proceeds of Crime* (*Money Laundering*) *and Terrorist Financing Act* (*Canada*), the *Criminal Code* (*Canada*), the *United Nations Act* (*Canada*) and all applicable anti-money laundering and counter-terrorism financing provisions of the Bank Secrecy Act and all regulations issued pursuant to any of the foregoing. No Group Member (i) is a Person designated by the U.S. government on the list of the Specially Designated Nationals and Blocked Persons (the "SDN List") with which a U.S. Person cannot deal with or otherwise engage in business transactions, (ii) is a Person designated by the Canadian government on any list set out in the United Nations Al-Qaida and Taliban Regulations, the Regulations Implementing the United Nations Resolutions on the Suppression of Terrorism or the Criminal Code (collectively, the "Terrorist Lists") with which a Canadian Person cannot deal with or otherwise engage in business transactions, (iii) is a Person who is otherwise the target of U.S. or Canadian economic sanctions laws such that a U.S. Person or Canadian Person cannot deal or otherwise engage in business transactions with such Person or (iv) is controlled by (including without limitation by virtue of such person being a director or owning voting shares or interests), or acts, directly or indirectly, for or on behalf of, any person or entity on the SDN List, a Terrorist List or a foreign government that is the target of U.S. or Canadian economic sanctions prohibitions such that the entry into, or performance under, this Agreement or any other Loan Document would be prohibited under U.S. law or Canadian law.

5.21.2. Patriot Act. The Group Members and each of their Affiliates are in compliance with (a) the Trading with the Enemy Act, and each of the foreign assets control regulations of the United States Treasury Department (31 CFR, Subtitle B Chapter V, as amended) and any other enabling legislation or executive order relating thereto, (b) the Patriot Act and (c) other federal, provincial or state laws or similar foreign laws relating to "know your customer" and anti-money laundering rules and regulations, including without limitation, the *Proceeds of Crime (Money Laundering)* and *Terrorist Financing Act* (*Canada*). No part of the proceeds of any Loan will be used directly or indirectly for any payments to any government official or employee, political party, official of a political party, candidate for political office, or anyone else acting in an official capacity, in order to obtain, retain or direct business or obtain any improper advantage, in violation of the United States Foreign Corrupt Practices Act of 1977.

5.22. Senior Debt. The Obligations shall rank pari passu with any other senior Debt of the Loan Parties, and shall constitute senior indebtedness as defined in any other documentation documenting any junior indebtedness of any Loan Party.

5.23. Withholdings and Remittances. Each Canadian Loan Party has remitted all Canada Pension Plan contributions, provincial pension plan contributions, workers' compensation assessments, employment insurance premiums, employee health premiums, municipal real estate taxes and other taxes payable under applicable law by them, and, furthermore, have withheld from each payment made to any of its present or former employees, officers and directors, and to all persons who are non-residents of Canada for the purposes of the Tax Act all amounts required by law to be withheld, including without limitation all payroll deductions required to be withheld and has remitted such amounts to the proper governmental authority within the time required under applicable law.

5.24. Asset Purchase Documentation. As of the Closing Date, the Borrower has delivered to the Agent a complete and correct copy of the Asset Purchase Documents (including all schedules, exhibits, amendments, supplements, modifications, assignments and all other material documents delivered pursuant thereto or in connection therewith). No Loan Party and, to the best of each Loan Party's knowledge, no other party thereto is in default in the performance or compliance with any provisions thereof. The Asset Purchase Agreement complies in all material respects with, and the transactions contemplated by the Asset Purchase Documents have been (or, substantially contemporaneously herewith will be) consummated in all material respects in accordance with, all applicable requirements of law. The Asset Purchase Agreement is in full force and effect and has not been terminated, rescinded or withdrawn. All material requisite approvals by Governmental Authorities having jurisdiction over the Seller, any Group Member or the other Persons referenced therein with respect to the transactions contemplated by the Asset Purchase Documents have been obtained, and no such approvals impose any conditions to the consummation of the transactions contemplated by the Asset Purchase Documents or to the conduct by any Loan Party of its business thereafter. To the best of each Loan Party's knowledge, the Seller and Asset Purchaser's representations or warranties in the Asset Purchase Agreement are true and correct in all material respects.

5.25. Inactive Subsidiaries. No Inactive Subsidiary (x) has any Subsidiaries, assets, properties, rights, liabilities or operations or (y) engages in any business. Except as set forth in Schedule 5.25, no Stock of any Inactive Subsidiary is evidenced by certificates.[1]

Section 6. Affirmative Covenants.

Until all Obligations (other than contingent indemnification obligations to the extent no claim giving rise thereto has been asserted) are Paid in Full, each Loan Party agrees that, unless at any time the Lender shall otherwise expressly consent in writing, it will:

6.1. Information. Unless such information set out below is available in the Public Record, furnish to Agent and the Lender:

6.1.1. Annual Report. Promptly when available and in any event within the time period prescribed by any relevant Governmental Authority: a copy of the annual audit report for Borrower and its Subsidiaries for such Fiscal Year, along with the audited consolidated financial statements of Borrower and the Subsidiaries as at the end of such Fiscal Year, which audit report is without qualification by independent auditors of recognized standing selected by Borrower and acceptable to Agent in its reasonable discretion (it being understood that as of the Closing Date, the Borrower's auditor as of the date hereof, Deloitte & Touche LLP, is acceptable to Agent).

[1] Note: Any stock disclosed on Schedule 5.25 will be required to be delivered as a closing condition.

6.1.2. Quarterly Reports. Promptly when available and in any event within the time period prescribed by any relevant Governmental Authority, consolidated balance sheets of Borrower and its Subsidiaries as of the end of such fiscal quarter, together with consolidated financial statements for such period and a customary Management Discussion and Analysis relating to such information, together with a comparison with the corresponding period of the previous Fiscal Year and a comparison with the budget for such period of the current Fiscal Year, certified by the chief financial officer of Borrower.

6.1.3. [Reserved].

6.1.4. Compliance Certificate. Contemporaneously with the furnishing of a copy of each annual audit report pursuant to Section 6.1.1 and each set of statements pursuant to Section 6.1.2 for each calendar quarter (beginning with the calendar quarter ending March 31, 2013) a duly completed Compliance Certificate, with appropriate insertions, dated the date of such annual report or such quarterly statements, and signed by the chief financial officer of Borrower, containing a computation of each of the financial ratios and restrictions set forth in Section 7.13 and to the effect that such officer has not become aware of any Event of Default or Default that has occurred and is continuing or, if there is any such Event of Default, describing it and the steps, if any, being taken to cure it.

6.1.5. [Reserved].

6.1.6. Notice of Default; Litigation; ERISA Matters. Promptly upon becoming aware of any of the following, written notice describing the same and the steps being taken by Borrower or the applicable Loan Party affected thereby with respect thereto:

(a) the occurrence of an Event of Default or a Default;

(b) any litigation, arbitration or governmental investigation or proceeding not previously disclosed by Borrower to the Lender which has been instituted or, to the knowledge of Borrower, is threatened against Borrower or any other Group Member, or to which any of the properties of any thereof is subject, which could reasonably be expected to have a Material Adverse Effect;

(c) [Reserved];

(d) any cancellation or material change in coverage in any insurance maintained by Borrower or any other Group Member; or

(e) any other event (including (i) any violation of any Environmental Law or the assertion of any Environmental Claim, (ii) the enactment or effectiveness of any law, rule or regulation, (iii) any violation or noncompliance with any law or (iv) any breach or non-performance of, or any default under, any contractual obligation of any Group Member) which could reasonably be expected to have a Material Adverse Effect.

6.1.7. Management Report. Promptly upon receipt thereof, copies of all detailed financial and management reports submitted to Borrower or any other Loan Party by independent auditors in connection with each annual or interim audit made by such auditors of the books of Borrower or any other Loan Party.

6.1.8. Projections. As soon as practicable, and in any event not later than 30 days after the commencement of each Fiscal Year, financial projections for Borrower and its Subsidiaries for such Fiscal Year (including monthly operating and cash flow budgets) prepared in a manner consistent with the projections delivered by Borrower to Agent prior to the Closing Date or otherwise in a manner reasonably satisfactory to Agent, accompanied by a certificate of the chief financial officer of Borrower to the effect that (a) such projections were prepared by Borrower, in good faith, (b) Borrower has a reasonable basis for the assumptions contained in such projections and (c) such projections have been prepared in accordance with such assumptions.

6.1.9. Other Information. Promptly from time to time, such other information concerning Borrower and any other Group Member as the Lender or Agent may reasonably request.

6.2. Books; Records; Inspections. Keep, and cause each other Loan Party to keep, its books and records in accordance with sound business practices sufficient to allow the preparation of financial statements in accordance with IFRS; permit, and cause each other Loan Party to permit, Agent (accompanied by the Lender) or any representative thereof to inspect, at any reasonable time and with reasonable notice (or at any time without notice if an Event of Default exists), the properties and operations of Borrower or such other Loan Party; and permit, and cause each other Loan Party to permit, at any reasonable time and with reasonable notice (or at any time without notice if an Event of Default exists), Agent (accompanied by the Lender) or any representative thereof to visit any or all of its offices, to discuss its financial matters with its directors or officers and its independent auditors (and Borrower hereby authorizes such independent auditors to discuss such financial matters with the Lender or Agent or any representative thereof), and to examine (and, at the expense of Borrower or the applicable Loan Party, photocopy extracts from) any of its books or other records; and permit, and cause each other Loan Party to permit, Agent and its representatives to inspect, at any reasonable time and with reasonable notice (or at any time without notice if an Event of Default exists), the Collateral and other tangible assets of Borrower or such Loan Party, to perform appraisals of the equipment of Borrower or such Party, and to inspect, audit, check and make copies of and extracts from the books, records, computer data, computer programs, journals, orders, receipts, correspondence and other data relating to any Collateral.

6.3. Maintenance of Property; Insurance.

(a) Keep, and cause each other Loan Party to keep, all property useful and necessary in the business of Borrower or such other Loan Party in good working order and condition, ordinary wear and tear excepted.

(b) Maintain, and cause each other Group Member to maintain, with responsible insurance companies, such insurance coverage as shall be required by all laws, governmental regulations and court decrees and orders applicable to it and such other insurance, to such extent and against such hazards and liabilities, as is customarily maintained by companies similarly situated; provided that in any event, such insurance shall insure against all risks and liabilities of the type insured against as of the Closing Date and shall have insured amounts no less than, and deductibles no higher than, those amounts provided for as of the Closing Date. Upon request of Agent or the Lender, Borrower shall furnish to Agent or such Lender a certificate setting forth in reasonable detail the nature and extent of all insurance maintained by Borrower and each other Group Member. Borrower shall cause each issuer of an insurance policy to provide Agent with an endorsement (i) showing Agent as a loss payee with respect to each policy of property or casualty insurance and naming Agent as an additional insured with respect to each policy of liability insurance, (ii) providing that 30 days' notice will be given to Agent prior to any cancellation of, or reduction or change in coverage provided by or other material modification to such policy and (iii) acceptable in all other respects to Agent. Borrower shall execute and deliver to Agent, upon request of Agent, a collateral assignment, in form and substance satisfactory to Agent, of each business interruption insurance policy maintained by the Loan Parties.

(c) Unless Borrower provides Agent with evidence of the continuing insurance coverage required by this Agreement, Agent may purchase insurance (to the extent of such insurance coverage as shall be required by clause (b) above) at Borrower's expense to protect Agent's and the Lender's interests in the Collateral. This insurance may, but need not, protect Borrower's and each other Group Member's interests. The coverage that Agent purchases may, but need not, pay any claim that is made against Borrower or any other Group Member in connection with the Collateral. Borrower may later cancel any insurance purchased by Agent, but only after providing Agent with evidence that Borrower has obtained the insurance coverage required by this Agreement. If Agent purchases insurance for the Collateral, as set forth above, Borrower will be responsible for the costs of that insurance, including interest and any other charges that may be imposed with the placement of the insurance, until the effective date of the cancellation or expiration of the insurance and the costs of the insurance may be added to the principal amount of the Loans owing hereunder.

6.4. Compliance with Laws and Contractual Obligations; Payment of Taxes and Liabilities.

(a) Comply, and cause each other Group Member to comply, in all material respects with all applicable laws, rules, regulations, decrees, orders, judgments, licenses and permits and all indentures, agreements and other instruments binding upon it or its property, except where failure to comply could not reasonably be expected to have a Material Adverse Effect; (b) without limiting clause (a) above, ensure, and cause each other Group Member to ensure, that no person who owns a controlling interest in or otherwise controls a Group Member is or shall be (i) listed on the Specially Designated Nationals and Blocked Person List maintained by OFAC, Department of the Treasury, and/or any other similar lists maintained by OFAC pursuant to any authorizing statute, Executive Order or regulation or (ii) a person designated under Section 1(b), (c) or (d) of Executive Order 13224, any related enabling legislation or any other similar Executive Orders; (c) without limiting clause (a) above, comply and cause each other Group Member to comply, with all applicable Bank Secrecy Act and anti-money laundering laws and regulations; and (d) timely prepare and file all Tax Returns required to be filed by applicable law and pay, and cause each other Group Member to pay, prior to delinquency, all taxes and other governmental charges against it or any of its property, as well as claims of any kind which, if unpaid, could become a Lien on any of its property; provided that the foregoing shall not require Borrower or any other Group Member to pay any such Tax or charge so long as it shall promptly contest the validity thereof in good faith by appropriate proceedings and shall set aside on its books adequate reserves with respect thereto in accordance with IFRS;

6.5. Maintenance of Existence. Maintain and preserve, and (subject to Section 7.5) cause each other Loan Party to maintain and preserve, (a) its existence and good standing (as applicable) in the jurisdiction of its organization and (b) its qualification to do business and good standing (as applicable) in each jurisdiction where the nature of its business makes such qualification necessary, other than any such jurisdiction where the failure to be qualified or in good standing could not reasonably be expected to have a Material Adverse Effect.

6.6. Employee Benefit Plans.

(a) Canadian Employees.

(i) Each Canadian Loan Party will cause to be delivered to the Agent, promptly upon the Agent's written request, a copy of each Canadian Pension Plan and Canadian Employee Plan and, if applicable, related trust agreements or other funding instruments and all amendments thereto.

(ii) Each Canadian Loan Party shall to the extent it receives any correspondence from any Governmental Authority with respect to any revocation of a Canadian Pension Plan or Canadian Employee Plan, promptly provide the Agent with such correspondence. Each Canadian Loan Party shall ensure that each Canadian Pension Plan or Canadian Employee Plan retains its registered status under and is administered in all material respects in accordance with the terms of the applicable Canadian Pension Plan text, funding agreement and Canadian Employee Benefits Legislation.

(iii) Each Canadian Loan Party will cause all reports and disclosures required by any Canadian Pension Plan or applicable Canadian Employee Benefits Legislation to be filed and distributed as required.

(iv) Each applicable Canadian Loan Party shall perform in all material respects all obligations (including (if applicable), funding, investment and administration obligations) required to be performed by such Canadian Loan Party in connection with each applicable Canadian Pension Plan and Canadian Employee Plan and the funding therefore; make and pay all current service and, as applicable, special payments relating to solvency deficiencies under each applicable Canadian Pension Plan and pay all premiums required to be made or paid by it in accordance with the terms of each applicable Canadian Employee Plan and Canadian Employee Benefits Legislation and withhold by way of authorized payroll deductions or otherwise collect and pay into the applicable Canadian Pension Plan or Canadian Employee Plan all employee contributions required to be withheld or collected by it in accordance with the terms of each applicable Canadian Pension Plan or Canadian Employee Plan, and Canadian Employee Benefits Legislation; and ensure that, to the extent that such Canadian Loan Party has a Canadian Pension Plan which is a defined benefit pension plan, that such plan is fully funded, both on an ongoing basis and on a solvency basis (using actuarial methods and assumptions which are consistent with the actuarial valuations last filed with the applicable governmental authorities and which are consistent with Canadian GAAP or IFRS).

6.7. Environmental Matters. If any release or disposal of Hazardous Substances shall occur or shall have occurred on or from any real property or any other assets of Borrower or any other Group Member, cause, or direct the applicable Group Member to cause, the prompt containment and removal of such Hazardous Substances and the remediation of such real property or other assets as is necessary to comply with all Environmental Laws and to preserve the value of such real property or other assets. Without limiting the generality of the foregoing, Borrower shall, and shall cause each other Group Member to, comply with each valid Federal or state judicial or administrative order requiring the performance at any real property by Borrower or any other Group Member of activities in response to the release or threatened release of a Hazardous Substance. If any violation of any Environmental Law shall occur or shall have occurred at any real property or any other assets of Borrower or any other Group Member or otherwise in connection with their operations, cause, or direct the applicable Group Member to cause, the prompt correction of such violation.

6.8. Asset Purchase. The Borrower shall cause the Asset Purchase to be consummated in accordance with the terms of the Asset Purchase Documents and applicable requirements of law and shall cause compliance by Asset Purchaser in all material respects with its obligations under the Asset Purchase Documents. The Loan Parties shall deliver such agreements, documents and instruments reasonably requested by Agent to evidence consummation of the transactions contemplated by the Asset Purchase Documents.

6.9. Further Assurances. Promptly upon request by the Agent, the Loan Parties shall (and, subject to the limitations hereinafter set forth, shall cause each of their Subsidiaries to) take such additional actions as the Agent may reasonably require from time to time in order (i) to subject to the Liens created by any of the Collateral Documents any of the properties, rights or interests, whether now owned or hereafter acquired, covered or intended to be covered by any of the Collateral Documents, (ii) to perfect and maintain the validity, effectiveness and priority of any of the Collateral Documents and the Liens intended to be created thereby, and (iii) to better assure, convey, grant, assign, transfer, preserve, protect and confirm to the Agent and the Lender the rights granted or now or hereafter intended to be granted to the Agent and the Lender under any Loan Document or under any other document executed in connection therewith. Without limiting the generality of the foregoing and except as otherwise approved in writing by the Lender, the Loan Parties shall cause each of their Subsidiaries (including any Subsidiary formed or acquired after the Closing Date by any Loan Party, but excluding Inactive Subsidiaries) to guaranty the Obligations and cause each such Subsidiary to grant to the Agent, for the benefit of the Agent and the Lender, a security interest in, subject to the limitations hereinafter set forth, all of such Subsidiary's property to secure such guaranty, in each case pursuant to documents in form and substance reasonably satisfactory to Agent. Furthermore and except as otherwise approved in writing by the Lender, Borrower shall, and shall cause each of its Subsidiaries (except Inactive Subsidiaries) to, pledge all of the Stock and Stock Equivalents of each of its Subsidiaries to the Agent for the benefit of the Agent and the Lender, to secure the Obligations, in each case pursuant to documents in form and substance reasonably satisfactory to Agent. In connection with each pledge of Stock and Stock Equivalents, Borrower and each such Loan Party Subsidiary shall deliver, or cause to be delivered, to the Agent, irrevocable proxies and stock powers and/or assignments, as applicable, duly executed in blank, in each case pursuant to documents in form and substance satisfactory to Agent. In the event any Loan Party acquires or leases as lessee any real property, simultaneously with such acquisition, such Person shall execute and/or deliver, or cause to be executed and/or delivered, to the Agent, (x) a fully executed Mortgage, in form and substance reasonably satisfactory to the Agent together with in the case of a lease, such lease amendments, consents and/or estoppels as Agent may reasonably request, and in any event, together with an A.L.T.A. lender's title insurance policy issued by a title insurer reasonably satisfactory to the Agent, in form and substance and in an amount reasonably satisfactory to the Agent insuring that the Mortgage is a valid and enforceable first priority Lien on the respective property, free and clear of all defects, encumbrances and Liens, (y) then current A.L.T.A. surveys, certified to the Agent and the Lender by a licensed surveyor sufficient to allow the issuer of the lender's title insurance policy to issue such policy without a survey exception and (z) an environmental site assessment prepared by a qualified firm acceptable to the Agent, in form and substance reasonably satisfactory to the Agent.

6.10. Post-Closing Obligations. * * *

6.11. Board Observer. Agent shall have the right to designate one (1) observer (the "Board Observer") to attend, as a nonvoting observer, two meetings of the board of directors of the Borrower in each Fiscal Year (each, a "Board Meeting") at which the Borrower's management is scheduled to present the Borrower's financial statements and financial and operating results and discuss the marketing of Enablex / Emselex. The Borrower shall provide the Board Observer with (i) reasonable advance notice of all Board Meetings or notice of such Board Meetings at the same time such notice is delivered to the directors and (ii) provide all documents and other written materials (including consents) delivered to the directors in connection with such meetings at the same time such notice and documents and other written materials are delivered to the directors. The Borrower shall reimburse the Board Observer for its reasonable, documented out-of-pocket fees, costs, expenses and disbursements (including reasonable and documented travel and lodging expenses) in connection with attending Board Meetings. The Board Observer shall be subject to the same obligations of confidentiality as a director, except that the Board Observer may disclose or communicate information to the Agent and the Lender notwithstanding such obligations.

Section 7. Negative Covenants.

Until the Obligations (other than contingent indemnification obligations to the extent no claim giving rise thereto has been asserted) are Paid in Full, each Loan Party agrees that, unless at any time the Lender shall otherwise expressly consent in writing, it will:

7.1. Debt. Not, and not suffer or permit any Group Member to, create, incur, assume or suffer to exist any Debt, except for the following Debt of the Borrower and/or Loan Party Subsidiaries: * * *

7.2. Liens. Not, and not suffer or permit any Group Member to, create or permit to exist any Lien on any of its real or personal properties, assets or rights of whatsoever nature (whether now owned or hereafter acquired), except: * * *

7.3. [Omitted].

7.4. Restricted Payments. * * *

7.5. Mergers; Consolidations; Asset Sales. * * *

7.6. Modification of Asset Purchase and Organizational Documents. Not, and not suffer or permit any waiver, amendment or modification of any term of any Asset Purchase Document, or any term of the charter, limited liability company agreement, partnership agreement, articles of incorporation, by-laws or other organizational documents of Borrower or any other Group Member, in each case except for those waivers, amendments and modifications that do not materially adversely affect the interests of the Agent or the Lender under the Loan Documents or in the Collateral (it being understood and agreed that any adverse impact on the effectiveness or validity of any Collateral Document or the Liens granted to the Agent thereunder shall be deemed to materially adversely affect such interests of the Agent and the Lender).

7.7. Use of Proceeds. Not use the proceeds of the Loans for any purposes other than solely as provided in Section 2.1.3.

7.8. Transactions with Affiliates. Not, and not suffer or permit any Group Member to, enter into any transaction with any Affiliate of the Borrower or of any such Group Member, except: * * *

7.9. Inconsistent Agreements. Not, and not suffer or permit any other Group Member to, enter into any agreement containing any provision which would (i) be violated or breached by any borrowing by Borrower hereunder or by the performance by Borrower or any other Loan Party of any of its Obligations hereunder or under any other Loan Document, (ii) prohibit Borrower or any other Group Member from granting to Agent and the Lender a Lien on any of its assets that constitute Collateral or (iii) other than pursuant to any agreement in effect on the Closing Date and set forth on Schedule 7.9, or pursuant to the Loan Documents, create or permit to exist or become effective any encumbrance or restriction on the ability of any other Subsidiary to (x) pay dividends or make other distributions to Borrower or any Wholly-Owned Subsidiary, or pay any Debt owed to Borrower or any Wholly-Owned Subsidiary, (y) make loans or advances to Borrower or any Wholly-Owned Subsidiary or (z) transfer any of its assets or properties to Borrower or any Wholly-Owned Subsidiary, except, in the case of clause (ii) and (iii) above: (a) negative pledges and restrictions on Liens in favor of any holder of Debt permitted under Section 7.1(b) and 7.1(k) but solely to the extent any negative pledge or limitation on Liens relates to the property that is the subject of such Debt and the proceeds and products thereof, (b) customary restrictions on leases, subleases, licenses or asset sale agreements otherwise permitted hereby so long as such restrictions relate to the assets subject thereto, (c) customary provisions restricting assignment of any agreement entered into in the ordinary course of business, (d) [Reserved], (e) related to any sale, transfer, disposition or conveyance of property permitted by Section 7.5(b) pending such sale, transfer, disposition or conveyance, solely to the assets subject to such sale, transfer, disposition or conveyance of property and (f) prohibitions and limitations that exist pursuant to applicable requirements of law.

7.10. Business Activities. Not, and not suffer or permit any Group Member to, engage in any line of business other than the businesses engaged in on the Closing Date and businesses reasonably related thereto or such other businesses as could reasonably be contemplated to be engaged in by any Loan Party as a result of such Loan Party carrying out its business strategy as set forth in the Public Record, provided that such businesses are in the biopharmaceuticals and medical devices industry.

7.11. Investments. Not, and not suffer or permit any Group Member to, make or permit to exist, any Investment in any other Person, except the following: * * *

7.12. Fiscal Year. Not, and not suffer or permit any other Group Member to, change its Fiscal Year.

7.13. Financial Covenants.

7.13.1. EBITDA. Not and not suffer or permit EBITDA for any Computation Period ending on or after March 31, 2013, to be less than the applicable amount set forth below for such Computation Period (subject to adjustment as described in Section 7.13.5); provided, that with respect to any incurrence of subordinated Debt pursuant to Section 7.1(c), and any Permitted Acquisition, in each case to be consummated prior to the availability of financial statements for the Fiscal Quarter ending March 31, 2013, EBITDA shall not be less than CDN$* * *

Computation Period	Amount
March 31, 2013	* * *
June 30, 2013	* * *
September 30, 2013	* * *
December 31, 2013	* * *
March 31, 2014	* * *
June 30, 2014	* * *
September 30, 2014	* * *
December 31, 2014	* * *
March 31, 2015	* * *

7.13.2. Maximum Total Leverage Ratio. Not and not suffer or permit the Maximum Total Leverage Ratio for any Computation Period ending on or after March 31, 2013, to be more than the applicable Maximum Total Leverage Ratio set forth below at the end of each such Computation Period:

Computation Period	Ratio
September 30, 2012	7.0:1.0
December 31, 2012	7.0:1.0
March 31, 2013	7.0:1.0
June 30, 2013	7.0:1.0
September 30, 2013	7.0:1.0
December 31, 2013	7.0:1.0
March 31, 2014	7.0:1.0
June 30, 2014	7.0:1.0
September 30, 2014	7.0:1.0
December 31, 2014	7.0:1.0
March 31, 2015	7.0:1.0

7.13.3. Minimum Net Sales. Not and not suffer or permit Net Sales for any Computation Period ending on or after March 31, 2013, to be less than the applicable Net Sales set forth below at the end of each such Computation Period (subject to adjustment as described in Section 7.13.5); provided, that with respect to any incurrence of subordinated Debt pursuant to Section 7.1(c), and any Permitted Acquisition, in each case to be consummated prior to the availability of financial statements for the Fiscal Quarter ending March 31, 2013, Net Sales shall not be less than CDN$* * *

Computation Period	Amount
March 31, 2013	* * *
June 30, 2013	* * *
September 30, 2013	* * *
December 31, 2013	* * *
March 31, 2014	* * *
June 30, 2014	* * *
September 30, 2014	* * *
December 31, 2014	* * *
March 31, 2015	* * *

7.13.4. Sinking Fund Deposit Cure. If, at any time, the Borrower deposits cash into the Sinking Fund Account (the amount of such deposit, the "Sinking Fund Deposit Amount"), then: * * *

7.13.5. Principal Repayment and Excess Cash in Sinking Fund. * * *

7.14. Deposit Accounts and Securities Accounts. Not, and not suffer or permit any Group Member to, maintain or establish any deposit account or securities account other than the deposit accounts and securities accounts set forth on Schedule 7.14 without prior written notice to Agent and unless Agent, Borrower or such other Group Member and the bank or securities intermediary at which such deposit account or securities account, as applicable, is to be opened or maintained enter into a Control Agreement (blocked account agreement with respect to a deposit account in Canada) regarding such deposit account or securities account, as applicable, on terms satisfactory to Agent.

7.15. Sale-Leasebacks. Not and not suffer or permit any Group Member to, engage in a sale leaseback, synthetic lease or similar transaction involving any of its assets.

7.16. Hazardous Substances. Not, and not suffer or permit any other Group Member to, cause or suffer to exist any release of any Hazardous Substances at, to or from any real property owned, leased, subleased or otherwise operated or occupied by any Group Member that would violate any Environmental Law, form the basis for any Environmental Claims or otherwise adversely affect the value or marketability of any real property (whether or not owned by any Group Member), other than such violations, Environmental Claims and effects that would not, in the aggregate, be reasonably be expected to have a Material Adverse Effect. Notwithstanding the foregoing, under no circumstances will any Group Member cause or suffer to exist any disposal of any Hazardous Substances at, on, under or in any real property owned, leased, subleased, or otherwise operated or occupied by any Group Member.

7.17. Asset Purchase Agreement Indemnity. Not, and not suffer or permit, directly or indirectly, the seeking of pricing and reimbursement for the Product (as defined in the Asset Purchase Agreement) in France, Italy or Spain in contravention of Section 11.5(d) of the Asset Purchase Agreement.

7.18. Establishment of Defined Benefit Plan. Notwithstanding any other provision of this Agreement or any other Loan Document, not, and not suffer or permit, (i) establishing or contributing to any Defined Benefit Plan or (ii) acquiring an interest in any Person if such Pension sponsors, administers, maintains or contributes to, or has any liability in respect of any Defined Benefit Plan.

7.19. ERISA Liability. Not, and not suffer or permit, any liability under ERISA and the sponsorship of any "pension plan" or any liability subject to Title IV of ERISA.

7.20. Inactive Subsidiaries. Not suffer or permit any Inactive Subsidiary (x) to have any Subsidiaries, assets, properties, rights, liabilities or operations, (y) to engage in any business or enter into any transaction except as required by Section 6.10(c), or (z) other than in the case of Orbis Pharma Inc., to have any of its Stock evidenced by certificates.

Section 8. Events of Default; Remedies.

8.1. Events of Default. Each of the following shall constitute an Event of Default under this Agreement:

8.1.1. Non-Payment of Credit. Default, in the payment when due of the principal of the Loan shall occur; or default, and continuance thereof for 5 Business Days, in the payment when due of any interest, fee, or other amount payable by any Loan Party hereunder or under any other Loan Document shall occur.

8.1.2. Default Under Other Debt.

(a) Any default for the payment of principal or interest when due shall occur under the terms applicable to any Debt (other than the Obligations) of any Group Member in an aggregate amount (for all such Debt so affected and including undrawn committed or available amounts and amounts owing to all creditors under any combined or syndicated credit arrangement) exceeding CDN$* * *; and

(b) Any default shall occur under the terms applicable to any Debt (other than the Obligations) of any Group Member in an aggregate amount (for all such Debt so affected and including undrawn committed or available amounts and amounts owing to all creditors under any combined or syndicated credit arrangement) exceeding CDN$* * * and such default shall result in the acceleration of the maturity of such Debt or permit the holder or holders thereof, or any trustee or agent for such holder or holders, to cause such Debt to become due and payable (or require Borrower or any other Group Member to purchase or redeem such Debt or post cash collateral in respect thereof) prior to its expressed maturity.

8.1.3. Bankruptcy; Insolvency. Any Loan Party becomes insolvent or generally fails to pay, or admits in writing its inability or refusal to pay, debts as they become due; or any Loan Party applies for, consents to, or acquiesces in the appointment of a trustee, receiver, ad hoc manager or other custodian for such Loan Party or any property thereof, or makes a general assignment for the benefit of creditors; or, in the absence of such application, consent or acquiescence, a trustee, receiver, ad hoc manager or other custodian is appointed for any Loan Party or for a substantial part of the property of any Loan Party and is not discharged within 60 days; or any bankruptcy, reorganization, debt arrangement, or other case or proceeding under any bankruptcy or insolvency law (including in respect of Merus Labs Luxco S.à r.l.: (i) insolvency proceedings (*faillite*), or (ii) proceedings for voluntary arrangement with its creditors (*concordat préventif de faillite)*, (iii) controlled management (*gestion contrôlée*) or (iv) suspension of payments (*sursis de paiement*) or (v) voluntary dissolution or liquidation (*dissolution ou liquidation volontaire*) or (vi) any similar foreign law proceedings having similar effects), or any dissolution or liquidation proceeding, is commenced in respect of any Loan Party, and if such case or proceeding is not commenced by such Loan Party, it is consented to or acquiesced in by such Loan Party, or remains for 60 days undismissed; or any Loan Party takes any action to authorize, or in furtherance of, any of the foregoing.

8.1.4. Plan of Arrangement. If any Loan Party or any other Person shall take any steps or actions (other than preparation of preliminary legal documentation and similar preparatory actions) to pursue or provide any notice to any Person that they intend to pursue a recapitalization of any Loan Party, whether pursuant to a plan of arrangement under the Canada Business Corporations Act (Canada) or otherwise.

8.1.5. Non-Compliance with Loan Documents.

(a) Failure by Borrower or any other Loan Party to comply with or to perform any covenant set forth in Sections 6.1.1, 6.1.2, 6.1.4, 6.1.6, 6.3(b), 6.5, 6.7, 6.8 and 7; (b) default by the Asset Purchaser in any material respect of any of its obligations under the Asset Purchase Documents or (c) failure by Borrower or any other Loan Party to comply with or to perform any other provision of this Agreement or any other Loan Document applicable to it (and not constituting an Event of Default under any other provision of this Section 8) and continuance of such failure described in this clause (c) for 30 days.

8.1.6. Representations; Warranties. Any representation or warranty made by any Loan Party herein or any other Loan Document is breached or is false or misleading in any material respect, or any schedule, certificate, financial statement, report, notice or other writing furnished by any Loan Party to Agent or the Lender in connection herewith is false or misleading in any material respect on the date as of which the facts therein set forth are stated or certified.

8.1.7. [Reserved].

8.1.8. Canadian Pensions Plans. (a) Any Person institutes steps to terminate a Canadian Pension Plan or causes such Canadian Pension Plan to no longer be registered if required to be registered, if as a result of such termination or de-registration any Loan Party could be required to make a contribution to such Canadian Pension Plan, or could incur a liability or obligation to such Canadian Pension Plan, in excess of CDN$* * *; or (b) a contribution failure occurs with respect to any Canadian Pension Plan sufficient to give rise to a Lien under any Canadian Employee Benefits Legislation.

8.1.9. Judgments.

(a) Final judgments which exceed an aggregate of CDN$* * * shall be rendered against any Group Member and shall not have been paid, discharged or vacated or had execution thereof stayed pending appeal within 30 days after entry or filing of such judgments; or

(b) One or more non-monetary judgments, orders or decrees shall be rendered against any one or more of the Loan Parties or any of their respective Subsidiaries which has had or would reasonably be expected to have, either individually or in the aggregate, a Material Adverse Effect, and there shall be any period of ten (10) consecutive days during which a stay of enforcement of such judgment or order, by reason of a pending appeal or otherwise, shall not be in effect.

8.1.10. Invalidity of Collateral Documents. Any Collateral Document shall cease to be in full force and effect; or any Group Member or other grantor or pledgor (or any Person by, through or on behalf of any Group Member, grantor or pledgor) shall contest in any manner the validity, binding nature or enforceability of any Collateral Document.

8.1.11. Invalidity of Subordination Provisions. Any subordination provision in any document or instrument governing Debt that is intended to be subordinated to the Obligations or any subordination provision in any subordination agreement that relates to any such Debt, or any subordination provision in any guaranty by any Loan Party of any such Debt, shall cease to be in full force and effect, or any Person (including the holder of any applicable Debt) shall contest in any manner the validity, binding nature or enforceability of any such provision.

8.1.12. Change of Control. (a) A Change of Control shall occur, (b) Borrower shall cease to, directly or indirectly, own and control 100% of each class of the outstanding Stock and Stock Equivalents of each Subsidiary of the Borrower, or (c) a "Change of Control" or other similar event shall occur, as defined in, or under, any indenture, agreement, instrument or other documentation evidencing or otherwise relating to any Debt.

8.2. Remedies. If any Event of Default described in Section 8.1.3 shall occur, the Loans and all other Obligations shall become immediately due and payable and all outstanding Commitments shall terminate, all without presentment, demand, protest or notice of any kind; and, if any other Event of Default shall occur and be continuing, Agent may, and upon the written request of the Lender shall, declare all or any part of the Loans and other Obligations to be due and payable and/or all or any part of the Commitments then outstanding to be terminated, whereupon the Loans and other Obligations shall become immediately due and payable (in whole or in part, as applicable), and such Commitments shall immediately terminate (in whole or in part, as applicable), all without presentment, demand, protest or notice of any kind. Agent shall promptly advise Borrower of any such declaration, but failure to do so shall not impair the effect of such declaration. Any cash collateral delivered hereunder shall be applied by Agent to any remaining Obligations and any excess remaining after the Obligations shall have been Paid in Full shall be delivered to Borrower or as a court of competent jurisdiction may elect.

8.3. Borrower's Right to Cure. Notwithstanding anything to the contrary contained in Section 8.1.5, in the event of any Event of Default under Section 7.13 (a "Curable Default"), the Borrower may cure such Event of Default if it complies with the provisions set forth in Section 7.13.4. From the effective date of the delivery of the Sinking Fund Deposit Cure Notice to Agent until the earlier to occur of the Required Deposit Date and the date on which Agent is notified that the applicable Retroactive Effect Deposit will not be deposited into the Sinking Fund Account, neither Agent nor Lender shall impose the Default Rate, accelerate the Obligations or exercise any enforcement remedy against any Group Member or any of their respective properties solely as a result of the existence of the applicable Curable Default. In the event that the applicable Retroactive Effect Deposit is deposited into the Sinking Fund Account and the inclusion of the Retroactive Effect Deposit in the calculation of, as applicable, EBITDA, the Maximum Total Leverage Ratio or Net Sales for the Reference Computation Period results in compliance with, respectively, Section 7.13.1, Section 7.13.2 or Section 7.13.3 for the Reference Computation Period, the applicable Curable Default shall be deemed waived.

Section 9. Agent.

9.1. Appointment; Authorization.

(a) Each Lender hereby irrevocably appoints, designates and authorizes Agent to take such action on its behalf under the provisions of this Agreement and each other Loan Document and to exercise such powers and perform such duties as are expressly delegated to it by the terms of this Agreement or any other Loan Document, together with such powers as are reasonably incidental thereto. Notwithstanding any provision to the contrary contained elsewhere in this Agreement or in any other Loan Document, Agent shall not have any duty or responsibility except those expressly set forth herein, nor shall Agent have or be deemed to have any fiduciary relationship with the Lender, and no implied covenants, functions, responsibilities, duties, obligations or liabilities shall be read into this Agreement or any other Loan Document or otherwise exist against Agent.

9.2. Delegation of Duties. Agent may execute any of its duties under this Agreement or any other Loan Document by or through agents, employees or attorneys in fact and shall be entitled to advice of counsel concerning all matters pertaining to such duties. Agent shall not be responsible for the negligence or misconduct of any agent or attorney in fact that it selects with reasonable care.

9.3. Limited Liability. None of Agent or any of its directors, officers, employees or agents shall (a) be liable for any action taken or omitted to be taken by any of them under or in connection with this Agreement or any other Loan Document or the transactions contemplated hereby (except to the extent resulting from its own gross negligence or willful misconduct as determined in a final non-appealable judgment by a court of competent jurisdiction), or (b) be responsible in any manner to the Lender for any recital, statement, representation or warranty made by any Loan Party or Affiliate of any Loan Party, or any officer thereof, contained in this Agreement or in any other Loan Document, or in any certificate, report, statement or other document referred to or provided for in, or received by Agent under or in connection with, this Agreement or any other Loan Document, or the validity, effectiveness, genuineness, enforceability or sufficiency of this Agreement or any other Loan Document (or the creation, perfection or priority of any Lien or security interest therein), or for any failure of any Loan Party or any other party to any Loan Document to perform its Obligations hereunder or thereunder. Agent shall not be under any obligation to the Lender to ascertain or to inquire as to the observance or performance of any of the agreements contained in, or conditions of, this Agreement or any other Loan Document, or to inspect the properties, books or records of any Loan Party or Affiliate of any Loan Party.

9.4. Successor Agent. Agent may resign as Agent at any time upon 30 days' prior notice to the Lender. If Agent resigns under this Agreement, the Lender shall, with (so long as no Event of Default exists) the consent of Borrower (which shall not be unreasonably withheld or delayed), appoint a successor agent for the Lender. If no successor agent is appointed prior to the effective date of the resignation of Agent, Agent may appoint, on behalf after consulting with the Lender and (so long as no Event of Default exists) Borrower, a successor agent. Upon the acceptance of its appointment as successor agent hereunder, such successor agent shall succeed to all the rights, powers and duties of the retiring Agent and the term "Agent" shall mean such successor agent, and the retiring Agent's appointment, powers and duties as Agent shall be terminated. After any retiring Agent's resignation hereunder as Agent, the provisions of this Section 9 and Sections 10.4 and 10.5 shall continue to inure to its benefit as to any actions taken or omitted to be taken by it while it was Agent under this Agreement. If no successor agent has accepted appointment as Agent by the date which is 30 days following a retiring Agent's notice of resignation, the retiring Agent's resignation shall nevertheless thereupon become effective and the Lender shall perform all of the duties of Agent hereunder until such time as the Lender shall appoint a successor agent as provided for above.

9.5. Collateral Matters. The Lender irrevocably authorizes Agent, at its option and in its discretion, (a) to release any Lien granted to or held by Agent under any Collateral Document (i) when all Obligations have been Paid in Full; (ii) constituting property sold or to be sold or disposed of as part of or in connection with any sale or other disposition permitted hereunder (it being agreed and understood that Agent may conclusively rely without further inquiry on a certificate of an officer of Borrower as to the sale or other disposition of property being made in compliance with this Agreement); or (iii) subject to Section 10.1, if approved, authorized or ratified in writing by the Lender; or (b) to subordinate its interest in any Collateral to any holder of a Lien on such Collateral which is permitted by clause (d)(i) or (d)(ii) of Section 7.2 (it being understood that Agent may conclusively rely on a certificate from Borrower in determining whether the Debt secured by any such Lien is permitted by Section 7.1(b)). Upon request by Agent at any time, the Lender will confirm in writing Agent's authority to release, or subordinate its interest in, particular types or items of Collateral pursuant to this Section 9.5. The Agent shall have the right, in accordance with the Collateral Documents, to sell, lease or otherwise dispose of any Collateral for cash, credit or any combination thereof, and Agent may purchase any Collateral at public or, if permitted by law, private sale and, in lieu of actual payment of the purchase price, may credit bid and setoff the amount of such price against the Obligations.

Section 10. Miscellaneous.

10.1. Waiver; Amendments. No delay on the part of Agent or the Lender in the exercise of any right, power or remedy shall operate as a waiver thereof, nor shall any single or partial exercise by any of them of any right, power or remedy preclude other or further exercise thereof, or the exercise of any other right, power or remedy. No amendment, modification or waiver of, or consent with respect to, any provision of this Agreement, the Notes or any of the other Loan Documents (or any subordination and intercreditor agreement or other subordination provisions relating to any other Debt) shall in any event be effective unless the same shall be in writing and approved by the Agent and the Lender, and then any such amendment, modification, waiver or consent shall be effective only in the specific instance and for the specific purpose for which given. No provision of Section 9 or other provision of this Agreement affecting Agent in its capacity as such shall be amended, modified or waived without the consent of Agent.

10.2. Notices. All notices hereunder shall be in writing (including facsimile transmission) and shall be sent to the applicable party at its address shown on Annex II or at such other address as such party may, by written notice received by the other parties, have designated as its address for such purpose. Notices sent by facsimile or other electronic transmission shall be deemed to have been given when sent; notices sent to the Borrower by mail shall be deemed to have been given three Business Days after the date when sent by registered or certified mail, postage prepaid; and notices sent by hand delivery or overnight courier service shall be deemed to have been given when received.

10.3. Computations. Unless otherwise specifically provided herein, any accounting term used in this Agreement (including in Section 7.13 or any related definition) shall have the meaning customarily given such term in accordance with IFRS, and all financial computations (including pursuant to Section 7.13 and the related definitions, and with respect to the character or amount of any asset or liability or item of income or expense, or any consolidation or other accounting computation) hereunder shall be computed in accordance with IFRS consistently applied; provided that if Borrower notifies Agent that Borrower wishes to amend any covenant in Section 7.13 (or any related definition) to eliminate or to take into account the effect of any change after the Closing Date in IFRS on the operation of such covenant (or if the Lender wishes to amend Section 7.13 (or any related definition) for such purpose), then Borrower's compliance with such covenant shall be determined on the basis of IFRS in effect immediately before the relevant change in IFRS became effective, until either such notice is withdrawn or such covenant (or related definition) is amended in a manner satisfactory to Borrower and the Lender. The explicit qualification of terms or computations by the phrase "in accordance with IFRS" shall in no way be construed to limit the foregoing.

10.4. Costs; Expenses. Each party shall bear its own costs (including Legal Costs) in connection with the preparation, execution, delivery and administration on or prior to the Closing Date (including perfection and protection of Collateral prior to and on the Closing Date) of this Agreement, the other Loan Documents and all other documents provided for herein or delivered or to be delivered hereunder or in connection herewith. After the Closing Date, Borrower agrees to pay on demand all reasonable out-of-pocket costs and expenses of Agent and the Lender (including Legal Costs) in connection with the administration (including perfection and protection of Collateral subsequent to the Closing Date) of this Agreement, the other Loan Documents and all other documents provided for herein or delivered or to be delivered hereunder or in connection herewith (including any proposed or actual amendment, supplement or waiver to any Loan Document), and all out-of-pocket costs and expenses (including Legal Costs) incurred by Agent and the Lender in connection with the collection of the Obligations and enforcement of this Agreement, the other Loan Documents or any such other documents. In addition, Borrower agrees to pay, and to save Agent and the Lender harmless from all liability for, any fees of Borrower's auditors in connection with any reasonable exercise by Agent and the Lender of their rights pursuant to Section 6.2. All Obligations provided for in this Section 10.4 shall survive repayment of the Loans, cancellation of the Notes and termination of this Agreement.

10.5. Indemnification by Borrower. In consideration of the execution and delivery of this Agreement by Agent and the Lender and the agreement to extend the Commitments provided hereunder, Borrower hereby agrees to indemnify, exonerate and hold Agent, the Lender and each of the officers, directors, employees, Affiliates and agents of Agent and the Lender (each a "Lender Party") free and harmless from and against any and all actions, causes of action, suits, losses, liabilities (including, without limitation, strict liabilities), damages, fines, penalties and expenses, including Legal Costs (collectively, the "Indemnified Liabilities"), incurred by Lender Parties or asserted against the Lender Party by any Person (including in connection with any action, suit or proceeding brought by the Borrower, any other Group Member or any Lender Party) as a result of, or arising out of, or relating to (a) any repayment of Debt, tender offer, merger, purchase of Stock and Stock Equivalents, purchase of assets or other similar or dissimilar transaction financed or proposed to be financed in whole or in part, directly or indirectly, with the proceeds of the Loans, (b) the generation, use, handling, recycling, reclamation, release, emission, discharge, transportation, storage, treatment or disposal of any Hazardous Substance at any property owned or leased by Borrower or any other Group Member, (c) any violation of or liability under any Environmental Laws or any Environmental Claim with respect to conditions at any property owned or leased by any Group Member or the operations conducted thereon, (d) the investigation, cleanup or remediation of offsite locations at which any Group Member or their respective predecessors are alleged to have directly or indirectly released or disposed of Hazardous Substances and any related Environmental Claims or (e) the execution, delivery, performance or enforcement of this Agreement or any other Loan Document by any Lender Party, except to the extent any such Indemnified Liabilities result from the applicable Lender Party's own gross negligence or willful misconduct as determined by a court of competent jurisdiction. If and to the extent that the foregoing undertaking may be unenforceable for any reason, Borrower hereby agrees to make the maximum contribution to the payment and satisfaction of each of the Indemnified Liabilities which is permissible under applicable law. All Obligations provided for in this Section 10.5 shall survive repayment of the Loans, cancellation of the Notes, any foreclosure under, or any modification, release or discharge of, any or all of the Collateral Documents and termination of this Agreement.

10.6. Marshaling; Payments Set Aside. Neither Agent nor the Lender shall be under any obligation to marshal any assets in favor of Borrower or any other Person or against or in payment of any or all of the Obligations. To the extent that Borrower makes a payment or payments to Agent or the Lender, or Agent or the Lender enforces its Liens or exercises its rights of set-off, and such payment or payments or the proceeds of such enforcement or set-off or any part thereof are subsequently invalidated, declared to be fraudulent or preferential, set aside or required (including pursuant to any settlement entered into by Agent or the Lender in its discretion) to be repaid to a trustee, receiver or any other party in connection with any bankruptcy, insolvency or similar proceeding, or otherwise, then (a) to the extent of such recovery, the obligation hereunder or part thereof originally intended to be satisfied shall be revived and continued in full force and effect as if such payment had not been made or such enforcement or setoff had not occurred and (b) the Lender severally agrees to pay to Agent upon demand its ratable share of the total amount so recovered from or repaid by Agent to the extent paid to such Lender.

10.7. Nonliability of the Lender. The relationship between Borrower on the one hand and the Lender and Agent on the other hand shall be solely that of borrower and lender. Neither Agent nor the Lender shall have any fiduciary responsibility to Borrower or any other Group Member. Neither Agent nor the Lender undertakes any responsibility to Borrower or any other Group Member to review or inform Borrower or any other Group Member of any matter in connection with any phase of Borrower's or any other Group Member's business or operations. Execution of this Agreement by Borrower constitutes a full, complete and irrevocable release of any and all claims which Borrower may have at law or in equity in respect of all prior discussions and understandings, oral or written, relating to the subject matter of this Agreement and the other Loan Documents. Neither Agent nor the Lender shall have any liability with respect to, and Borrower hereby waives, releases and agrees not to sue for, any special, indirect, punitive or consequential damages or liabilities.

10.8. Anti-Money Laundering.

(a) Each Canadian Loan Party acknowledges that, pursuant to the *Proceeds of Crime (Money Laundering) and Terrorist Financing Act* (Canada) and other applicable anti-money laundering, anti-terrorist financing, government sanction and "know your client" Laws, whether within Canada or elsewhere (collectively, including any guidelines or orders thereunder, "AML Legislation"), the Lender and the Agent may be required to obtain, verify and record information regarding each Canadian Loan Party, its directors, authorized signing officers, direct or indirect shareholders or other Persons in control of each Canadian Loan Party, and the transactions contemplated hereby. Each Canadian Loan Party shall promptly provide all such information, including supporting documentation and other evidence, as may be reasonably requested by the Lender or the Agent, or any prospective assign or participant of the Lender or the Agent, in order to comply with any applicable AML Legislation, whether now or hereafter in existence.

(b) If the Agent has ascertained the identity of each Canadian Loan Party or any authorized signatories of each Canadian Loan Party for the purposes of applicable AML Legislation, then the Agent:

(i) shall be deemed to have done so as an agent for the Lender, and this Agreement shall constitute a "written agreement" in such regard between the Lender and the Agent within the meaning of applicable AML Legislation; and

(ii) shall provide to the Lender copies of all information obtained in such regard without any representation or warranty as to its accuracy or completeness.

Notwithstanding the preceding sentence and except as may otherwise be agreed in writing, the Lender agrees that the Agent has no obligation to ascertain the identity of each Canadian Loan Party or any authorized signatories of each Canadian Loan Party on behalf of the Lender, or to confirm the completeness or accuracy of any information it obtains from each Canadian Loan Party or any such authorized signatory in doing so.

10.9. Currency Indemnity. If, for the purposes of obtaining judgment in any court in any jurisdiction with respect to this Agreement or any other Loan Document, it becomes necessary to convert into a particular currency (the "**Judgment Currency**") any amount due under this Agreement or under any other Loan Document in any currency other than the Judgment Currency (the "**Currency Due**"), then conversion shall be made at the rate of exchange prevailing on the Business Day before the day on which judgment is given. For this purpose "rate of exchange" means the rate at which the Agent is able, on the relevant date, to purchase the Currency Due with the Judgment Currency in accordance with its normal practice through its bankers. In the event that there is a change in the rate of exchange prevailing between the Business Day before the day on which the judgment is given and the date of receipt by the Agent of the amount due, each Canadian Loan Party will, on the date of receipt by the Agent, pay such additional amounts, if any, or be entitled to receive reimbursement of such amount, if any, as may be necessary to ensure that the amount received by the Agent on such date is the amount in the Judgment Currency which when converted at the rate of exchange prevailing on the date of receipt by the Agent is the amount then due under this Agreement or such other Loan Document in the Currency Due. If the amount of the Currency Due which the Agent is so able to purchase is less than the amount of the Currency Due originally due under this Agreement or any other Loan Document, each Canadian Loan Party shall indemnify and save the Agent and the Lender harmless from and against all loss or damage arising as a result of such deficiency. This indemnity shall constitute an obligation separate and independent from the other obligations contained in this Agreement and the other Loan Documents, shall give rise to a separate and independent cause of action, shall apply irrespective of any indulgence granted by the Agent or the Lender from time to time and shall continue in full force and effect notwithstanding any judgment or order for a liquidated sum in respect of an amount due under this Agreement or any other Loan Document or under any judgment or order.

10.10. Confidentiality. Agent and the Lender agree to use commercially reasonable efforts (equivalent to the efforts Agent or such Lender applies to maintain the confidentiality of its own confidential information) to maintain as confidential all information provided to them by any Loan Party and designated as confidential, except that Agent and the Lender may disclose such information (a) to Persons employed or engaged by Agent or such Lender or any of their Affiliates (including collateral managers of the Lender) in evaluating, approving, structuring or administering the Loan and the Commitments; (b) to any assignee or participant or potential assignee or participant that has agreed to comply with the covenant contained in this Section 10.10 (and any such assignee or participant or potential assignee or participant may disclose such information to Persons employed or engaged by them as described in clause (a) above); (c) as required or requested by any federal or state regulatory authority or examiner, or any insurance industry association, or as reasonably believed by Agent or such Lender to be compelled by any court decree, subpoena or legal or administrative order or process; (d) as, on the advice of Agent's or such Lender's counsel, is required by law; (e) in connection with the exercise of any right or remedy under the Loan Documents or in connection with any litigation to which Agent or such Lender is a party; (f) to any nationally recognized rating agency or investor of the Lender that requires access to information about the Lender's investment portfolio in connection with ratings issued or investment decisions with respect to such Lender; (g) that ceases to be confidential through no fault of Agent or the Lender; (h) to a Person that is an investor or prospective investor in a Securitization (as defined below) that agrees that its access to information regarding Borrower and the Loan and Commitments is solely for purposes of evaluating an investment in such Securitization and who agrees to treat such information as confidential; (i) to a Person that is a trustee, collateral manager, servicer, noteholder or secured party in a Securitization in connection with the administration, servicing and reporting on the assets serving as collateral for such Securitization; or (j) to a Person that is an investor or prospective investor in the Agent or any of its Affiliates. For purposes of this Section 10.10, "Securitization" means a public or private offering by the Lender or any of its Affiliates or their respective successors and assigns, of securities which represent an interest in, or which are collateralized, in whole or in part, by the Loans or the Commitments. Notwithstanding the foregoing, Borrower consents to the publication by Agent or the Lender of a tombstone or similar advertising material relating to the financing transactions contemplated by this Agreement, and Agent reserves the right to provide to industry trade organizations information necessary and customary for inclusion in league table measurements.

10.11. Captions. Captions used in this Agreement are for convenience only and shall not affect the construction of this Agreement.

10.12. Nature of Remedies. All Obligations of Borrower and rights of Agent and the Lender expressed herein or in any other Loan Document shall be in addition to and not in limitation of those provided by applicable law. No failure to exercise and no delay in exercising, on the part of Agent or the Lender, any right, remedy, power or privilege hereunder, shall operate as a waiver thereof; nor shall any single or partial exercise of any right, remedy, power or privilege hereunder preclude any other or further exercise thereof or the exercise of any other right, remedy, power or privilege.

10.13. Counterparts. This Agreement may be executed in any number of counterparts and by the different parties hereto on separate counterparts and each such counterpart shall be deemed to be an original, but all such counterparts shall together constitute but one and the same Agreement. Receipt by telecopy or electronic transmission of any executed signature page to this Agreement or any other Loan Document shall constitute effective delivery of such signature page.

10.14. Severability. The illegality or unenforceability of any provision of this Agreement or any instrument or agreement required hereunder shall not in any way affect or impair the legality or enforceability of the remaining provisions of this Agreement or any instrument or agreement required hereunder.

10.15. Entire Agreement. This Agreement, together with the other Loan Documents, embodies the entire agreement and understanding among the parties hereto and supersedes all prior or contemporaneous agreements and understandings of such Persons, verbal or written, relating to the subject matter hereof and thereof and any prior arrangements made with respect to the payment by Borrower of (or any indemnification for) any fees, costs or expenses payable to or incurred (or to be incurred) by or on behalf of Agent or the Lender

10.16. Successors; Assigns. This Agreement shall be binding upon Borrower, the Lender and Agent and their respective successors and assigns, and shall inure to the benefit of Borrower, the Lender and Agent and the successors and assigns of the Lender and Agent. No other Person shall be a direct or indirect legal beneficiary of, or have any direct or indirect cause of action or claim in connection with, this Agreement or any of the other Loan Documents. Borrower may not assign or transfer any of its rights or Obligations under this Agreement without the prior written consent of Agent and the Lender.

10.17. Governing Law. THIS AGREEMENT AND EACH NOTE SHALL BE A CONTRACT MADE UNDER AND GOVERNED BY THE INTERNAL LAWS OF THE STATE OF NEW YORK APPLICABLE TO CONTRACTS MADE AND TO BE PERFORMED ENTIRELY WITHIN SUCH STATE, WITHOUT REGARD TO CONFLICT OF LAWS PRINCIPLES (OTHER THAN SECTION 5-1401 OF THE NEW YORK GENERAL OBLIGATIONS LAW).

10.18. Forum Selection; Consent to Jurisdiction; Service of Process. ANY LITIGATION BASED HEREON, OR ARISING OUT OF, UNDER, OR IN CONNECTION WITH THIS AGREEMENT OR ANY OTHER LOAN DOCUMENT, SHALL BE BROUGHT AND MAINTAINED EXCLUSIVELY IN THE COURTS OF THE STATE OF NEW YORK OR IN THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK; PROVIDED THAT ANY SUIT SEEKING ENFORCEMENT AGAINST ANY COLLATERAL OR OTHER PROPERTY MAY BE BROUGHT, AT AGENT'S OPTION, IN THE COURTS OF ANY JURISDICTION WHERE SUCH COLLATERAL OR OTHER PROPERTY MAY BE FOUND. EACH LOAN PARTY HEREBY EXPRESSLY AND IRREVOCABLY SUBMITS TO THE JURISDICTION OF THE COURTS OF THE STATE OF NEW YORK AND OF THE UNITED STATES DISTRICT COURT FOR THE SOUTHERN DISTRICT OF NEW YORK FOR THE PURPOSE OF ANY SUCH LITIGATION AS SET FORTH ABOVE. EACH LOAN PARTY FURTHER IRREVOCABLY CONSENTS TO THE SERVICE OF PROCESS BY REGISTERED MAIL, POSTAGE PREPAID, OR BY PERSONAL SERVICE WITHIN OR WITHOUT THE STATE OF NEW YORK. EACH LOAN PARTY HEREBY EXPRESSLY AND IRREVOCABLY WAIVES, TO THE FULLEST EXTENT PERMITTED BY LAW, ANY OBJECTION WHICH IT MAY NOW OR HEREAFTER HAVE TO THE LAYING OF VENUE OF ANY SUCH LITIGATION BROUGHT IN ANY SUCH COURT REFERRED TO ABOVE AND ANY CLAIM THAT ANY SUCH LITIGATION HAS BEEN BROUGHT IN AN INCONVENIENT FORUM. Each Loan Party hereby appoints CT Corporation as such Loan Party's agent where notices and demands to or upon such Loan Party in respect of this Agreement or any other Loan Document may be served (without prejudice to the right of Agent or Lender to serve process in any other manner permitted by law). If for any reason such process agent is unable to act as such, such Loan Party will within 30 days appoint a substitute process agent located in the State of New York and give notice of such appointment to Agent.

10.19. Waiver of Jury Trial. EACH LOAN PARTY, AGENT AND EACH LENDER HEREBY WAIVES ANY RIGHT TO A TRIAL BY JURY IN ANY ACTION OR PROCEEDING TO ENFORCE OR DEFEND ANY RIGHTS UNDER THIS AGREEMENT, ANY NOTE, ANY OTHER LOAN DOCUMENT AND ANY AMENDMENT, INSTRUMENT, DOCUMENT OR AGREEMENT DELIVERED OR WHICH MAY IN THE FUTURE BE DELIVERED IN CONNECTION HEREWITH OR THEREWITH OR ARISING FROM ANY LENDING RELATIONSHIP EXISTING IN CONNECTION WITH ANY OF THE FOREGOING, AND AGREES THAT ANY SUCH ACTION OR PROCEEDING SHALL BE TRIED BEFORE A COURT AND NOT BEFORE A JURY.

10.20. Collateral Agent. Each Lender hereby appoints PDL BIOPHARMA, INC. as its collateral agent under the Guarantee and Collateral Agreement and agrees that in so acting PDL BIOPHARMA, INC. will have all the rights, protections, exculpations, indemnities and other benefits provided to PDL BIOPHARMA, INC. under Section 9 hereof, and authorizes and directs PDL BIOPHARMA, INC. to take or refrain from taking any and all action that it deems necessary or advisable in fulfilling its role as Collateral Agent under each Guarantee and Collateral Agreement.

[signature pages follow]

The parties hereto have caused this Agreement to be duly executed and delivered by their duly authorized officers as of the date first set forth above.

MERUS LABS INTERNATIONAL INC.

By:_____
Name:
Title:

MERUS LABS LUXCO S.À R.L.

By:_____
Name:
Title:

ECG HOLDINGS INC.

By:_____
Name:
Title:

MERUS LABS INC.

By:_____
Name:
Title:

MERUS LABS NETHERLANDS B.V.

By:_____
Name:
Title: Director A

By:_____
Name:
Title: Director B

[Credit Agreement – Signature Page]

PDL BIOPHARMA, INC.,
as Agent and the Lender

By: _____
Name: John P. McLaughlin
Title: President and Chief Executive Officer

[Credit Agreement – Signature Page]

ANNEX I

Commitments

Closing Date Commitment: $* * *

Additional Commitment: $* * *

ANNEX II

Addresses

LOAN PARTIES

Address for Notices:
Merus Labs International Inc.
30 St. Patrick St., Ste. 301,
Toronto, Ontario M5T 3A3
Attention: Chief Executive Officer
Facsimile: (416) 593-4434

Copy to:
Clark Wilson LLP
Suite 800 – 885 West Georgia Street
Vancouver, British Columbia V6C 3H1
Attention: Stewart Muglich
Facsimile: (604) 687-6314

AGENT

PDL BioPharma, Inc.,
as Agent and the Lender

Address for Notices:
932 Southwood Boulevard
Incline Village, NV 89451
Attention: General Counsel
Telephone: (775) 832-8500
Facsimile: (775) 832-8501

Bank: * * *

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

	For the Years Ended December 31,					For the Six Months Ended
	2007	2008	2009	2010	2011	June 30, 2012
Earnings:						
Income before income taxes	$ 191,073	$ 243,334	$ 280,285	$ 150,370	$ 307,428	$ 175,103
Add: fixed charges	16,267	14,285	19,430	43,578	36,153	16,603
Earnings	$ 207,340	$ 257,619	$ 299,715	$ 193,948	$ 343,581	$ 191,706
Fixed Charges:						
Interest expense	$ 16,200	$ 14,219	$ 19,357	$ 43,529	$ 36,102	$ 16,573
Estimated interest portion of rent expense	67	66	73	49	51	30
Fixed charges	$ 16,267	$ 14,285	$ 19,430	$ 43,578	$ 36,153	$ 16,603
Ratio of earnings to fixed charges	12.75	18.03	15.43	4.45	9.50	11.55

Exhibit 31.1

CERTIFICATIONS

I, John P. McLaughlin, President and 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: August 2, 2012

/s/ John P. McLaughlin

John P. McLaughlin
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 31.2

CERTIFICATIONS

I, Bruce Tomlinson, 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: August 2, 2012

/s/ Bruce Tomlinson

Bruce Tomlinson
Vice President and Chief Financial Officer
(Principal Financial Officer)

Exhibit 32.1

CERTIFICATION

I, John P. McLaughlin, President and Chief Executive Officer of PDL BioPharma, Inc. (the "Registrant"), hereby certify in accordance with 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, based on my knowledge:

(1) the Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, of the Registrant, to which this certification is attached as an exhibit (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m); and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

A signed original of this written statement required by Section 906 will be provided to the Securities and Exchange Commission or its staff upon request.

Dated: August 2, 2012

/s/ John P. McLaughlin

John P. McLaughlin
President and Chief Executive Officer
(Principal Executive Officer)

Exhibit 32.2

CERTIFICATION

I, Bruce Tomlinson, Vice President and Chief Financial Officer, of PDL BioPharma, Inc. (the "Registrant"), hereby certify in accordance with 18 U.S.C. 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, that, based on my knowledge:

(1) the Quarterly Report on Form 10-Q for the quarter ended June 30, 2012, of the Registrant, to which this certification is attached as an exhibit (the "Report"), fully complies with the requirements of Section 13(a) or 15(d) of the Securities Exchange Act of 1934 (15 U.S.C. 78m); and

(2) the information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of the Registrant.

A signed original of this written statement required by Section 906 will be provided to the Securities and Exchange Commission or its staff upon request.

Dated: August 2, 2012

/s/ Bruce Tomlinson

Bruce Tomlinson
Vice President and Chief Financial Officer
(Principal Financial Officer)