

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q

(Mark One)

Quarterly report pursuant to Section 13 or 15(d) of the Securities Exchange Act of 1934
For the quarterly period ended September 30, 2019

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



Delaware
(State or other jurisdiction of incorporation or organization)

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

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

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

Securities registered pursuant to Section 12(b) of the Securities Exchange Act of 1934:

<u>Title of each class</u>	<u>Trading symbol</u>	<u>Name of each exchange on which registered</u>
Common Stock, par value \$0.01 per share	PDLI	The Nasdaq Stock Market LLC

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes No

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

Large accelerated filer Accelerated filer Non-accelerated filer Smaller reporting company Emerging growth company

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

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

As of October 31, 2019, there were 114,184,610 shares of the registrant's Common Stock outstanding.

PDL BIOPHARMA, INC.
2019 Form 10-Q
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We own or have rights to certain trademarks, trade names, copyrights and other intellectual property used in our business, including PDL BioPharma and the PDL logo, each of which is considered a trademark. All other company names, product names, trade names and trademarks included in this Quarterly Report on Form 10-Q are trademarks, registered trademarks or trade names of their respective owners.

PART I. FINANCIAL INFORMATION

ITEM 1. FINANCIAL STATEMENTS

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
Revenues				
Product revenue, net	\$ 20,345	\$ 24,387	\$ 64,868	\$ 79,472
Royalty rights - change in fair value	23,865	42,184	(4,277)	66,117
Royalties from Queen et al. patents	—	533	9	4,534
Interest revenue	—	754	—	2,254
License and other	(45)	40	(48)	614
Total revenues	<u>44,165</u>	<u>67,898</u>	<u>60,552</u>	<u>152,991</u>
Operating expenses				
Cost of product revenue (excluding intangible asset amortization and impairment)	15,033	11,926	40,191	37,016
Amortization of intangible assets	1,575	1,577	4,745	14,254
General and administrative	12,092	13,211	33,037	39,401
Sales and marketing	1,712	3,469	6,515	14,367
Research and development	4,310	672	6,065	2,149
Impairment of intangible assets	—	—	—	152,330
Change in fair value of contingent consideration	—	302	—	(22,433)
Total operating expenses	<u>34,722</u>	<u>31,157</u>	<u>90,553</u>	<u>237,084</u>
Operating income (loss)	<u>9,443</u>	<u>36,741</u>	<u>(30,001)</u>	<u>(84,093)</u>
Non-operating (expense) income, net				
Interest and other income, net	1,460	1,581	4,984	4,871
Interest expense	(3,011)	(2,866)	(8,950)	(9,262)
Equity affiliate - change in fair value	(27,378)	—	18,109	—
Gain on sale of intangible assets	3,476	—	3,476	—
Loss on exchange of convertible notes	(3,900)	—	(3,900)	—
Total non-operating (expense) income, net	<u>(29,353)</u>	<u>(1,285)</u>	<u>13,719</u>	<u>(4,391)</u>
(Loss) income before income taxes	(19,910)	35,456	(16,282)	(88,484)
Income tax (benefit) expense	(1,944)	9,900	(419)	(3,346)
Net (loss) income	<u>(17,966)</u>	<u>25,556</u>	<u>(15,863)</u>	<u>(85,138)</u>
Less: Net loss attributable to noncontrolling interests	(182)	—	(340)	—
Net (loss) income attributable to PDL's shareholders	<u>\$ (17,784)</u>	<u>\$ 25,556</u>	<u>\$ (15,523)</u>	<u>\$ (85,138)</u>
Net (loss) income per share				
Basic	<u>\$ (0.16)</u>	<u>\$ 0.18</u>	<u>\$ (0.13)</u>	<u>\$ (0.58)</u>
Diluted	<u>\$ (0.16)</u>	<u>\$ 0.18</u>	<u>\$ (0.13)</u>	<u>\$ (0.58)</u>
Weighted-average shares outstanding				
Basic	<u>112,986</u>	<u>143,171</u>	<u>119,966</u>	<u>147,159</u>
Diluted	<u>112,986</u>	<u>144,224</u>	<u>119,966</u>	<u>147,159</u>

See accompanying notes.

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

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
Net (loss) income	\$ (17,966)	\$ 25,556	\$ (15,863)	\$ (85,138)
Other comprehensive loss, net of tax				
Change in unrealized gains (losses) on investments in available-for-sale securities:				
Change in fair value of investments in available-for-sale securities, net of tax	—	—	—	(578)
Adjustment for net gains realized and included in net loss, net of tax	—	—	—	(603)
Total change in unrealized gains on investments in available-for-sale securities, net of tax	—	—	—	(1,181)
Total other comprehensive loss, net of tax	—	—	—	(1,181)
Comprehensive (loss) income	(17,966)	25,556	(15,863)	(86,319)
Less: Comprehensive loss attributable to noncontrolling interests	(182)	—	(340)	—
Comprehensive (loss) income attributable to PDL's shareholders	<u>\$ (17,784)</u>	<u>\$ 25,556</u>	<u>\$ (15,523)</u>	<u>\$ (86,319)</u>

^(a) Net of tax of \$314 for the nine months ended September 30, 2018.

See accompanying notes.

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

	September 30, 2019 (unaudited)	December 31, 2018 (Note 1)
Assets		
Current assets:		
Cash and cash equivalents	\$ 294,270	\$ 394,590
Accounts receivable, net	12,581	21,648
Notes receivable	63,317	63,042
Inventory	20,942	18,942
Prepaid and other current assets	15,779	18,995
Total current assets	406,889	517,217
Property and equipment, net	6,576	7,387
Royalty rights - at fair value	313,943	376,510
Investment in equity affiliate	67,200	—
Notes receivable, long-term	691	771
Intangible assets, net	47,349	51,319
Other assets	22,497	10,532
Total assets	\$ 865,145	\$ 963,736
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 13,256	\$ 13,142
Accrued liabilities	27,653	39,312
Accrued income taxes	17	16
Total current liabilities	40,926	52,470
Convertible notes payable	132,484	124,644
Other long-term liabilities	54,301	56,843
Total liabilities	227,711	233,957
Commitments and contingencies (Note 12)		
Stockholders' equity:		
Preferred stock, par value \$0.01 per share, 10,000 shares authorized; no shares issued and outstanding	—	—
Common stock, par value \$0.01 per share, 350,000 shares authorized; 114,185 and 136,513 shares issued and outstanding at September 30, 2019 and December 31, 2018, respectively	1,142	1,365
Additional paid-in capital	(100,419)	(98,030)
Treasury stock, at cost; zero and 750 shares held at September 30, 2019 and December 31, 2018, respectively	—	(2,103)
Retained earnings	736,695	828,547
Total PDL stockholders' equity	637,418	729,779
Noncontrolling interests	16	—
Total stockholders' equity	637,434	729,779
Total liabilities and stockholders' equity	\$ 865,145	\$ 963,736

See accompanying notes.

PDL BIOPHARMA, INC.
CONDENSED CONSOLIDATED STATEMENTS OF STOCKHOLDERS' EQUITY
(In thousands, except share amounts)
(Unaudited)

	PDL Stockholders' Equity						
	Common Stock		Treasury Stock	Additional Paid-In Capital	Retained Earnings	Non-controlling Interest	Total Stockholders' Equity
	Shares	Amount					
Balance at December 31, 2018	136,512,522	\$ 1,365	\$ (2,103)	\$ (98,030)	\$ 828,547	\$ —	\$ 729,779
Issuance of common stock, net of forfeitures	764,785	8	—	(8)	—	—	—
Stock-based compensation expense	—	—	—	1,169	—	—	1,169
Repurchase and retirement of common stock	(13,460,164)	(135)	613	—	(44,831)	—	(44,353)
Transfer of subsidiary shares to non-controlling interest	—	—	—	—	—	572	572
Comprehensive income:							
Net income (loss)	—	—	—	—	6,680	(63)	6,617
Total comprehensive income	—	—	—	—	—	—	6,617
Balance at March 31, 2019	123,817,143	1,238	(1,490)	(96,869)	790,396	509	693,784
Issuance of common stock, net of forfeitures	37,996	—	—	—	—	—	—
Stock-based compensation expense	—	—	—	2,175	—	—	2,175
Repurchase and retirement of common stock	(8,185,970)	(81)	944	—	(26,897)	—	(26,034)
Transfer of subsidiary shares to non-controlling interest	—	—	—	229	—	(216)	13
Comprehensive loss:							
Net loss	—	—	—	—	(4,419)	(95)	(4,514)
Total comprehensive loss	—	—	—	—	—	—	(4,514)
Balance at June 30, 2019	115,669,169	1,157	(546)	(94,465)	759,080	198	665,424
Issuance of common stock, net of forfeitures	(18,061)	—	—	—	8	—	8
Stock-based compensation expense	—	—	—	2,059	—	—	2,059
Repurchase and retirement of common stock	(1,466,498)	(15)	546	—	(4,609)	—	(4,078)
Exchange of convertible notes	—	—	—	(8,013)	—	—	(8,013)
Comprehensive loss:							
Net loss	—	—	—	—	(17,784)	(182)	(17,966)
Total comprehensive loss	—	—	—	—	—	—	(17,966)
Balance at September 30, 2019	114,184,610	\$ 1,142	\$ —	\$ (100,419)	\$ 736,695	\$ 16	\$ 637,434

PDL Stockholders' Equity

	Common Stock		Treasury Stock	Additional Paid-In Capital	Retained Earnings	Accumulated Other Comprehensive Income (Loss)	Non-controlling Interest	Total Stockholders' Equity
	Shares	Amount						
Balance at December 31, 2017	153,774,756	\$ 1,538	\$ —	\$ (102,443)	\$ 945,614	\$ 1,181	\$ —	\$ 845,890
Issuance of common stock	37,500	—	—	—	—	—	—	—
Stock-based compensation expense	—	—	—	957	—	—	—	957
Repurchase and retirement of common stock	(1,000,000)	(10)	(1,188)	—	(2,961)	—	—	(4,159)
Comprehensive income:								
Net income	—	—	—	—	1,602	—	—	1,602
Change in unrealized gains on investments in available-for-sale securities, net of tax	—	—	—	—	—	(1,181)	—	(1,181)
Total comprehensive income	—	—	—	—	—	—	—	421
Balance at March 31, 2018	152,812,256	1,528	(1,188)	(101,486)	944,255	—	—	843,109
Issuance of common stock, net of forfeitures	324,591	4	—	(3)	3	—	—	4
Stock-based compensation expense	—	—	—	1,260	—	—	—	1,260
Repurchase and retirement of common stock	(7,165,415)	(72)	1,188	—	(20,565)	—	—	(19,449)
Comprehensive loss:								
Net loss	—	—	—	—	(112,296)	—	—	(112,296)
Total comprehensive loss	—	—	—	—	—	—	—	(112,296)
Balance at June 30, 2018	145,971,432	1,460	—	(100,229)	811,397	—	—	712,628
Issuance of common stock, net of forfeitures	575,831	6	—	(6)	—	—	—	—
Stock-based compensation expense	—	—	—	2,595	—	—	—	2,595
Repurchase and retirement of common stock	(571,051)	(6)	—	—	(1,386)	—	—	(1,392)
Comprehensive income:								
Net income	—	—	—	—	25,556	—	—	25,556
Total comprehensive income	—	—	—	—	—	—	—	25,556
Balance at September 30, 2018	\$ 145,976,212	\$ 1,460	\$ —	\$ (97,640)	\$ 835,567	\$ —	\$ —	\$ 739,387

See accompanying notes.

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

	Nine Months Ended September 30,	
	2019	2018
Cash flows from operating activities		
Net loss	\$ (15,863)	\$ (85,138)
Adjustments to reconcile net loss to net cash used in operating activities:		
Amortization of convertible notes conversion option and debt issuance costs	5,776	5,745
Accreted interest on convertible note principal	79	—
Amortization of intangible assets	4,745	14,254
Amortization of right-of-use assets	662	—
Impairment of intangible assets	—	152,330
Change in fair value of royalty rights - at fair value	4,277	(66,117)
Change in fair value of equity affiliate	(16,574)	—
Change in fair value of derivative assets	(1,487)	(114)
Change in fair value of contingent consideration	—	(22,433)
Other amortization and depreciation	2,295	3,061
Loss on exchange of convertible notes	3,900	—
Gain on sale of available-for-sale securities	—	(764)
Loss on disposal of property and equipment	—	66
Gain on sale of intangible assets	(3,476)	—
Provision for bad debts	(23)	—
Stock-based compensation expense	5,403	4,814
Deferred income taxes	(3,272)	(3,285)
Changes in assets and liabilities:		
Accounts receivable	8,815	15,752
Prepaid and other current assets	3,215	(4,557)
Accrued interest on notes receivable	—	(230)
Inventory	(2,787)	(3,471)
Other assets	358	(1,805)
Accounts payable	113	(10,774)
Accrued liabilities	(9,949)	(8,687)
Accrued income taxes	1	(1,286)
Other long-term liabilities	493	1,280
Net cash used in operating activities	<u>(13,299)</u>	<u>(11,359)</u>
Cash flows from investing activities		
Proceeds from sales of available-for-sale securities	—	4,116
Proceeds from royalty rights - at fair value	58,290	57,049
Purchase of royalty rights	—	(20,000)
Proceeds from the sale of intangible assets	5,000	—
Purchase of intangible assets	(1,700)	—
Investment in equity affiliate	(60,000)	—
Purchase of property and equipment	(504)	(4,641)
Net cash provided by investing activities	<u>1,086</u>	<u>36,524</u>
Cash flows from financing activities		
Repayment of convertible notes	—	(126,447)
Payment to exchange convertible notes	(7,451)	—
Net payments for capped call transactions	(3,694)	—
Payment of contingent consideration	(1,071)	—
Repurchase of Company common stock	(75,891)	(25,000)
Net cash used in financing activities	<u>(88,107)</u>	<u>(151,447)</u>
Net decrease in cash and cash equivalents	(100,320)	(126,282)
Cash and cash equivalents at beginning of the period	394,590	527,266
Cash and cash equivalents at end of period	<u>\$ 294,270</u>	<u>\$ 400,984</u>
Supplemental cash flow information		
Cash (refunded) paid for income taxes	\$ (2,685)	\$ 4,019
Cash paid for interest	\$ 2,063	\$ 4,591

Nine Months Ended September 30,

	<u>2019</u>		<u>2018</u>
Supplemental schedule of non-cash investing and financing activities			
December 2021 Notes exchanged for convertible notes due December 2024	\$ 86,053	\$	—
Assets held for sale reclassified from other assets to intangible assets	\$ —	\$	1,811

See accompanying notes.

1. Summary of Significant Accounting Policies

Basis of Presentation

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

The accompanying unaudited Condensed Consolidated Financial Statements and related financial information should be read in conjunction with the Company’s audited Consolidated Financial Statements and the related notes thereto for the year ended December 31, 2018, included in its Annual Report on Form 10-K for the fiscal year ended December 31, 2018, filed with the Securities and Exchange Commission (“SEC”) on March 15, 2019. The Condensed Consolidated Balance Sheet at December 31, 2018, included herein, has been derived from the audited Consolidated Financial Statements at that date, but does not include all disclosures required by GAAP.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the Condensed Consolidated Financial Statements and accompanying Notes to the Condensed Consolidated Financial Statements. The accounting estimates that require management’s most significant, difficult and subjective judgments include the valuation of royalty rights - at fair value, product revenue recognition and allowance for customer rebates and allowances, the valuation of notes receivable and inventory, the assessment of recoverability of intangible assets and their estimated useful lives, the valuation and recognition of stock-based compensation, the recognition and measurement of current and deferred income tax assets and liabilities, and the valuation of warrants to acquire shares of common stock. Actual results could differ from those estimates.

The Condensed Consolidated Financial Statements included herein include the accounts of the Company and its wholly-owned and majority-owned subsidiaries. All significant intercompany balances and transactions have been eliminated in consolidation.

Based on the nature of the Company’s existing investments and how they are managed, the Company structured its operations in four segments designated as Medical Devices, Strategic Positions, Pharmaceutical and Income Generating Assets. During the second quarter of 2019 the Company made an investment in Evofem Biosciences, Inc. (“Evofem”) (NASDAQ: EVFM) and added a new segment designated as Strategic Positions. This had no impact on its prior segment reporting structure.

- The Company’s Medical Devices segment consists of revenue derived from the LENSAR® Laser System sales made by the Company’s subsidiary, LENSAR, Inc. (“LENSAR”), which may include equipment, Patient Interface Devices (“PIDs” or “consumables”), procedure licenses, training, installation, warranty and maintenance agreements.
- The Company’s Strategic Positions segment consists of an investment in Evofem. The Company’s investment includes shares of common stock and warrants to purchase additional shares of common stock. Evofem is a publicly-traded clinical-stage biopharmaceutical company committed to developing and commercializing innovative products to address unmet needs in women's sexual and reproductive health. Evofem is leveraging its proprietary Multipurpose Vaginal pH Regulator (MVP-R™) platform to develop Amphora® (L-lactic acid, citric acid and potassium bitartrate) for hormone-free birth control.
- The Company’s Pharmaceutical segment consists of revenue derived from branded prescription medicine products sold under the name Tekturna® and Tekturna HCT® in the United States and Rasilez® and Rasilez HCT® in the rest of the world and an authorized generic form of Tekturna sold in the United States (collectively, the “Noden Products”). The branded prescription Noden Products were acquired from Novartis in July 2016 (the “Noden Transaction”) by the Company’s wholly-owned subsidiary, Noden Pharma DAC (“Noden DAC”). The Company, through its wholly-owned subsidiary, Noden Pharma USA Inc. (“Noden USA”) launched its authorized generic form of Tekturna in the United States in March 2019.
- The Company’s Income Generating Assets segment consists of revenue derived from (i) royalty rights - at fair value, (ii) notes and other long-term receivables, (iii) equity investments and (iv) royalties from issued patents in the United States and elsewhere covering the humanization of antibodies (“Queen et al. patents”).

Significant Accounting Policies

The Company's significant accounting policies are described in the Company's Annual Report on Form 10-K for the fiscal year ended December 31, 2018. Summarized below and in Note 2, *Investment in Evofem Biosciences, Inc.*, are the accounting pronouncements and policies adopted subsequent to December 31, 2018.

Adopted Accounting Pronouncements

Leases

In February 2016, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2016-02, *Leases*, that supersedes Accounting Standards Codification ("ASC") 840, *Leases*. Subsequently, the FASB issued several updates to ASU No. 2016-02, codified in ASC Topic 842 ("ASC 842"). The Company adopted ASC 842, *Leases*, on January 1, 2019 using the modified retrospective method for all leases not substantially completed as of the date of adoption. The reported results for the three and nine month periods ended September 30, 2019 reflect the application of ASC 842 guidance while the reported results for the three and nine month periods ended September 30, 2018 were prepared under the guidance of ASC 840, which is also referred to herein as "legacy GAAP" or the "previous guidance". The cumulative impact of the adoption of ASC 842 was not material, therefore, the Company did not record any adjustments to retained earnings. As a result of adopting ASC 842, the Company recorded operating lease right-of-use ("ROU") assets of \$2.1 million and operating lease liabilities of \$2.1 million, primarily related to corporate office leases, based on the present value of the future lease payments on the date of adoption. Changes to lessor accounting focused on conforming with certain changes made to lessee accounting and the recently adopted revenue recognition guidance. The adoption of ASC 842 did not materially change how the Company accounts for lessor arrangements.

Policy Elections and Practical Expedients Taken

For leases that commenced before the effective date of ASC 842, the Company elected the practical expedients to not reassess the following: (i) whether any expired or existing contracts contain leases; (ii) the lease classification for any expired or existing leases; and (iii) initial direct costs for any existing leases.

The Company adopted a policy of expensing short-term leases, defined as 12 months or less, as incurred.

The Company has a policy to exclude from the consideration in a lessor contract all taxes assessed by a governmental authority that are both imposed on and concurrent with a specific lease revenue-producing transaction and collected by the Company from a lessee.

General

The Company determines if an arrangement is a lease or contains an embedded lease at inception. The Company has lease arrangements with lease and non-lease components, which are accounted for separately.

Lessee arrangements

Lessee operating leases are included in Other assets, Accrued liabilities, and Other long-term liabilities in the Company's Condensed Consolidated Balance Sheet. The Company does not have lessee financing leases.

Operating lease ROU assets represent the Company's right to use an underlying asset for the lease term and lease liabilities represent its obligation to make lease payments arising from the lease. Operating lease ROU assets and liabilities are recognized at commencement date based on the present value of lease payments over the lease term. The Company uses the implicit rate when readily determinable at lease inception. As most of the Company's leases do not provide an implicit rate, the Company uses its incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments. The Company's remaining lease terms may include options to extend or terminate the lease when it is reasonably certain that the Company will exercise that option. Lease expense for lease payments is recognized on a straight-line basis as operating expense in the Condensed Consolidated Statements of Operations over the lease term.

Lessor arrangements

The Company leases medical device equipment to customers in both operating lease and sales-type lease arrangements generated from its Medical Devices segment.

PDL BIOPHARMA, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
(Unaudited)

For sales-type leases, the Company derecognizes the carrying amount of the underlying asset and capitalizes the net investment in the lease, which consists of the total minimum lease payments receivable from the lessee, at lease inception. The Company does not estimate an unguaranteed residual value of the equipment at lease termination because the equipment transfers to the lessee upon completion of the lease. Selling profit or loss is recognized at lease inception. Initial direct costs are recognized as an expense, unless there is no selling profit or loss. If there is no selling profit or loss, initial direct costs are deferred and recognized over the lease term. The Company recognizes interest income from the lease receivable over the lease term in Interest and other income, net in the Condensed Consolidated Statements of Operations.

For operating leases, rental income is recognized on a straight-line basis over the lease term. The cost of customer-leased equipment is recorded within Property and equipment, net in the accompanying Condensed Consolidated Balance Sheets and depreciated over the equipment's estimated useful life. Depreciation expense associated with the leased equipment under operating lease arrangements is reflected in Cost of product revenue in the accompanying Condensed Consolidated Statements of Operations. Some of the Company's operating leases include a purchase option for the customer to purchase the leased asset at the end of the lease arrangement. The Company manages its risk on its investment in the equipment through pricing and the term of the leases. Lessees do not provide residual value guarantees on leased equipment. Equipment returned to the Company may be leased or sold to other customers. Initial direct costs are deferred and recognized over the lease term.

Leases are generally not cancellable until after an initial term and may or may not require the customer to purchase a minimum number of procedures and consumables throughout the contract term.

For lease arrangements with lease and non-lease components where the Company is the lessor, the Company allocates the contract's transaction price to the lease and non-lease components on a relative standalone selling price basis using the Company's best estimate of the standalone selling price of each distinct product or service in the contract. Allocation of the transaction price is determined at the inception of the lease arrangement. The Company's leases primarily consist of leases with fixed lease payments. For those leases with variable lease payments, the variable lease payment is typically based upon use of the leased equipment or the purchase of procedure licenses and consumables used with the leased equipment. Non-lease components are accounted for under ASC 606, *Revenue from Contracts with Customers*. For additional information regarding ASC 606, see Note 15, *Revenue from Contracts with Customers*.

Intangibles-Goodwill and Other

In January 2017, the FASB issued ASU 2017-04, *Intangibles-Goodwill and Other: Simplifying the Test for Goodwill Impairment*, to simplify the subsequent measurement of goodwill by eliminating step two from the goodwill impairment test. Under the amendments, an entity will recognize an impairment charge for the amount by which the carrying value exceeds the fair value. The amendments are effective for fiscal years and interim periods within those years beginning after December 15, 2019 on a prospective basis and early adoption is permitted. The Company adopted the requirements of ASU No. 2017-04 on January 1, 2019. The adoption did not have an effect on the Company's Consolidated Financial Statements on the adoption date.

Recently Issued Accounting Pronouncements

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments*. The new guidance amends the impairment model to utilize an expected loss methodology in place of the currently used incurred loss methodology, which will result in more timely recognition of losses. ASU No. 2016-13 has an effective date of the fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. The Company is currently evaluating the impact of this guidance on its Consolidated Financial Statements.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement*. The new guidance modifies disclosure requirements related to fair value measurement. The amendments in ASU No. 2018-13 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Implementation on a prospective or retrospective basis varies by specific disclosure requirement. Early adoption is permitted. The standard also allows for early adoption of any removed or modified disclosures upon issuance of ASU No. 2018-13 while delaying adoption of the additional disclosures until their effective date. The Company is currently evaluating the impact of this guidance on its Consolidated Financial Statement disclosures.

In August 2018, the FASB issued ASU No. 2018-15, *Intangibles-Goodwill and Other-Internal-Use Software*. The new guidance reduces complexity for the accounting for costs of implementing a cloud computing service arrangement and aligns the

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requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). For public companies, the amendments in ASU No. 2018-15 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. Implementation should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. The Company is currently evaluating the impact of this guidance on its Consolidated Financial Statements.

2. Investment in Evofem Biosciences, Inc.

Equity Investment in Evofem Biosciences, Inc.

On April 10, 2019, the Company entered into a securities purchase agreement with Evofem and two other purchasers, pursuant to which the Company purchased \$60.0 million of Evofem securities in a private placement. The transaction was structured in two tranches.

The first tranche closed on April 11, 2019, pursuant to which the Company invested \$30.0 million to purchase 6,666,667 shares of Evofem common stock at \$4.50 per share and was also issued warrants to purchase up to 1,666,667 shares of Evofem common stock exercisable for seven years beginning six months after the issuance date at an exercise price of \$6.38 per share.

The second tranche closed on June 10, 2019, pursuant to which the Company invested an additional \$30.0 million to purchase an additional 6,666,667 shares of Evofem common stock at \$4.50 per share and was also issued warrants to purchase up to an additional 1,666,667 shares of Evofem common stock with the same terms as the warrants issued in the first tranche. Following the closing of the second tranche, the Company appointed one member to Evofem's Board of Directors and has a limited right to have one board observer participate in Evofem board meetings.

The Company has registration rights on customary terms for all Evofem shares issued under the securities purchase agreement, including the shares underlying the warrants.

As of September 30, 2019, the Company owned approximately 29% of Evofem's common stock. The Company's investment in Evofem qualifies for equity method accounting given its percentage ownership in Evofem and the ability to exercise significant influence. The Company elected the fair value method to account for its investment in Evofem as it believes it better reflects economic reality, the financial reporting of the investment and the current value of the asset. Changes in fair value of the Evofem equity investment are presented in Non-operating (expense) income, net on the Condensed Consolidated Statements of Operations. Because the mark to market valuation will occur at the end of each quarterly reporting period, changes in fair value will vary based upon the volatility of the stock price. The Evofem equity investment is presented on the Condensed Consolidated Balance Sheet as an Investment in equity affiliate and reflects the fair value of the equity investment at the end of the reporting period.

For the three months ended September 30, 2019, the Company recognized an unrealized loss of \$27.4 million, of which \$21.4 million was related to Evofem common stock and \$6.0 million was related to Evofem warrants. For the nine months ended September 30, 2019, the Company recognized an unrealized gain of \$18.1 million, of which \$16.6 million was related to Evofem common stock and \$1.5 million was related to Evofem warrants.

The latest Evofem financial statements can be found on their corporate website at www.evofem.com or filed with the SEC at www.sec.gov.

3. Cash and Cash Equivalents

As of September 30, 2019 and December 31, 2018, the Company had invested its excess cash balances primarily in money market funds. The fair values of cash equivalents approximate their carrying values due to the short-term nature of such financial instruments.

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The following table summarizes the Company's cash and cash equivalents by significant investment category as of September 30, 2019 and December 31, 2018:

<i>(in thousands)</i>	September 30, 2019	December 31, 2018
Cash	\$ 64,039	\$ 167,871
Money market funds	230,231	226,719
Total	<u>\$ 294,270</u>	<u>\$ 394,590</u>

The Company recognized zero and \$0.8 million of gains on sales of available-for-sale securities in the three and nine months ended September 30, 2018, respectively. As of September 30, 2019 and December 31, 2018 the Company had no available-for-sale securities.

4. Inventories

Inventories consisted of the following:

<i>(in thousands)</i>	September 30, 2019	December 31, 2018
Raw materials	\$ 6,132	\$ 6,214
Work in process	3,087	549
Finished goods	11,723	12,179
Total inventory	<u>\$ 20,942</u>	<u>\$ 18,942</u>

As of September 30, 2019 and December 31, 2018, the Company deferred approximately \$0.1 million and \$0.5 million, respectively, of costs associated with inventory transfers made under the Company's third-party logistic provider service arrangement. These costs have been recorded as Prepaid and other current assets on the Company's Condensed Consolidated Balance Sheets as of September 30, 2019 and December 31, 2018. The Company will recognize the cost of product sold as inventory is transferred from its third-party logistics provider to the Company's customers.

5. Fair Value Measurements

The fair value of the Company's financial instruments are estimates of the amounts that would be received if the Company were to sell an asset or pay to transfer a liability (exit price) in an orderly transaction between market participants at the measurement date. 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 observable inputs other than quoted prices in active markets for identical assets and liabilities, quoted prices for identical or similar assets or liabilities in inactive markets, or other inputs that are observable or can be corroborated by observable market data for substantially the full term of the assets or liabilities; and

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

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Assets/Liabilities Measured and Recorded at Fair Value on a Recurring Basis

The following table presents the fair value of the Company's financial instruments measured at fair value on a recurring basis by level within the valuation hierarchy:

<i>(in thousands)</i>	September 30, 2019				December 31, 2018			
	Level 1	Level 2	Level 3	Total	Level 1	Level 2	Level 3	Total
Financial assets:								
Money market funds	\$ 230,231	\$ —	\$ —	\$ 230,231	\$ 226,719	\$ —	\$ —	\$ 226,719
Corporate securities ⁽¹⁾	67,200	—	—	67,200	—	—	—	—
Warrants ⁽²⁾	—	10,923	—	10,923	—	62	—	62
Royalty rights - at fair value	—	—	313,943	313,943	—	—	376,510	376,510
Total	\$ 297,431	\$ 10,923	\$ 313,943	\$ 622,297	\$ 226,719	\$ 62	\$ 376,510	\$ 603,291
Financial liabilities:								
Contingent consideration, current ⁽³⁾	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 1,071	\$ 1,071
Total	\$ —	\$ —	\$ —	\$ —	\$ —	\$ —	\$ 1,071	\$ 1,071

⁽¹⁾ Corporate securities are classified as "Investment in equity affiliate" on the Condensed Consolidated Balance Sheet.

⁽²⁾ Warrants are included in "Other assets" on the Condensed Consolidated Balance Sheets.

⁽³⁾ Contingent consideration, current is classified as "Accrued liabilities" on the Condensed Consolidated Balance Sheet.

There have been no transfers between levels during the periods presented in the table above. The Company recognizes transfers between levels on the date of the event or change in circumstances that caused the transfer.

Money Market Funds - The fair values of cash equivalents approximate their carrying values due to the short-term nature of such financial instruments.

Corporate Securities - Corporate securities consists of common stock shares of Evofem, a clinical-stage biopharmaceutical company listed on Nasdaq. For additional information on the Evofem investment, see Note 2, *Investment in Evofem*.

Warrants - Warrants consist of rights to purchase shares of common stock in Evofem and CareView Communications, Inc. ("CareView"), see Note 2, *Investment in Evofem*, and Note 6, *Notes and Other Long-Term Receivables*. The fair value of the warrants is estimated using recently quoted market prices of the underlying equity security and the Black-Scholes option pricing model.

Royalty Rights - At Fair Value

Assertio (Depomed) Royalty Agreement

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

The rights acquired include Assertio's royalty and milestone payments accruing from and after October 1, 2013: (a) from Santarus, Inc. ("Santarus"), which was subsequently acquired by Salix Pharmaceuticals, Inc. ("Salix"), which itself was acquired by Valeant Pharmaceuticals International, Inc. ("Valeant"), which, in July 2018, changed its name to Bausch Health Companies Inc. ("Bausch Health") with respect to sales of Glumetza (metformin HCL extended-release tablets) in the United States; (b) from Merck & Co., Inc. with respect to sales of Janumet[®] XR (sitagliptin and metformin HCL extended-release

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tablets); (c) from Janssen Pharmaceutica N.V. with respect to potential future development milestones and sales of its approved fixed-dose combination of Invokana® (canagliflozin, a sodium glucose cotransporter 2 (SGLT2) inhibitor) and extended-release metformin tablets, marketed as Invokamet XR®; (d) from Boehringer Ingelheim and Eli Lilly and Company with respect to potential future development milestones and sales of the investigational fixed-dose combinations of drugs and extended-release metformin subject to Assertio's license agreement with Boehringer Ingelheim, including its approved products, Jentadueto XR® and Synjardy XR®; and (e) from LG Life Sciences and Bausch Health for sales of extended-release metformin tablets in Korea and Canada, respectively.

In February 2013, a generic equivalent to Glumetza was approved by the U.S. Food and Drug Administration ("FDA") and in August 2016, two additional generic equivalents to Glumetza were approved by the FDA. In February 2016, Lupin Pharmaceuticals, Inc., in August 2017, Teva Pharmaceutical Industries Ltd., and in July 2018, Sun Pharmaceutical, Inc. ("Sun") each launched a generic equivalent approved product. In May 2017, the Company received notification that a subsidiary of Valeant had launched an authorized generic equivalent product in February 2017, and the Company received royalties on such authorized generic equivalent product under the same terms as the branded Glumetza product, retroactive to February 2017. The Company continues to monitor whether the generic competition further affects sales of Glumetza and thus royalties on such sales paid to the Company, and the impact of the launched authorized generic equivalent. Due to the uncertainty around Bausch Health's marketing and pricing strategy, as well as Sun's recently launched generic product and limited historical demand data after generic market entrance, the Company may need to further evaluate future cash flows in the event of more rapid reduction or increase in market share of Glumetza and its authorized generic equivalent product and/or a further erosion in net pricing.

The Company determined that its royalty purchase interest in Depo DR Sub, LLC represented a variable interest in a variable interest entity. However, the Company did not have the power to direct the activities of Depo DR Sub, LLC that most significantly impact Depo DR Sub, LLC's economic performance and was not the primary beneficiary of Depo DR Sub, LLC; therefore, Depo DR Sub, LLC was not subject to consolidation by the Company.

On August 2, 2018, PDL Investment Holding, LLC ("PDLIH"), a wholly-owned subsidiary of the Company and assignee from the Company under the Assertio Royalty Agreement, entered into an amendment to the Assertio Royalty Agreement with Assertio. Pursuant to the amendment, PDLIH purchased all of Assertio's remaining interests in royalty and milestone payments payable on sales of Type 2 diabetes products licensed by Assertio for \$20.0 million. Prior to the amendment, the Assertio Royalty Agreement provided that the Company would have received all royalty and milestone payments due under license agreements between Assertio and its licensees until the Company received payments equal to two times the cash payment it made to Assertio, or approximately \$481.0 million, after which all net payments received by Assertio would have been shared equally between the Company and Assertio. Following the amendment, the Assertio Royalty Agreement provides that the Company will receive all royalty and milestone payments due under the license agreements between Assertio and its licensees. The Company has elected to continue to follow the fair value option and carry the financial asset at fair value.

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

As of December 31, 2018, in conjunction with the amendment described above, the Company was provided the power to direct the activities of Depo DR Sub, LLC and is the primary beneficiary of Depo DR Sub, LLC; therefore, Depo DR Sub, LLC is subject to consolidation by the Company. As of September 30, 2019, Depo DR Sub, LLC did not have any assets or liabilities of value for consolidation with the Company.

In October 2018, PDL submitted notice of its intent to exercise its audit right under the Assertio Royalty Agreement with respect to Glumetza royalties for the period beginning January 1, 2016 and ending December 31, 2018. No material adjustments were identified in connection with this audit.

The financial asset acquired represents a single unit of accounting. This financial asset is classified as a Level 3 asset within the fair value hierarchy, as the Company's valuation utilized significant unobservable inputs, including estimates as to the probability and timing of future commercialization for products not yet approved by regulatory agencies outside of the United States. The estimated fair value of the financial asset acquired was determined by using a discounted cash flow analysis related to the expected future cash flows to be generated by each licensed product. The discounted cash flows are based upon expected royalties from sales of licensed products over approximately an eight-year period. The estimated fair value of the asset is

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subject to variation should those cash flows vary significantly from the Company's estimates. The Company periodically assesses the expected future cash flows and to the extent such payments are greater or less than its initial estimates, or the timing of such payments is materially different than the original estimates, the Company will adjust the estimated fair value of the asset. A third-party expert is engaged to assist management with the development of its estimate of the expected future cash flows, when deemed necessary. Should the expected royalties increase or decrease by 2.5%, the fair value of the asset could increase or decrease by \$6.6 million, respectively. Significant judgment is required in selecting appropriate discount rates. The discount rates utilized range from 10% to 24%. Should these discount rates increase or decrease by 2.5%, the fair value of the asset could decrease by \$21.9 million or increase by \$25.8 million, respectively.

As of September 30, 2019, the Company's discounted cash flow analysis reflects its expectations as to the amount and timing of future cash flows up to the valuation date for the above described royalty streams.

As of September 30, 2019, the fair value of the asset acquired as reported in the Company's Condensed Consolidated Balance Sheet was \$265.0 million and the maximum loss exposure was \$265.0 million.

Viscogliosi Brothers Royalty Agreement

On June 26, 2014, the Company entered into a Royalty Purchase and Sale Agreement (the "VB Royalty Agreement") with Viscogliosi Brothers, LLC ("VB"), whereby VB conveyed to the Company the right to receive royalties payable on sales of a spinal implant that has received pre-market approval from the FDA held by VB and commercialized by Paradigm Spine, LLC ("Paradigm Spine"), in exchange for a \$15.5 million cash payment, less fees. Paradigm Spine was acquired in March 2019 by RTI Surgical Holdings, Inc.

The royalty rights acquired include royalties accruing from and after April 1, 2014. Under the terms of the VB Royalty Agreement, the Company receives all royalty payments due to VB pursuant to certain technology transfer agreements between VB and Paradigm Spine until the Company has received payments equal to 2.3 times the cash payment made to VB, after which all rights to receive royalties will be returned to VB. VB's ability to repurchase the royalty right for a specified amount expired on June 26, 2018.

The estimated fair value of the royalty rights at September 30, 2019, was determined by using a discounted cash flow analysis related to the expected future cash flows to be received. This asset is classified as a Level 3 asset, as the Company's valuation utilized significant unobservable inputs, including estimates as to the probability and timing of future sales of the licensed product. The discounted cash flow was based upon expected royalties from sales of licensed product over approximately a nine-year period. The estimated fair value of the asset is subject to variation should those cash flows vary significantly from the Company's estimates. The Company periodically assesses the expected future cash flows and to the extent such payments are greater or less than its initial estimates, or the timing of such payments is materially different than the original estimates, the Company will adjust the estimated fair value of the asset. A third-party expert is engaged to assist management with the development of its estimate of the expected future cash flows, when deemed necessary. Should the expected royalties increase or decrease by 2.5%, the fair value of the asset could increase or decrease by \$0.4 million, respectively. Significant judgment is required in selecting the appropriate discount rate. The discount rate utilized was 15.0%. Should this discount rate increase or decrease by 2.5%, the fair value of this asset could decrease by \$1.3 million or increase by \$1.5 million, respectively.

As of September 30, 2019, the Company's discounted cash flow analysis reflects its expectations as to the amount and timing of future cash flows up to the valuation date.

As of September 30, 2019, the fair value of the asset acquired as reported in the Company's Condensed Consolidated Balance Sheet was \$14.5 million and the maximum loss exposure was \$14.5 million.

University of Michigan Royalty Agreement

On November 6, 2014, the Company acquired a portion of all royalty payments of the Regents of the University of Michigan's ("U-M") worldwide royalty interest in Cerdelga® (eliglustat) for \$65.6 million pursuant to the Royalty Purchase and Sale Agreement with U-M (the "U-M Royalty Agreement"). Under the terms of the U-M Royalty Agreement, the Company receives 75% of all royalty payments due under U-M's license agreement with Genzyme Corporation, a Sanofi company ("Genzyme") until expiration of the licensed patents, excluding any patent term extension. Cerdelga, an oral therapy for adult patients with Gaucher disease type 1, was developed by Genzyme. Cerdelga was approved in the United States in August 2014, in the

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European Union in January 2015, and in Japan in March 2015. In addition, marketing applications for Cerdelga are under review by other regulatory authorities. While marketing applications have been approved in the United States, the European Union and Japan, national pricing and reimbursement decisions are delayed in some countries.

The estimated fair value of the royalty right at September 30, 2019 was determined by using a discounted cash flow analysis related to the expected future cash flows to be received. This asset is classified as a Level 3 asset, as the Company's valuation utilized significant unobservable inputs, including estimates as to the probability and timing of future sales of the licensed product. The discounted cash flow was based upon expected royalties from sales of licensed product over approximately a three-year period. Based on the results of the Company's analysis, which considered input from a third-party expert and the variance between the Company's forecast model and actual results, the Company wrote down the fair value of the royalty asset by \$3.1 million in the third quarter ended September 30, 2019. The estimated fair value of the asset is subject to variation should those cash flows vary significantly from the Company's estimates. An evaluation of those estimates, discount rate utilized and general market conditions affecting fair market value is performed in each reporting period. A third-party expert is engaged to assist management with the development of its estimate of the expected future cash flows, when deemed necessary. Should the expected royalties increase or decrease by 2.5%, the fair value of the asset could increase or decrease by \$0.5 million, respectively. Significant judgment is required in selecting the appropriate discount rate. The discount rate utilized was approximately 12.8%. Should this discount rate increase or decrease by 2.5%, the fair value of this asset could decrease or increase by \$0.7 million, respectively.

As of September 30, 2019, the Company's discounted cash flow analysis reflects its expectations as to the amount and timing of future cash flows.

As of September 30, 2019, the fair value of the asset acquired as reported in the Company's Condensed Consolidated Balance Sheet was \$21.2 million and the maximum loss exposure was \$21.2 million.

AcelRx Royalty Agreement

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

As of September 30, 2019, and December 31, 2018, the Company determined that its royalty rights under the AcelRx Royalty Agreement represented a variable interest in a variable interest entity. However, the Company does not have the power to direct the activities of ARPI LLC that most significantly impact ARPI LLC's economic performance and is not the primary beneficiary of ARPI LLC; therefore, ARPI LLC is not subject to consolidation by the Company.

Due to the slower than expected adoption of the product since its initial launch relative to the Company's estimates and the increased variance noted between the Company's forecast model and actual results in the three months ended June 30, 2019, the Company utilized a third-party expert in the second quarter of 2019 to reassess the market and expectations for the Zalviso product. Key findings from the third-party study included: the post-surgical PCA (Patient-Controlled Analgesia) market being smaller than previously forecasted; the higher price of the product relative to alternative therapies, the product not being used as a replacement for systemic opioids and the design of the delivery device, which is pre-filled for up to three days of treatment, which restricts its use for shorter recovery time procedures. Based on this analysis and the impact to the projected sales-based royalties and milestones, the Company wrote down the fair value of the royalty asset by \$60.0 million in the second quarter of 2019.

The estimated fair value of the royalty right at September 30, 2019 was determined by using a discounted cash flow analysis related to the expected future cash flows to be received. This asset is classified as a Level 3 asset, as the Company's valuation utilized significant unobservable inputs, including estimates as to the probability and timing of future sales of the licensed

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product. The discounted cash flow was based upon expected royalties from sales of licensed product over approximately a thirteen-year period. The estimated fair value of the asset is subject to variation should those cash flows vary significantly from the Company's estimates. An evaluation of those estimates, discount rate utilized and general market conditions affecting fair market valuation is performed for each reporting period. A third-party expert is engaged to assist management with the development of its estimate of the expected future cash flows, when deemed necessary. Should the expected royalties increase or decrease by 2.5%, the fair value of the asset could increase or decrease by \$0.3 million, respectively. Significant judgment is required in selecting the appropriate discount rate. The discount rate utilized was approximately 13.4%. Should this discount rate increase or decrease by 2.5%, the fair value of this asset could decrease by \$1.2 million or increase by \$1.5 million, respectively.

As of September 30, 2019, the Company's discounted cash flow analysis reflects its expectations as to the amount and timing of future cash flows up to the valuation date.

As of September 30, 2019, the fair value of the asset acquired as reported in the Company's Condensed Consolidated Balance Sheet was \$12.7 million and the maximum loss exposure was \$12.7 million.

Kybella Royalty Agreement

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

The estimated fair value of the royalty right at September 30, 2019, was determined by using a discounted cash flow analysis related to the expected future cash flows to be received. This asset is classified as a Level 3 asset, as the Company's valuation utilized significant unobservable inputs, including estimates as to the probability and timing of future sales of the licensed product. The discounted cash flow was based upon expected royalties from sales of a licensed product over approximately a six-year period. The estimated fair value of the asset is subject to variation should those cash flows vary significantly from the Company's estimates. An evaluation of those estimates, discount rate utilized and general market conditions affecting fair market value is performed in each reporting period. A third-party expert is engaged to assist management with the development of its estimate of the expected future cash flows, when deemed necessary. Should the expected royalties increase or decrease by 2.5%, the fair value of the asset could increase or decrease by less than \$0.1 million, respectively. Significant judgment is required in selecting the appropriate discount rate. The discount rate utilized was approximately 14.4%. Should this discount rate increase or decrease by 2.5%, the fair value of this asset could decrease or increase by less than \$0.1 million, respectively.

As of September 30, 2019, the Company's discounted cash flow analysis reflects its expectations as to the amount and timing of future cash flows up to the valuation date.

As of September 30, 2019, the fair value of the asset acquired as reported in the Company's Condensed Consolidated Balance Sheet was \$0.6 million and the maximum loss exposure was \$0.6 million.

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The following tables summarize the changes in Level 3 Royalty Right Assets and the gains and losses included in earnings for the nine months ended September 30, 2019:

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

<i>(in thousands)</i>	Royalty Rights - At Fair Value
Fair value as of December 31, 2018	\$ 376,510
Total net change in fair value for the period	
Change in fair value of royalty rights - at fair value	\$ (4,277)
Proceeds from royalty rights - at fair value	\$ (58,290)
Total net change in fair value for the period	(62,567)
Fair value as of September 30, 2019	<u>\$ 313,943</u>

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

<i>(in thousands)</i>	Fair Value as of December 31, 2018	Royalty Rights - Change in Fair Value	Fair Value as of September 30, 2019
Assertio (Depomed)	\$ 264,371	\$ 599	\$ 264,970
VB	14,108	354	14,462
U-M	25,595	(4,379)	21,216
AcelRx	70,380	(57,650)	12,730
KYBELLA	2,056	(1,491)	565
	<u>\$ 376,510</u>	<u>\$ (62,567)</u>	<u>\$ 313,943</u>

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The following table summarizes the changes in Level 3 Liabilities and the gains and losses included in earnings for the nine months ended September 30, 2019:

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

<i>(in thousands)</i>	Contingent Consideration
Fair value as of December 31, 2018	\$ (1,071)
Financial instruments purchased	—
Settlement of financial instrument ⁽¹⁾	1,071
Fair value as of September 30, 2019	<u>\$ —</u>

⁽¹⁾ Represents the final conversion consideration and earn out liability for the LENSAR acquisition of assets from Precision Eye Services.

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

<i>(in thousands)</i>	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
Total change in fair value for the period included in earnings for royalty right assets held at the end of the reporting period	\$ 23,865	\$ 42,184	\$ (4,277)	\$ 66,117
Total change in fair value for the period included in earnings for liabilities held at the end of the reporting period	\$ —	\$ (302)	\$ —	\$ 22,433

Assets/Liabilities Measured and Recorded at Fair Value on a Nonrecurring Basis

The Company remeasures the fair value of certain assets and liabilities upon the occurrence of certain events. Such assets consist of long-lived assets, including property and equipment and intangible assets and the shares of Alphaeon Class A common stock, received in connection with loans made to LENSAR by the Company prior to its acquisition of LENSAR. During the three months ended June 30, 2018, the Company recorded an impairment charge of \$152.3 million for the Noden intangible assets related to the increased probability of a generic form of aliskiren being launched in the United States. As a result of this impairment charge, which was based on the estimated fair value of the assets, the remaining carrying value of these intangible assets was determined to be \$40.1 million. The fair value calculation included level 3 inputs. The Company’s carrying value of the 1.7 million shares of Alphaeon common stock as of both September 30, 2019 and December 31, 2018 is \$6.6 million based on an estimated per share value of \$3.84, which was established by a valuation performed when the shares were acquired. The value of the Company’s investment in Alphaeon is not readily determinable as Alphaeon’s shares are not publicly traded. The Company evaluates the fair value of this investment by performing a qualitative assessment each reporting period. If the results of this qualitative assessment indicate that the fair value is less than the carrying value, the investment is written down to its fair value. There have been no such write downs since the Company acquired these shares. This investment is included in Other long-term assets. For additional information on the Alphaeon investment, see Note 6, *Notes and Other Long-Term Receivables*.

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Assets/Liabilities Not Subject to Fair Value Recognition

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

<i>(in thousands)</i>	September 30, 2019			December 31, 2018		
	Carrying Value	Fair Value Level 2	Fair Value Level 3	Carrying Value	Fair Value Level 2	Fair Value Level 3
Assets:						
Wellstat Diagnostics note receivable	\$ 50,191	\$ —	\$ 52,690	\$ 50,191	\$ —	\$ 57,322
Hyperion note receivable	1,200	—	1,200	1,200	—	1,200
CareView note receivable	11,458	—	11,458	11,458	—	11,458
Total	\$ 62,849	\$ —	\$ 65,348	\$ 62,849	\$ —	\$ 69,980
Liabilities:						
December 2021 Notes	\$ 55,652	\$ 61,984	\$ —	\$ 124,644	\$ 151,356	\$ —
December 2024 Notes	76,832	81,034	—	—	—	—
Total	\$ 132,484	\$ 143,018	\$ —	\$ 124,644	\$ 151,356	\$ —

During the year ended December 31, 2018 the Company recorded an impairment loss of \$8.2 million for the note receivable with CareView Communications, Inc. (“CareView”). There were no impairment losses on notes receivable in the three and nine month periods ended September 30, 2019.

As of September 30, 2019 and December 31, 2018, the estimated fair value of the CareView note receivable was determined using discounted cash flow models, incorporating expected principal and interest payments and also considered the recoverability of the note receivable balance utilizing third-party revenue multiples for small cap healthcare technology companies. As of September 30, 2019 and December 31, 2018, the estimated fair value of the Wellstat Diagnostics and Hyperion Catalysis International, Inc. (“Hyperion”) notes receivable were determined by using an asset approach and discounted cash flow model related to the underlying collateral and adjusted to consider estimated costs to sell the assets.

The Company determined its notes receivable assets are Level 3 assets as the Company’s valuations utilized significant unobservable inputs, including estimates of future revenues, discount rates, expectations about settlement, terminal values, required yield and the value of underlying collateral. The Company engages third-party valuation experts when deemed necessary to assist in evaluating its investments and the related inputs needed to estimate the fair value of certain investments.

The CareView note receivable is secured by substantially all assets of, and equity interests in CareView. The Wellstat Diagnostics note receivable is secured by substantially all assets of Wellstat Diagnostics and is supported by a guaranty from the Wellstat Diagnostics Guarantors (as defined in Note 6, *Notes and Other Long-Term Receivables*).

On September 30, 2019, the carrying value of one of the Company’s notes receivable assets differed from its estimated fair value. This is the result of inputs used in estimating the fair value of the collateral, including appraisals, projected cash flows of collateral assets and discount rates used when performing a discounted cash flow analysis.

The fair values of the Company’s convertible senior notes were determined using quoted market pricing.

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

Asset	Valuation Technique	Unobservable Input	September 30, 2019	December 31, 2018
Wellstat Diagnostics				
<i>Wellstat Guarantors intellectual property</i>	<i>Income Approach</i>			
		Discount rate	12%	12%
		Royalty amount	\$21 million	\$21 million
<i>Settlement Amount</i>	<i>Income Approach</i>			
		Discount rate	15%	15%
		Settlement amount	\$28 million	\$34 million
Real Estate Property				
	<i>Market Approach</i>			
		Annual appreciation rate	4%	4%
		Estimated realtor fee	6%	6%
		Estimated disposal date	3/31/2020	9/30/2019
CareView				
<i>Note receivable cash flows</i>	<i>Income Approach</i>			
		Discount rate	30%	30%

6. Notes and Other Long-Term Receivables

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

Wellstat Diagnostics Note Receivable and Credit Agreement and Related Litigation

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

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

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

Except as otherwise described herein, the material terms of the amended and restated credit agreement are substantially the same as those of the original credit agreement, including quarterly interest payments at the rate of 5% per annum (payable in cash or in kind). In addition, the Company was to continue to receive quarterly royalty payments based on a low double-digit royalty rate of Wellstat Diagnostics' net revenues. However, pursuant to the amended and restated credit agreement: (i) the

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principal amount was reset to approximately \$44.1 million, which was comprised of approximately \$33.7 million original loan principal and interest, \$1.3 million term loan principal and interest and \$9.1 million forbearance principal and interest; (ii) the specified internal rates of return increased; (iii) the default interest rate was increased; (iv) Wellstat Diagnostics' obligation to provide certain financial information increased in frequency to monthly; (v) internal financial controls were strengthened by requiring Wellstat Diagnostics to maintain an independent, third-party financial professional with control over fund disbursements; (vi) the Company waived the existing events of default; and (vii) the owners and affiliates of Wellstat Diagnostics were required to contribute additional capital to Wellstat Diagnostics upon the sale of an affiliate entity. The amended and restated credit agreement had an ultimate maturity date of December 31, 2021 (but has subsequently been accelerated as described below).

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

On August 5, 2014, the Company delivered a notice of default (the "Wellstat Diagnostics Borrower Notice") to Wellstat Diagnostics, which accelerated all obligations under the amended and restated credit agreement and demanded immediate payment in full in an amount equal to approximately \$53.9 million, (which amount, in accordance with the terms of the amended and restated credit agreement, included an amount that, together with interest and royalty payments already made to the Company, would generate a specified internal rate of return to the Company), plus accruing fees, costs and interest, and demanded that Wellstat Diagnostics protect and preserve all collateral securing its obligations.

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

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

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

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

On October 14, 2016, the Company sent a notice of default and reference to foreclosure proceedings to certain of the Wellstat Diagnostics Guarantors which are not defendants in the New York action, but which are owners of real estate assets over which a deed of trust in favor of the Company securing the guarantee of the loan to Wellstat Diagnostics had been executed. On March

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2, 2017, the Company sent a second notice to foreclose on the real estate assets, and noticed the sale for March 29, 2017. The sale was taken off the calendar by the trustee under the deed of trust and has not been re-scheduled yet. On March 6, 2017, the Company sent a letter to the Wellstat Diagnostics Guarantors seeking information in preparation for a UCC Article 9 sale of some or all of the intellectual property-related collateral of the Wellstat Diagnostics Guarantors. The Wellstat Diagnostics Guarantors did not respond to the Company's letter, but on March 17, 2017, filed an order to show cause with the Supreme Court of New York to enjoin the Company's sale of the real estate or enforcing its security interests in the Wellstat Diagnostics Guarantors' intellectual property during the pendency of any action involving the guarantees at issue. On February 6, 2018, the Supreme Court of New York issued an order from the bench which enjoins the Wellstat Diagnostics Guarantors from selling, encumbering, removing, transferring or altering the collateral pending the outcome of the proceedings before it. The Supreme Court of New York also issued an order precluding the Company from foreclosing on certain of the Wellstat Diagnostics Guarantors' collateral pending the outcome of the proceedings before it. In September of 2018, discovery in the New York action was completed. Summary judgment motions were filed by Wellstat Diagnostics and the Company in 2018 and a hearing was held on May 22, 2019. On September 11, 2019, the Supreme Court of New York granted the Company's summary judgment motion, the court holding that the guarantees executed by the Wellstat Diagnostics Guarantors are valid and enforceable, and that the Wellstat Diagnostics Guarantors are liable for the amount owed under the loan agreement. The court ordered a damages inquest before a special referee to calculate the amount owed under the loan agreement between Wellstat Diagnostics and the Company. On September 12, 2019, the Wellstat Diagnostics Guarantors filed a notice of appeal in relation to the court's decision. On September 17, 2019, the Wellstat Diagnostics Guarantors requested a stay of the enforcement of the New York Supreme Court's decision pending their appeal of the decision. The court is in the process of scheduling the hearing dates for the damages inquest.

In an unrelated litigation, Wellstat Therapeutics filed a lawsuit against BTG International, Inc. for breach of contract (the "BTG Litigation"). In September 2017, the Delaware Chancery Court found in favor of Wellstat Therapeutics and awarded a judgment of \$55.8 million in damages, plus interest. In October 2017, the Company filed a motion with the Supreme Court of New York requesting a pre-judgment attachment of the award. In June 2018, the Delaware Supreme Court largely affirmed the September 2017 decision of the Delaware Chancery Court, including the \$55.8 million awarded in judgment. In August of 2018, in a letter to the Company's counsel, Wellstat Guarantors' counsel confirmed that the Wellstat Guarantors are preserving the BTG Litigation judgment award proceeds consistent with the New York Court's prior directions.

On October 22, 2015, certain of the Wellstat Diagnostics Guarantors filed a separate complaint against the Company in the Supreme Court of New York seeking a declaratory judgment that certain contractual arrangements entered into between the parties subsequent to Wellstat Diagnostics' default, and which relate to a split of proceeds in the event that the Wellstat Diagnostics Guarantors voluntarily monetize any assets that are the Company's collateral, is of no force or effect. This case has been joined for all purposes, including discovery and trial, and consolidated with the pending case filed by the Company. The Wellstat Diagnostic Guarantors filed a summary judgment motion with regard to this case, which was also heard by the court at the hearing on May 22, 2019. The court, in its September 11, 2019 decision, denied in its entirety the Wellstat Diagnostics Guarantors' motion for summary judgment.

Effective April 1, 2014, and as a result of the event of default, the Company determined the loan to be impaired and it ceased to accrue interest revenue. At that time and as of September 30, 2019, it has been determined that an allowance on the carrying value of the note was not necessary, as the Company believes the value of the collateral securing Wellstat Diagnostics' obligations exceeds the carrying value of the asset and is sufficient to enable the Company to recover the current carrying value of \$50.2 million. The Company continues to closely monitor the timing and expected recovery of amounts due, including litigation and other matters related to Wellstat Diagnostics Guarantors' assets. There can be no assurance that an allowance on the carrying value of the notes receivable investment will not be necessary in a future period depending on future developments.

Hyperion Agreement

On January 27, 2012, the Company and Hyperion (which is also a Wellstat Diagnostics Guarantor) entered into an agreement whereby Hyperion sold to the Company the royalty streams accruing from January 1, 2012 through December 31, 2013 due from Showa Denko K.K. ("SDK") related to a certain patent license agreement between Hyperion and SDK dated December 31, 2008. In exchange for the lump sum payment to Hyperion of \$2.3 million, in addition to any royalties from SDK, the Company was to receive two equal payments of \$1.2 million on March 5, 2013 and March 5, 2014. The first payment of \$1.2 million was paid on March 5, 2013, but the second payment that was due on March 5, 2014 has not been made by Hyperion. Effective as of such date and as a result of the event of default, the Company ceased to accrue interest revenue. As of

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September 30, 2019, the estimated fair value of the collateral was determined to be in excess of the carrying value. There can be no assurance of realizing value from such collateral in the event of the Company's foreclosure on the collateral.

Avinger Credit and Royalty Agreement

On April 18, 2013, the Company entered into a credit agreement with Avinger, Inc. (the "Avinger Credit and Royalty Agreement"). Under the terms of the Avinger Credit and Royalty Agreement, the Company received a low, single-digit royalty on Avinger's net revenues until April 2018. Commencing in October 2015, after Avinger repaid \$21.4 million pursuant to its note payable to the Company prior to its maturity date, the royalty on Avinger's net revenues was reduced by 50%, subject to certain minimum payments from the prepayment date until April 18, 2018. The Company accounted for the royalty rights in accordance with the fair value option. As of April 18, 2018, there were no further obligations owed to the Company.

CareView Credit Agreement

On June 26, 2015, the Company entered into a credit agreement with CareView, under which the Company made available to CareView up to \$40.0 million in loans comprised of two tranches of \$20.0 million each, subject to CareView's attainment of specified milestones relating to the placement of CareView Systems. On October 7, 2015, the Company and CareView entered into an amendment of the credit agreement to modify certain definitions related to the first and second tranche milestones and the Company funded the first tranche of \$20.0 million, net of fees, based on CareView's attainment of the first milestone, as amended. The second \$20.0 million tranche was not funded due to CareView's failure to achieve the related funding milestones and there is no additional funding obligation due from the Company. Outstanding borrowings under the credit agreement bear interest at the rate of 13.5% per annum and are payable quarterly in arrears.

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

In connection with the October 2015 amendment of the credit agreement, the Company and CareView also agreed to amend the warrant to purchase common stock agreement by reducing the warrant's exercise price from \$0.45 to \$0.40 per share.

In February 2018, the Company entered into a modification agreement with CareView (the "February 2018 Modification Agreement") whereby the Company agreed, effective December 28, 2017, to modify the credit agreement before remedies could otherwise have become available to the Company under the credit agreement in relation to certain obligations of CareView that would potentially not be met, including the requirement to make principal payments. Under the February 2018 Modification Agreement, the Company agreed that (i) a lower liquidity covenant would be applicable and (ii) principal repayment would be delayed until December 31, 2018. In exchange for agreeing to these modifications, among other things, the exercise price of the Company's warrant to purchase 4.4 million shares of common stock of CareView was repriced from \$0.40 to \$0.03 per share and, subject to the occurrence of certain events, CareView agreed to grant the Company additional equity interests. As a result of the February 2018 Modification Agreement, the Company determined the loan to be impaired and it ceased to accrue interest revenue effective October 1, 2017.

In September 2018, the Company entered into an amendment to the February 2018 Modification Agreement with CareView whereby the Company agreed, effective as of September 28, 2018, that a lower liquidity covenant would be applicable. In December 2018, the Company further modified the loan by agreeing that (i) a lower liquidity covenant would be applicable, (ii) the first principal payment would be deferred until January 31, 2019, and (iii) the scheduled interest payment due December 31, 2018 would be deferred until January 31, 2019. In December 2018, and in consideration of the further modification to the credit agreement, the Company completed an impairment analysis and determined that the note was impaired and recorded an impairment loss of \$8.2 million. For additional information see Note 5, *Fair Value Measurements*. As of March 31, 2019, the principal repayment and interest payments were deferred until April 30, 2019. The principal repayment and interest payment were subsequently deferred until May 15, 2019. In May 2019, and in consideration of additional capital raised by CareView, the Company further modified the loan by agreeing that (i) the first principal and interest payments would be deferred until September 30, 2019 and (ii) the remaining liquidity covenant would be removed. In September 2019, the Company further modified the loan by agreeing that the first principal and interest payments would be deferred until November 30, 2019. As of September 30, 2019, the Company performed an analysis and determined that no additional impairment was required and estimated the fair value of the warrant to be less than \$0.1 million.

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7. Leases

Lessee arrangements

The Company has operating leases for corporate offices and certain equipment. The Company's operating leases have remaining lease terms ranging from one to seven years, some of which include options to extend the leases for up to five years, and some of which include options to terminate the leases within three years.

The components of lease expense are as follows:

<i>(in thousands)</i>	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
Operating lease cost	\$ 234	\$ 289	\$ 701	\$ 898
Short-term lease cost	53	13	97	37
Total lease cost	\$ 287	\$ 302	\$ 798	\$ 935

Supplemental cash flow information related to leases is as follows:

<i>(in thousands)</i>	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
Cash paid for amounts included in the measurement of lease liabilities:				
Operating cash flows from operating leases	\$ 235	\$ 289	\$ 685	\$ 898
Right-of-use-assets obtained in exchange for lease obligations:				
Operating leases	\$ —	N/A	\$ 2,111	N/A

N/A Not applicable

The following table presents the lease balances within the Condensed Consolidated Balance Sheet, weighted-average remaining lease term, and weighted-average discount rates related to the Company's operating leases (in thousands):

Operating Leases	Classification	September 30, 2019
Operating lease ROU assets	Other assets	\$ 1,439
Operating lease liabilities, current	Accrued liabilities	\$ 723
Operating lease liabilities, long-term	Other long-term liabilities	751
Total operating lease liabilities	Total operating lease liabilities	\$ 1,474
Weighted-average remaining lease term		1.75 years
Weighted-average discount rate		6%

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Maturities of operating lease liabilities as of September 30, 2019 are as follows (in thousands):

Fiscal Year	Amount
2019 (Remaining three months)	\$ 235
2020	833
2021	470
2022	—
2023	—
Thereafter	—
Total operating lease payments	1,538
Less: imputed interest	64
Total operating lease liabilities	\$ 1,474

Future minimum operating lease payments as of December 31, 2018 were as follows (in thousands):

Fiscal Year	Amount
2019	\$ 1,140
2020	1,003
2021	559
2022	—
2023	—
Thereafter	—
Total	\$ 2,702

As of September 30, 2019, the Company had no additional significant operating or finance leases that had not yet commenced.

Lessor arrangements

The Company has operating and sales-type leases for medical device equipment generated from its medical devices segment. The Company's leases have remaining lease terms of less than one year to five years, some of which include options to extend the leases on a month-to-month basis if the customer does not notify the Company of the intention to return the equipment at the end of the lease term. The Company typically does not offer options to terminate the leases before the end of the lease term.

The components of lease income are as follows:

<i>(in thousands)</i>	Classification	Three Months Ended		Nine Months Ended	
		September 30,		September 30,	
		2019	2018	2019	2018
Sales-type lease selling price	Product revenue, net	\$ 217	\$ 417	\$ 217	\$ 568
Cost of underlying asset		(34)	(208)	(34)	(266)
Operating profit		\$ 183	\$ 209	\$ 183	\$ 302
Interest income on the lease receivable	Interest and other income, net	\$ 12	\$ 12	\$ 38	\$ 37
Initial direct costs incurred	Operating expense	\$ (14)	\$ (23)	\$ (14)	\$ (31)
Operating lease Income	Product revenue, net	\$ 1,351	\$ 1,511	\$ 3,943	\$ 5,787

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Net investment in sales-type leases are as follows:

<i>(in thousands)</i>	Classification	September 30, 2019	December 31, 2018
Lease payment receivable, current	Accounts receivable, net and Notes receivable, current	\$ 468	\$ 533
Lease payment receivable, long-term	Notes receivable, long-term and Other assets	691	475
Total lease payment receivable		\$ 1,159	\$ 1,008

Equipment under lease is stated at cost less accumulated depreciation and is classified as "Property and equipment, net" on the Condensed Consolidated Balance Sheets. Depreciation is computed using the straight-line method over an estimated useful life of the greater of the lease term or five years to ten years. Equipment under lease is as follows:

<i>(in thousands)</i>	September 30, 2019	December 31, 2018
Equipment under lease	\$ 6,314	\$ 6,529
Less accumulated depreciation	(4,818)	(3,665)
Equipment under lease, net	\$ 1,496	\$ 2,864

Maturities of sales-type lease receivables as of September 30, 2019 are as follows (in thousands):

Fiscal Year	Amount
2019 (Remaining three months)	\$ 143
2020	475
2021	279
2022	230
2023	112
Thereafter	—
Total undiscounted cash flows	1,239
Present value of lease payments (recognized as lease receivables)	1,159
Difference between undiscounted and discounted cash flows	\$ 80

Maturities of operating lease receivables as of September 30, 2019 are as follows (in thousands):

Fiscal Year	Amount
2019 (Remaining three months)	\$ 697
2020	1,979
2021	895
2022	266
2023	81
Thereafter	—
Total undiscounted cash flows	\$ 3,918

8. Intangible Assets

Intangible Assets, Net

On June 8, 2018, Noden DAC entered into a Settlement Agreement (the “Settlement Agreement”) with Anchen Pharmaceuticals, Inc. and its affiliates (“Anchen”) to resolve the patent litigation relating to infringement of U.S. Patent No. 8,617,595 (the “595 Patent”) based on their submission of an Abbreviated New Drug Application (“ANDA”) seeking authorization from the FDA to market a generic version of aliskiren, the active ingredient in the Tekturna and Tekturna HCT drug. Under the Settlement Agreement, Anchen, the sole ANDA filer of which the Company is aware, agreed to not commercialize its generic version of aliskiren prior to March 1, 2019. Per the Settlement Agreement, Anchen may commercialize their formulation of aliskiren, but is not permitted to commercialize a copy of Tekturna.

Accordingly, management evaluated the ongoing value of the Noden DAC asset group based upon the probability of Anchen’s market entry of a generic version of aliskiren in the United States and the associated cash flows and conducted a test for impairment. Due to the increased probability of a generic version of aliskiren being launched in the United States, the Company revised its estimates of future cash flows and as a result of this analysis, determined that the sum of undiscounted cash flows was not greater than the carrying value of the assets. Therefore, the Company performed a discounted cash flow analysis to estimate the fair value of the asset group in accordance with ASC Topic 360, *Impairment or Disposal of Long-lived Assets*. The cash flows used in this analysis are those expected to be generated by market participants, discounted to reflect an appropriate amount of risk, which was determined to be 21%. The Company concluded that the Noden DAC acquired product rights and customer relationship long-lived assets, with a carrying amount of \$192.5 million, were no longer recoverable and wrote them down to their estimated fair value of \$40.1 million, resulting in an impairment charge of \$152.3 million in the second quarter of 2018. This write-down is included in “Impairment of intangible assets” in the Condensed Consolidated Statement of Operations and the Condensed Consolidated Statement of Cash Flows for the nine months ended September 30, 2018.

On March 4, 2019, the Company announced the U.S. commercial launch of an authorized generic form of Tekturna, with the same drug formulation as Tekturna. The Company performed an impairment assessment of the Noden asset group at this time by estimating the undiscounted future cash flows with respect to the asset and comparing the sum of these cash flows to the asset’s carrying value and concluded a further impairment was not required.

On March 22, 2019, the FDA approved Anchen’s generic form of aliskiren. The Company performed an impairment assessment of the Noden asset group at this time and concluded no further impairment was required.

Future events, such as FDA approval of additional generic forms of aliskiren, or pricing or market share pressure resulting from existing generic competition, may be further indicators of impairment which may require the Company to perform additional impairment testing.

In April 2019, LENSAR acquired certain intellectual property from a third-party for \$2.0 million in cash and obligations to pay a \$0.3 million milestone payment and royalties upon the completion of certain events.

In September 2019, LENSAR exclusively licensed certain intellectual property from a third-party for \$3.5 million in cash for use in research and development activities. The amount was immediately expensed and is included in Research and development expense in the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2019.

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The components of intangible assets as of September 30, 2019 and December 31, 2018 were as follows:

<i>(in thousands)</i>	September 30, 2019			December 31, 2018		
	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount	Gross Carrying Amount	Accumulated Amortization	Net Carrying Amount
Finite-lived intangible assets:						
Acquired products rights ⁽¹⁾	\$ 36,143	\$ (5,647)	\$ 30,496	\$ 36,143	\$ (2,258)	\$ 33,885
Customer relationships ^{(1) (2) (4)}	8,028	(1,420)	6,608	8,028	(782)	7,246
Acquired technology ^{(2) (3) (5)}	11,500	(1,549)	9,951	11,011	(1,203)	9,808
Acquired trademarks ⁽²⁾	570	(276)	294	570	(190)	380
	\$ 56,241	\$ (8,892)	\$ 47,349	\$ 55,752	\$ (4,433)	\$ 51,319

- ⁽¹⁾ The Company acquired certain intangible assets as part of the Noden transaction. They are being amortized on a straight-line basis over a weighted-average period of eight years.
- ⁽²⁾ The Company acquired certain intangible assets as part of its acquisition of LENSAR in May 2017. They are being amortized on a straight-line basis over a weighted-average period of 15 years. The intangible assets for customer relationships are being amortized using a double-declining method of amortization as such method better represents the economic benefits to be obtained.
- ⁽³⁾ The Company acquired certain intangible assets as part of the foreclosure on certain of Direct Flow Medical, Inc. (“DFM”) assets. In August 2019, the Company sold the DFM intangible assets for \$5.0 million in cash and a single-digit percentage of any net final award received as part of the acquirer’s monetization process using the intangible assets. Prior to the sale, these intangible assets were being amortized on a straight-line basis over a weighted-average period of 10 years.
- ⁽⁴⁾ LENSAR acquired certain intangible assets for customer relationships from Precision Eye Services, which are being amortized using a double-declining method over a period of 20 years.
- ⁽⁵⁾ LENSAR acquired certain intangible assets from a third-party, which are being amortized on a straight-line basis over a period of 15 years.

For the three and nine months ended September 30, 2019, amortization expense was \$1.6 million and \$4.7 million, respectively, and for the three and nine months ended September 30, 2018 amortization expense was \$1.6 million and \$14.3 million, respectively. The decline in the nine months ended September 30, 2019 as compared to the nine months ended September 30, 2018 is primarily due to the Noden DAC impairment described above.

Based on the intangible assets recorded at September 30, 2019, and assuming no subsequent additions to or impairment of the underlying assets, the remaining amortization expense is expected to be as follows (in thousands):

Fiscal Year	Amount
2019 (Remaining three months)	\$ 1,560
2020	6,213
2021	6,181
2022	6,076
2023	6,014
Thereafter	21,305
Total remaining amortization expense	\$ 47,349

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9. Accrued Liabilities

Accrued liabilities consist of the following:

<i>(in thousands)</i>	September 30, 2019	December 31, 2018
Accrued rebates, chargebacks and other revenue reserves	\$ 10,265	\$ 20,133
Deferred revenue	4,782	8,811
Compensation	5,750	4,468
Interest	1,375	344
Legal	740	623
Other	4,741	4,933
Total	\$ 27,653	\$ 39,312

The following table provides a summary of activity with respect to the Company's sales allowances and accruals for the nine months ended September 30, 2019:

<i>(in thousands)</i>	Discount and Distribution Fees	Government Rebates and Chargebacks	Assistance and Other Discounts	Product Returns	Total
Balance at December 31, 2018	\$ 3,094	\$ 8,901	\$ 3,457	\$ 4,681	\$ 20,133
Allowances for current period sales	4,122	10,020	4,194	1,317	19,653
Allowances for prior period sales	50	1,841	120	33	2,044
Credits/payments for current period sales	(1,944)	(7,401)	(3,105)	(263)	(12,713)
Credits/payments for prior period sales	(3,075)	(10,228)	(3,329)	(2,220)	(18,852)
Balance at September 30, 2019	<u>\$ 2,247</u>	<u>\$ 3,133</u>	<u>\$ 1,337</u>	<u>\$ 3,548</u>	<u>\$ 10,265</u>

10. Convertible Senior Notes

Description	Maturity Date	Principal Balance Outstanding	Carrying Value	
		September 30, 2019	September 30, 2019	December 31, 2018
<i>(in thousands)</i>				
Convertible Senior Notes				
December 2021 Notes	December 1, 2021	\$ 63,947	\$ 55,652	\$ 124,644
December 2024 Notes	December 1, 2024	86,053	\$ 76,832	—
Total		<u>\$ 150,000</u>	<u>\$ 132,484</u>	<u>\$ 124,644</u>

February 2018 Notes

On February 12, 2014, the Company issued \$300.0 million in aggregate principal amount, at par, of the 4.0% Convertible Senior Notes due February 1, 2018 (the "February 2018 Notes") in an underwritten public offering, for net proceeds of \$290.2 million. The February 2018 Notes were due February 1, 2018. In November 2015, \$53.6 million in aggregate principal amount of the February 2018 Notes were repurchased and in November 2016 an additional \$120.0 million in aggregate principal amount of the February 2018 Notes were repurchased in open market transactions. In connection with these repurchases, the Company unwound a corresponding portion of the purchased call options and warrants related to the notes.

On February 1, 2018, upon maturity of the February 2018 Notes, the Company repaid a total cash amount of \$129.0 million to the custodian, The Bank of New York Mellon Trust Company, N.A., which was comprised of \$126.4 million in principal amount and \$2.6 million in accrued interest, to retire the February 2018 Notes.

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

<i>(in thousands)</i>	Three Months Ended September 30, 2018	Nine Months Ended September 30, 2018
Contractual coupon interest	\$ —	\$ 421
Amortization of debt issuance costs	—	88
Amortization of debt discount	—	293
Total	<u>\$ —</u>	<u>\$ 802</u>

December 2021 Notes

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

In September 2019, the Company entered into privately negotiated exchange agreements with certain holders of approximately \$86.1 million aggregate principal amount of outstanding December 2021 Notes. The Company exchanged \$86.1 million aggregate principal of December 2021 Notes for an identical principal amount of 2.75% Convertible Senior Notes due December 1, 2024 (the "December 2024 Notes"), plus a cash payment of \$70.00 for each \$1,000 principal amount tendered ("Exchange Transaction"). See "December 2024 Notes" below. The terms of the remaining December 2021 Notes remained unchanged.

The Exchange Transaction qualified as a debt extinguishment and the Company recognized a loss on exchange of the convertible notes of \$3.9 million, which is included in Non-operating (expense) income, net in the Condensed Consolidated Statements of Operations for the three and nine months ended September 30, 2019.

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

The December 2021 Notes are convertible under any of the following circumstances at any time prior to the close of business on the business day immediately preceding June 1, 2021 (or at any time beginning on June 1, 2021 until the close of business on the second scheduled trading day immediately preceding the stated maturity):

- During any fiscal quarter (and only during such fiscal quarter) commencing after the fiscal quarter ended June 30, 2017, if the last reported sale price of Company common stock for at least 20 trading days (whether or not consecutive), in the period of 30 consecutive trading days, ending on, and including, the last trading day of the immediately preceding fiscal quarter, exceeds 130% of the conversion price for the notes on each applicable trading day;
- During the five business-day period immediately after any five consecutive trading-day period, which the Company refers to as the measurement period, in which the trading price per \$1,000 principal amount of notes for each trading day of that measurement period was less than 98% of the product of the last reported sale price of Company common stock and the conversion rate for the notes for each such trading day; or
- Upon the occurrence of specified corporate events as described in the December 2021 Notes Indenture.

The initial conversion rate for the December 2021 Notes is 262.2951 shares of the Company's common stock per \$1,000 principal amount of December 2021 Notes, which is equivalent to an initial conversion price of approximately \$3.81 per share

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of common stock, subject to adjustments upon the occurrence of certain specified events as set forth in the December 2021 Notes Indenture.

In accordance with the accounting guidance for convertible debt instruments that may be settled in cash or other assets on conversion, the Company was required to separately account for the liability component of the instrument in a manner that reflects the market interest rate for a similar nonconvertible instrument at the date of issuance. As a result, the Company separated the principal balance of the December 2021 Notes between the fair value of the debt component with the remainder of the consideration being allocated to the equity component. Using an assumed borrowing rate of 9.5%, which represented the estimated market interest rate for a similar nonconvertible instrument available to the Company on the date of issuance, the Company recorded a debt discount of \$4.3 million, allocated \$23.8 million to additional paid-in capital for the conversion feature and allocated \$12.8 million to deferred tax liability. The debt discount, including the conversion feature and issuance costs allocated to debt, which remained after amortization and the effect of the Exchange Transaction, is being amortized to interest expense over the term of the December 2021 Notes and increases interest expense during the term of the December 2021 Notes from the 2.75% cash coupon interest rate to an effective interest rate of 9.7%. As of September 30, 2019, the remaining discount amortization period is 2.2 years.

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

<i>(in thousands)</i>	September 30, 2019		December 31, 2018	
Principal amount of the December 2021 Notes	\$	63,947	\$	150,000
Unamortized discount of liability component		(8,295)		(25,356)
Net carrying value of the December 2021 Notes	\$	55,652	\$	124,644

Interest expense for the December 2021 Notes included in the Company's Condensed Consolidated Statements of Operations was as follows:

<i>(in thousands)</i>	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
Contractual coupon interest	\$ 939	\$ 1,031	\$ 3,002	\$ 3,095
Amortization of debt issuance costs	17	19	57	57
Amortization of debt discount	130	136	406	405
Amortization of conversion feature	1,692	1,680	5,252	4,903
Total	\$ 2,778	\$ 2,866	\$ 8,717	\$ 8,460

As of September 30, 2019, the December 2021 Notes are not convertible.

Capped Call Transaction

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

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transaction during the relevant valuation period under the capped call transaction, with such number of shares of the Company's common stock and/or amount of cash subject to the cap price.

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

In connection with the September 2019 Exchange Transaction, the Company unwound a portion of the capped call entered into when the December 2021 Notes were issued, as discussed below. The \$0.9 million proceeds from the unwind of the capped call, which reflected the value of the options outstanding at the time of the Exchange Transaction and the average share price of the Company's common stock were included as an increase to Additional paid-in capital within stockholders' equity.

December 2024 Notes

On September 17, 2019, the Company exchanged \$86.1 million aggregate principal of December 2021 Notes for an identical aggregate original principal amount of December 2024 Notes, plus a cash payment of \$70.00 for each \$1,000 principal amount exchanged, totaling approximately \$6.0 million. The December 2024 Notes are due December 1, 2024, and the Company pays interest at 2.75% on the December 2024 Notes semiannually in arrears on June 1 and December 1 of each year, beginning December 1, 2019. The original principal of the December 2024 Notes will accrete at a rate of 2.375% per year ("Accretion Interest") commencing September 17, 2019 through the maturity of the December 2024 Notes. The accreted principal amount of the December 2024 Notes is payable in cash upon maturity.

Upon the occurrence of a fundamental change, as defined in the indenture entered into in connection with the December 2024 Notes (the "December 2024 Notes Indenture"), holders have the option to require the Company to repurchase their December 2024 Notes at a purchase price equal to 100% of the accreted principal amount of such December 2024 Notes, plus accrued interest on the original principal amount thereon.

The December 2024 Notes are convertible under any of the following circumstances at any time prior to the close of business on the business day immediately preceding June 1, 2024 (or at any time beginning on June 1, 2024 until the close of business on the second scheduled trading day immediately preceding the stated maturity):

- During any fiscal quarter (and only during such fiscal quarter) commencing after the fiscal quarter ended December 31, 2019, if the last reported sale price of Company common stock for at least 20 trading days (whether or not consecutive), in the period of 30 consecutive trading days, ending on, and including, the last trading day of the immediately preceding fiscal quarter, exceeds 130% of the conversion price for the notes on each applicable trading day;
- During the five business-day period immediately after any five consecutive trading-day period, which the Company refers to as the measurement period, in which the trading price per \$1,000 original principal amount of notes for each trading day of that measurement period was less than 98% of the product of the last reported sale price of Company common stock and the conversion rate for the notes for each such trading day;
- Upon the occurrence of specified corporate events or upon a redemption of the notes, in each case as described in the December 2024 Notes Indenture; or
- On or after June 1, 2024, at the option of the holder prior to the second scheduled trading day preceding December 1, 2024.

In accordance with the terms of the December 2024 Notes Indenture, the Company has the right, but not the obligation, to redeem all or any portion of the December 2024 Notes that is equal to \$1,000 original principal amount or an integral multiple of \$1,000 prior to their scheduled maturity on a redemption date beginning on or after December 1, 2021 and on or before the 60th scheduled trading day before December 1, 2024, for a cash purchase price equal to the redemption price, but only if the last reported sale price of Company common stock exceeds 128% of the conversion price for the December 2024 Notes on (i) each of at least 20 trading Days (whether or not consecutive) during the 30 consecutive trading days ending on, and including, the trading day immediately before the redemption notice date for such redemption; and (ii) the trading day immediately before such redemption notice date. The redemption price for the December 2024 Notes called for redemption is equal to the then accreted principal amount of such December 2024 Notes plus accrued but unpaid interest on the original principal amount thereon. The calling of any December 2024 Notes for redemption will constitute a make-whole fundamental change with

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respect to such notes, entitling the holders who convert such December 2024 Notes called for redemption prior to the applicable redemption date to receive an increase in the applicable conversion rate, as described in the December 2024 Notes Indenture.

The initial conversion rate for the December 2024 Notes is 262.2951 shares of the Company's common stock per \$1,000 original principal amount of December 2024 Notes, which is equivalent to an initial conversion price of approximately \$3.81 per share of common stock, subject to adjustments upon the occurrence of certain specified events as set forth in the December 2024 Notes Indenture.

In accordance with the accounting guidance for an extinguishment of convertible debt instruments with a cash conversion feature, the Company was required to allocate the fair value of the consideration transferred between the liability component and the equity component. To calculate the fair value of the debt immediately prior to derecognition, the carrying value was recalculated in a manner that reflected the estimated market interest rate for a similar nonconvertible instrument at the date of issuance. Using an assumed borrowing rate of 7.05% the Company calculated the fair value of the debt representing the amount allocated to the liability component of the December 2024 Notes with the remainder of the consideration allocated to the equity conversion feature, to reflect the reacquisition of the embedded conversion option. The conversion feature together with the fees allocated to the debt are accounted for as a debt discount. As a result of the Exchange Transaction, the Company recorded a total debt discount of \$9.4 million, which included the cash conversion feature of \$8.1 million and the debt issuance fees of \$1.3 million, charged \$5.5 million to Additional paid-in capital and recorded \$1.2 million to deferred tax liability. The amount charged to Additional paid-in capital represents the difference between the consideration paid for the Exchange Transaction and the fair value of the debt prior to the extinguishment.

The Accretion Interest and debt discount, including the conversion feature and issuance costs allocated to debt, are being amortized to interest expense over the term of the December 2024 Notes which increases interest expense during the term of the December 2024 Notes from the 2.75% cash coupon interest rate to an effective interest rate of 7.5%. As of September 30, 2019, the remaining discount amortization period is 5.2 years.

The carrying value, accretion and unamortized discount of the December 2024 Notes were as follows:

<i>(in thousands)</i>	September 30, 2019	December 31, 2018
Principal amount of the December 2024 Notes	\$ 86,053	\$ —
Unamortized discount of liability component	(9,300)	—
Accretion Interest on outstanding principal	79	—
Net carrying value of the December 2024 Notes	<u>\$ 76,832</u>	<u>\$ —</u>

Interest expense for the December 2024 Notes included in the Company's Condensed Consolidated Statements of Operations was as follows:

<i>(in thousands)</i>	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
Contractual coupon interest	\$ 92	\$ —	\$ 92	\$ —
Accretion Interest on outstanding principal	79	—	79	—
Amortization of debt issuance costs	8	—	8	—
Amortization of conversion feature	54	—	54	—
Total	<u>\$ 233</u>	<u>\$ —</u>	<u>\$ 233</u>	<u>\$ —</u>

Capped Call Transaction

In connection with the offering of the December 2024 Notes, the Company entered into a privately-negotiated capped call transaction with an affiliate of the underwriter of such issuance. The aggregate cost of the capped call transaction was \$4.5 million. The capped call transaction is generally expected to reduce the potential dilution upon conversion of the December 2024 Notes and/or partially offset any cash payments the Company is required to make in excess of the principal amount of converted December 2024 Notes in the event that the market price per share of the Company's common stock, as measured

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under the terms of the capped call transaction, is greater than the strike price of the capped call transaction. This initially corresponds to the approximate \$3.81 per share conversion price of the December 2024 Notes and is subject to anti-dilution adjustments substantially similar to those applicable to the conversion rate of the December 2024 Notes. The cap price of the capped call transaction was initially \$4.88 per share and is subject to certain adjustments under the terms of the capped call transaction. The Company will not be required to make any cash payments to the option counterparty upon the exercise of the options that are a part of the capped call transaction, but the Company will be entitled to receive from it an aggregate amount of cash and/or number of shares of the Company's common stock, based on the settlement method election chosen for the related convertible senior notes, with a value equal to the amount by which the market price per share of the Company's common stock, as measured under the terms of the capped call transaction, is greater than the strike price of the capped call transaction during the relevant valuation period under the capped call transaction, with such number of shares of the Company's common stock and/or amount of cash subject to the cap price.

The Company evaluated the capped call transaction under authoritative accounting guidance and determined that it should be accounted for as separate transaction from the debt as it was entered into with a separate counterparty and does not relate to the same risk. The \$4.5 million premium for the capped call was classified as a reduction to Additional paid-in capital within stockholders' equity and will not be subject to recurring fair value measurement.

The net impact to the Company's stockholders' equity included in Additional paid-in capital related to the issuance of the Notes and capped call transactions was as follows:

<i>(in thousands)</i>	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
Conversion option adjustment	\$ 5,402	\$ —	\$ 5,402	\$ —
Net payments for capped call transactions	3,694	—	3,694	—
Deferred taxes	(1,217)	—	(1,217)	—
Issuance costs	134	—	134	—
Total	\$ 8,013	\$ —	\$ 8,013	\$ —

11. Other Long-Term Liabilities

Other long-term liabilities consist of the following:

<i>(in thousands)</i>	September 30,	December 31,
	2019	2018
Uncertain tax positions	\$ 32,829	\$ 31,706
Deferred tax liabilities	9,598	13,847
Accrued lease guarantee	10,700	10,700
Long-term incentive accrual	92	125
Other	1,082	465
Total	\$ 54,301	\$ 56,843

12. Commitments and Contingencies

Lease Guarantee

In connection with the spin-off (the "Spin-Off") by the Company of Facet Biotech Corporation ("Facet"), the Company entered into amendments to the leases for the Company's former facilities in Redwood City, California, under which Facet was added as a co-tenant, and a Co-Tenancy Agreement, under which Facet agreed to indemnify the Company for all matters related to the leases attributable to the period after the Spin-Off date. In April 2010, Abbott Laboratories acquired Facet and later renamed the entity AbbVie Biotherapeutics, Inc. ("AbbVie"). If AbbVie were to default under its lease obligations, the Company could be held liable by the landlord as a co-tenant and, thus, the Company has in substance guaranteed the payments under the lease

agreements for the Redwood City facilities. As of September 30, 2019, the total lease payments for the duration of the guarantee, which runs through December 2021, are approximately \$25.4 million.

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

The Company has recorded a liability of \$10.7 million on its Condensed Consolidated Balance Sheets as of September 30, 2019 and December 31, 2018, related to this guarantee. In future periods, the Company may adjust this liability for any changes in the ultimate outcome of this matter that are both probable and estimable.

Purchase Obligations

Noden DAC and Novartis entered into a supply agreement pursuant to which Novartis will manufacture and supply to Noden DAC a bulk tableted form of the Noden Products and active pharmaceutical ingredient ("API"). In May 2019, Noden DAC and Novartis entered into an amended supply agreement pursuant to which Novartis will supply to Noden DAC a bulk tableted form of the Noden Products through 2020 and API through June 2021. The supply agreement may be terminated by either party for material breach that remains uncured for a specified time period. Under the terms of the amended supply agreement, Noden DAC is committed to purchase certain quantities of bulk product and API that would amount to approximately \$82.7 million through June 2021, of which \$54.3 million is committed over the next twelve months, which are guaranteed by the Company. While the supply agreement provides that the parties will agree to reasonable accommodations with respect to changes in firm orders, the Company expects that Noden DAC will meet the requirements of the supply agreement, unless otherwise negotiated.

LENSAR entered into various supply agreements for the manufacture and supply of certain components. The supply agreements commit LENSAR to a minimum purchase obligation of approximately \$6.1 million over the next twelve months. LENSAR expects to meet these requirements.

Escrow Receivable

On April 1, 2014, the Company entered into a note purchase agreement with Accel 300, LLC ("Accel 300"), a wholly-owned subsidiary of kaléo, Inc. ("kaléo"), pursuant to which the Company acquired \$150.0 million of secured notes due 2029 (the "kaléo Note"). The kaléo Note was issued pursuant to an indenture between Accel 300 and U.S. Bank, National Association, as trustee, and was secured by 20% of net sales of its first approved product, Auvi-Q[®] (epinephrine auto-injection, USP) (known as Allerject[®] in Canada) and 10% of net sales of kaléo's second proprietary auto-injector based product, EVZIO (naloxone hydrochloride injection) (the "kaléo Revenue Interests"), and a pledge of kaléo's equity ownership in Accel 300. On September 21, 2017, the Company entered into an agreement (the "kaléo Note Sale Agreement") with MAMKangaroo Lender, LLC, a Delaware limited liability company (the kaléo Purchaser"), pursuant to which the Company sold its entire interest in the kaléo Note for an aggregate cash purchase price of \$141.7 million.

Pursuant to the terms of the kaléo Note Sale Agreement, \$1.4 million of the aggregate purchase price was deposited into an escrow account as a potential payment against certain contingencies. The escrow period ended on March 20, 2019 and the escrow agent released the entire \$1.4 million to the Company.

13. Stockholders' Equity

Stock Repurchase Program

On September 25, 2017, the Company announced that its board of directors authorized the repurchase of issued and outstanding shares of the Company's common stock having an aggregate value of up to \$25.0 million pursuant to a share repurchase program. The repurchases under the share repurchase program were made from time to time in the open market or in privately negotiated transactions and were funded from the Company's working capital. All shares of common stock repurchased under this share repurchase program were retired and restored to authorized but unissued shares of common stock. The Company

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repurchased 8.7 million shares of its common stock under the share repurchase program during the fiscal year ended December 31, 2018, for an aggregate purchase price of \$25.0 million, or an average cost of \$2.86 per share, including trading commissions.

On September 24, 2018, the Company announced that its board of directors authorized the repurchase of issued and outstanding shares of the Company's common stock having an aggregate value of up to \$100.0 million pursuant to a share repurchase program. The Company repurchased 22.4 million shares of its common stock under this share repurchase program during the nine months ended September 30, 2019, for an aggregate purchase price of \$74.5 million, or an average cost of \$3.33 per share, including trading commissions. Since the inception of this share repurchase program through September 30, 2019, the Company has repurchased 31.0 million shares for an aggregate purchase price of \$100.0 million, or an average cost of \$3.22 per share, including trading commissions. All shares of common stock repurchased under this share repurchase program were retired and restored to authorized but unissued shares of common stock. This program was completed in July 2019.

14. Stock-Based Compensation

The Company grants restricted stock awards and stock options pursuant to a stockholder approved stock-based incentive plan.

The following table summarizes the Company's stock option and restricted stock award activity during the nine months ended September 30, 2019:

<i>(in thousands, except per share amounts)</i>	Stock Options		Restricted Stock Awards	
	Number of Shares Outstanding	Weighted Average Exercise Price	Number of Shares Outstanding	Weighted Average Grant-date Fair Value Per Share
Balance at December 31, 2018	7,869	\$ 2.82	883	\$ 2.87
Granted	5,796	\$ 3.17	905	\$ 3.58
Exercised or vested	—	\$ —	(335)	\$ 2.69
Forfeited or canceled	(968)	\$ 3.30	(121)	\$ 3.17
Balance at September 30, 2019	12,697	\$ 3.13	1,332	\$ 3.37

15. Revenue from Contracts with Customers

Revenue

Nature of Goods and Services

The following is a description of principal activities - separated by reportable segments - from which the Company generates its revenue. For more detailed information about reportable segments, see Note 16, *Segment Information*.

Medical Devices

The Medical Devices segment principally generates revenue from the sale and lease of the LENSAR® Laser System, which may include equipment, PIDs or consumables, procedure licenses, training, installation, warranty and maintenance agreements.

For bundled packages, the Company accounts for individual products and services separately if they are distinct - i.e. if a product or service is separately identifiable from other items in the bundled package and if the customer can benefit from it on its own or with other resources that are readily available to the customer. The LENSAR® Laser System, standard warranty training and installation services are one performance obligation. All other elements are separate performance obligations. PIDs, procedure licenses, warranty and maintenance services are also sold on a stand-alone basis.

As the Company both sells and leases the LENSAR® Laser System, the consideration (including any discounts) is first allocated between lease and non-lease components and then allocated between the separate products and services based on their stand-alone selling prices. The stand-alone selling prices for the PIDs and procedure licenses are determined based on the prices at

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which the Company separately sells the PIDs and procedure licenses. The LENSAR® Laser System and warranty stand-alone selling prices are determined using the expected cost plus a margin approach.

For LENSAR® Laser System sales, the Company recognizes Product revenue when a customer takes possession of the system. This usually occurs after the customer signs a contract, LENSAR installs the system, and LENSAR performs the requisite training for use of the system. For LENSAR® Laser System leases, the Company recognized Product revenue over the length of the lease in accordance with ASC Topic 840, *Leases*, through December 31, 2018 and recognized Product revenue in accordance with ASC Topic 842, *Leases*, after January 1, 2019. For additional information regarding accounting for leases, see *Note 7, Leases*.

The LENSAR® Laser System requires both a consumable and a procedure license to perform each procedure. The Company recognizes Product revenue for PIDs when the customer takes possession of the PID. PIDs are sold by the case. The Company recognizes Product revenue for procedure licenses when a customer purchases a procedure license from the web portal. Typically, consideration for PIDs and procedure licenses is considered fixed consideration except for certain customer agreements that provide for tiered volume discount pricing which is considered variable consideration.

The Company offers an extended warranty that provides additional services beyond the standard warranty. The Company recognizes Product revenue from the sale of extended warranties over the warranty period. Customers have the option of renewing the warranty period, which is considered a new and separate contract.

Pharmaceutical

The Company's Pharmaceutical segment consists of revenue derived from the Noden Products.

The agreement between Novartis and Noden DAC provides for various transition periods for development and commercialization activities relating to the Noden Products. Initially, Novartis distributed the Noden Products on behalf of Noden DAC worldwide and Noden DAC received a profit transfer on such sales. Generally, the profit transfer to Noden DAC was defined as gross revenues less product cost and a low single-digit percentage fee to Novartis. The profit transfer terminated upon the transfer of the marketing authorization from Novartis to Noden DAC in each country. In the United States, the duration of the profit transfer ran from July 1, 2016 through October 4, 2016. Outside the United States, the profit transfer ended in the first quarter of 2018.

Prior to the transfer of the marketing authorization, revenue was presented on a "net" basis; after the transfer of the marketing authorization, revenue is presented on a "gross" basis, meaning product costs are reported separately and there is no fee to Novartis. Except for the sales outside of the United States preceding the final profit transfer that occurred in the first quarter of 2018, revenues of the Noden Products for the periods herein are presented on a gross basis.

Noden USA launched an authorized generic of Tekturna in the United States in March 2019.

The Pharmaceutical segment principally generates revenue from products sold to wholesalers and distributors. Customer orders are generally fulfilled within a few days of receipt resulting in minimal order backlog. Contractual performance obligations are usually limited to transfer of the product to the customer. The transfer occurs either upon shipment or upon receipt of the product in certain countries outside the United States after considering when the customer obtains control of the product. In addition, in some countries outside of the United States, the Company sells product on a consignment basis where control is not transferred until the customer resells the product to an end user. At these points, customers are able to direct the use of and obtain substantially all of the remaining benefits of the product.

Sales to customers are initially invoiced at contractual list prices. Payment terms are typically 30 to 90 days based on customary practice in each country. Revenue is reduced from the list price at the time of recognition for expected chargebacks, discounts, rebates, sales allowances and product returns, which are collectively referred to as gross-to-net adjustments. These reductions are attributed to various commercial agreements, managed healthcare organizations and government programs such as Medicare, Medicaid, and the 340B Drug Pricing Program containing various pricing implications such as mandatory discounts, pricing protection below wholesaler list price and other discounts when Medicare Part D beneficiaries are in the coverage gap. These various reductions in the transaction price have been estimated using either a most likely amount, in the case of prompt pay discounts, or expected value method for all other variable consideration and have been reflected as liabilities and are settled through cash payments, typically within time periods ranging from a few months to one year. Significant judgment is required

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in estimating gross-to-net adjustments considering legal interpretations of applicable laws and regulations, historical experience, payer channel mix, current contract prices under applicable programs, unbilled claims, processing time lags and inventory levels in the distribution channel.

For licenses that are bundled with other promises, the Company utilizes judgment to assess the nature of the combined performance obligation to determine whether the combined performance obligation is satisfied over time or at a point in time and, if over time, the appropriate method of measuring progress for purposes of recognizing revenue from non-refundable, up-front license fees. The Company evaluates the measure of progress each reporting period and, if necessary, adjust the measure of performance and related revenue recognition.

Income Generating Assets

For licenses of intellectual property, if the license to the Company's intellectual property is determined to be distinct from the other performance obligations identified in the arrangement, the Company recognizes revenues from non-refundable, up-front fees allocated to the license when the license is transferred to the customer and the customer is able to use and benefit from the license.

In January 2018, DFM, LLC, a wholly-owned subsidiary of the Company, granted an exclusive license related to certain Direct Flow Medical, Inc. assets in exchange for \$0.5 million in cash and up to \$2.0 million in royalty payments. The \$0.5 million payment was accounted for in accordance with ASC 606 under which the full cash payment was recognized as revenue in the first quarter of 2018 as DFM, LLC had fulfilled its performance obligation under the agreement. In September 2019, the remaining assets of DFM, LLC were sold for \$5.0 million.

Disaggregation of Revenue

The Company disaggregates its revenue from contracts with customers by segment and geographic location as the Company believes it best depicts how the nature, amount, timing and uncertainty of its revenue and cash flows are affected by economic factors. In the following table, revenue is disaggregated by segment and primary geographical market for the three and nine months ended September 30, 2019 and 2018:

<i>(in thousands)</i>	Three Months Ended September 30, 2019		Three Months Ended September 30, 2018	
	Medical Devices	Pharmaceutical	Medical Devices	Pharmaceutical
Primary geographical markets:				
North America	\$ 2,779	\$ 6,119	\$ 2,315	\$ 10,036
Europe	699	5,496	565	5,810
Asia	3,178	654	2,158	1,926
Other	68	—	65	—
Total revenue from contracts with customers ⁽¹⁾	<u>\$ 6,724</u>	<u>\$ 12,269</u>	<u>\$ 5,103</u>	<u>\$ 17,772</u>

<i>(in thousands)</i>	Nine Months Ended September 30, 2019		Nine Months Ended September 30, 2018	
	Medical Devices	Pharmaceutical	Medical Devices	Pharmaceutical
Primary geographical markets:				
North America	\$ 7,066	\$ 21,295	\$ 4,634	\$ 31,743
Europe	2,421	16,532	1,859	18,172
Asia	8,540	4,817	4,915	12,078
Other	253	—	285	—
Total revenue from contracts with customers ⁽¹⁾	<u>\$ 18,280</u>	<u>\$ 42,644</u>	<u>\$ 11,693</u>	<u>\$ 61,993</u>

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⁽¹⁾ The tables above do not include lease revenue from the Company's Medical Devices segment. For the three-month periods ended September 30, 2019 and 2018, revenue accounted for under Topic 842 and 840, Leases, was \$1.3 million and \$1.5 million, respectively and for the nine-month periods ended September 30, 2019 and 2018 was \$3.9 million and \$5.8 million, respectively. For additional information, see Note 7, *Leases*.

Contract Balances

The following table provides information about receivables, contract assets and contract liabilities from contracts with customers:

<i>(in thousands)</i>	September 30, 2019		December 31, 2018	
Receivables, net	\$	12,581	\$	20,655
Contract assets	\$	3,849	\$	2,595
Contract liabilities	\$	4,901	\$	8,938

Receivables, Net—Receivables, net, include amounts billed and due from customers. The amounts due are stated at their net estimated realizable value and are classified as current or noncurrent based on the timing of when the Company expects to receive payment. The Company maintains an allowance for doubtful accounts to provide for the estimated amount of receivables that will not be collected. The allowance is based upon an assessment of customer creditworthiness, historical payment experience, the age of outstanding receivables and collateral to the extent applicable.

Contract assets—The Company's contract assets represent revenue recognized for performance obligations completed before an unconditional right to payment exists, and therefore invoicing or associated reporting from the customer regarding the computation of the net product sales has not yet occurred. The Company classifies contract assets in Prepaid and other current assets in the Company's Condensed Consolidated Balance Sheets based on the timing of when it expects to receive payment.

<i>(in thousands)</i>	Medical Devices		Pharmaceutical		Total	
Contract assets at December 31, 2018	\$	—	\$	2,595	\$	2,595
Contract assets recognized		—		(6,631)		(6,631)
Payments received		—		7,885		7,885
Contract assets at September 30, 2019	\$	—	\$	3,849	\$	3,849

Contract Liabilities—The Company's contract liabilities consist of deferred revenue for products sold to customers for which the performance obligation has not been completed by the Company. The Company classifies deferred revenue as current or noncurrent based on the timing of when it expects to recognize revenue. The noncurrent portion of deferred revenue is included in Other long-term liabilities in the Company's Condensed Consolidated Balance Sheets.

<i>(in thousands)</i>	Medical Devices		Pharmaceutical		Total	
Contract liabilities at December 31, 2018	\$	1,167	\$	7,771	\$	8,938
Contract liabilities recognized		788		2,903		3,691
Amounts recognized into revenue		(841)		(6,887)		(7,728)
Contract liabilities at September 30, 2019	\$	1,114	\$	3,787	\$	4,901

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Transaction Price Allocated to Future Performance Obligations

The following table includes estimated revenue expected to be recognized in the future related to performance obligations that are unsatisfied (or partially unsatisfied) at the end of the reporting period.

<i>(in thousands)</i>	Three Months Ended		Thereafter	Total
	December 31, 2019			
Medical device sales	\$	1,484	\$ 9,444	\$ 10,928
Pharmaceutical product sales	\$	58	\$ 2,326	\$ 2,384

The Company does not disclose the value of unsatisfied performance obligations for (i) contracts with original expected lengths of one year or less or (ii) contracts for which the Company recognizes revenue at the amount to which it has the right to invoice for the products delivered or services performed.

16. Segment Information

In connection with its investment in Evofem in the second quarter of 2019, the Company added a fourth reportable segment, "Strategic Positions."

Information regarding the Company's segments for the three and nine months ended September 30, 2019 and 2018 is as follows:

Revenues by segment

<i>(in thousands)</i>	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
Medical Devices	\$ 8,076	\$ 6,615	\$ 22,224	\$ 17,479
Strategic Positions	—	—	—	—
Pharmaceutical	12,269	17,772	42,644	61,993
Income Generating Assets	23,820	43,511	(4,316)	73,519
Total revenues	<u>\$ 44,165</u>	<u>\$ 67,898</u>	<u>\$ 60,552</u>	<u>\$ 152,991</u>

(Loss) income by segment

<i>(in thousands)</i>	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
Medical Devices	\$ (3,323)	\$ (934)	\$ (6,216)	\$ (3,425)
Strategic Positions	(4,738)	—	14,306	—
Pharmaceutical	(2,123)	4,132	3,177	(108,916)
Income Generating Assets	(7,600)	22,358	(26,790)	27,203
Total net (loss) income	<u>\$ (17,784)</u>	<u>\$ 25,556</u>	<u>\$ (15,523)</u>	<u>\$ (85,138)</u>

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NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS - (Continued)
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Information regarding the Company's segments as of September 30, 2019 and December 31, 2018 is as follows:

Long-lived assets by segment

<i>(in thousands)</i>	September 30, 2019	December 31, 2018
Medical Devices	\$ 2,387	\$ 3,545
Strategic Positions	—	—
Pharmaceutical	4,051	3,682
Income Generating Assets	138	160
Total long-lived assets	\$ 6,576	\$ 7,387

The operations for the Medical Devices segment are primarily located in the United States and the operations for the Pharmaceutical segment are primarily located in Italy, Ireland and the United States.

17. Concentration of Credit Risk

Product Line Concentration

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

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2019	2018	2019⁽¹⁾	2018
LENSAR	18%	10%	19%	11%
Noden	27%	26%	36%	41%
Assertio	55%	72%	45%	43%

⁽¹⁾ For the nine months ended September 30, 2019, the AcclRx royalty asset decrease in fair value of \$57.7 million, is excluded from total revenue when calculating product line concentration.

18. Income Taxes

Income tax (benefit) expense for the three months ended September 30, 2019 and 2018, was \$(1.9) million and \$9.9 million, respectively, and for the nine months ended September 30, 2019 and 2018, was \$(0.4) million and \$(3.3) million, respectively, which resulted primarily from applying the federal statutory income tax rate to income before income taxes. The Company's effective tax rate for the current period differs from the U.S. federal statutory rate of 21% due primarily to the effect of state income taxes, non-deductible executive compensation and the foreign tax rate differential associated with the Company's Noden DAC operations in Ireland.

The uncertain tax positions did not change during the three or nine months ended September 30, 2019 and 2018.

The Company's income tax returns are subject to examination by U.S. federal, foreign, state and local tax authorities for tax years 2000 forward. The Company is currently under audit by the California Franchise Tax Board (the "CFTB") for the tax years 2009 through 2015 and the Internal Revenue Service (the "IRS") for the tax year 2016. The timing of the resolutions to these audits and the amount to be ultimately paid, if any, is uncertain. The outcome of these audits could result in the payment of tax amounts that differ from the amounts the Company has reserved for uncertain tax positions for the periods under audit resulting in incremental expense or a reversal of the Company's reserves in a future period. At this time, the Company does not anticipate a material change in the unrecognized tax benefits related to the CFTB or IRS audits that would affect the effective tax rate or deferred tax assets over the next 12 months.

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19. Net (Loss) Income per Share

Net (Loss) Income per Basic and Diluted Share	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
<i>(in thousands, except per share amounts)</i>	2019	2018	2019	2018
Numerator				
(Loss) income attributable to PDL's shareholders used to compute net (loss) income per basic and diluted share	\$ (17,784)	\$ 25,556	\$ (15,523)	\$ (85,138)
Denominator				
Total weighted-average shares used to compute net (loss) income attributable to PDL's shareholders, per basic share	112,986	143,171	119,966	147,159
Restricted stock	—	1,053	—	—
Shares used to compute net (loss) income attributable to PDL's shareholders, per diluted share	112,986	144,224	119,966	147,159
Net (loss) income attributable to PDL's shareholders per share - basic	\$ (0.16)	\$ 0.18	\$ (0.13)	\$ (0.58)
Net (loss) income attributable to PDL's shareholders per share - diluted	\$ (0.16)	\$ 0.18	\$ (0.13)	\$ (0.58)

The Company computes net (loss) 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 (loss) income per diluted share include shares that may be issued pursuant to outstanding stock options and restricted stock awards in each case, on a weighted-average basis for the period they were outstanding, including, if applicable, the underlying shares using the treasury stock method.

The February 2018 Notes that were repaid on February 1, 2018, the December 2021 Notes and the December 2024 Notes allow, or previously allowed, for the settlement entirely or partially in cash, and are accounted for under the treasury stock method. Under the treasury stock method, the shares issuable upon conversion of the notes are not included in the calculation of diluted earnings per share except to the extent that the conversion value of the notes exceeds their principal amount. The effect of which, for diluted earnings per share purposes, is that only the number of shares of common stock that would be necessary to settle such excess, if we elected to settle such excess in shares, are included in the computation.

December 2021 Notes and December 2024 Notes Capped Call Potential Dilution

In November 2016, the Company issued \$150.0 million in aggregate principal of the December 2021 Notes. The Company entered into an Exchange Transaction in September 2019 through which it exchanged a portion of the December 2021 Notes for the December 2024 Notes with a later maturity of December 2024. Both the notes that mature in December 2021 and those that mature in December 2024 provide in certain situations for the conversion of the outstanding principal amount into shares of the Company's common stock at a predefined conversion rate. In conjunction with the issuance of the December 2021 Notes and the issuance of the December 2024 Notes pursuant to the Exchange Transaction, the Company entered into capped call transactions with a hedge counterparty. The capped call transactions are expected generally to reduce the potential dilution, and/or offset, to an extent, the cash payments the Company may choose to make in excess of the principal amount, upon conversion of the December 2021 Notes or the December 2024 Notes. The Company has excluded the capped call transaction from the net (loss) income per diluted share computation as such securities would have an anti-dilutive effect and those securities should be considered separately rather than in the aggregate in determining whether their effect on net (loss) income per diluted share would be dilutive or anti-dilutive. For additional information regarding the conversion rates and the capped call transaction related to the Company's December 2021 Notes and December 2024 Notes, see Note 10, *Convertible Senior Notes*.

Anti-Dilutive Effect of Restricted Stock Awards and Stock Options

For the three months ended September 30, 2019 and 2018, the Company excluded approximately 1.0 million and 1.3 million shares underlying restricted stock awards, respectively, and for the nine months ended September 30, 2019 and 2018, the Company excluded approximately 0.8 million and 2.3 million shares underlying restricted stock awards, respectively, in each

case calculated on a weighted-average basis, from its net (loss) income per diluted share calculations because their effect was anti-dilutive.

For the three months ended September 30, 2019 and 2018, the Company excluded approximately 12.6 million and 7.6 million shares underlying outstanding stock options, respectively, and for the nine months ended September 30, 2019 and 2018, the Company excluded approximately 10.7 million and 7.6 million shares underlying outstanding stock options, respectively, in each case calculated on a weighted-average basis, from its net (loss) income per diluted share calculations because their effect was anti-dilutive.

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

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

OVERVIEW

We seek to provide a significant return for our stockholders by entering into strategic transactions involving innovative late clinical-stage or early commercial-stage therapeutics with attractive revenue growth potential. Our leadership team has extensive experience in acquiring, commercializing and managing the life cycle of therapeutic products domestically and internationally across a number of indications and modalities. We intend to leverage this experience by pursuing the acquisition, growth and potential monetization of pharmaceutical products and companies.

Historically, we generated a substantial portion of our revenues through the license agreements related to patents covering the humanization of antibodies, which we refer to as the Queen et al. patents. In 2012, we began providing alternative sources of capital through royalty monetizations and debt facilities, and, in 2016, we began acquiring commercial-stage products and launching specialized companies dedicated to the commercialization of these products. As a result of the nature of these investments and how they are managed, we structured our operations in three segments designated as Medical Devices, Pharmaceutical and Income Generating Assets.

On April 10, 2019, we entered into a securities purchase agreement with Evofem Biosciences, Inc. ("Evofem"), pursuant to which we invested \$60 million in a private placement of securities. The transaction was structured in two tranches. The first tranche comprised \$30 million, which was funded on April 11, 2019. We had the right to invest an additional \$30 million in a second tranche, which we did on June 10, 2019, alongside two existing Evofem shareholders, who each invested an additional \$10 million. These investments are expected to provide funding for Evofem's pre-commercial activities for Amphora[®], its investigational, non-hormonal, on-demand prescription contraceptive gel for women. After completing the second tranche, we obtained the right to appoint one member to Evofem's Board of Directors and a limited right to have one non-voting observer

participate in Evofem board meetings. We believe this investment provides us the ability to take a significant position in a promising company at a critical stage of development where we can provide meaningful contributions through our capital and expertise. As a result of this investment we established a fourth segment, “Strategic Positions.”

Prospectively, we will continue to evaluate additional opportunities. We are targeting pharmaceutical products and companies focused on the U.S. market. We are open to various forms of transactions: acquisitions, licensing, joint-ventures or significant equity positions, but it is important to us to be able to be actively engaged in the management of these assets. With our expected focus on consummating strategic transactions involving late clinical-stage or early commercial-stage therapeutics with attractive revenue growth potential, we anticipate, that over time, more of our revenues will come from our Pharmaceutical segment and Medical Devices segments and, and less of our revenues will come from our Income Generating Assets segment.

Our Medical Devices segment consists of revenue from the sale and lease of the LENSAR[®] Laser System, which may include equipment, Patient Interface Devices (“PIDs”), procedure licenses, training, installation, warranty and maintenance agreements.

Our Strategic Positions segment consists of an investment in Evofem. Our investment includes shares of common stock and warrants to purchase additional shares of common stock. Evofem is a pre-commercial company and, as such, is not yet engaged in revenue-generating activities.

Our Pharmaceutical segment consists of revenue derived from branded prescription medicine products sold under the name Tekturna[®] and Tekturna HCT[®] in the United States, Rasilez[®] and Rasilez HCT[®] in the rest of the world and revenue generated from the sale of an authorized generic of Tekturna in the United States (collectively, the “Noden Products”).

Our Income Generating Assets segment consists of revenue derived from (i) notes and other long-term receivables, (ii) royalty rights and hybrid notes/royalty receivables, (iii) equity investments and (iv) royalties from issued patents in the United States and elsewhere covering the humanization of antibodies, which we refer to as the Queen et al. patents.

Medical Devices

LENSAR

LENSAR is a medical device company focused on delivering next generation femtosecond cataract laser technology used for refractive cataract surgery. Femtosecond cataract surgery uses advanced imaging and laser technology to customize planning and treatments to allow faster visual recovery and improved outcomes, as compared to conventional cataract surgery. LENSAR has developed the LENSAR[®] Laser System, which is the only femtosecond cataract laser built specifically for refractive cataract surgery. LENSAR has over 85 granted patents in the United States and the rest of the world and over 60 pending patent applications in the United States and rest of the world.

Cataract surgery is the highest volume surgical procedure performed worldwide with 29 million surgeries projected in 2019, the majority of which use conventional phacoemulsification techniques. LENSAR is currently focusing its research and development efforts on an integrated workstation to include the LENSAR[®] Laser System and phacoemulsification system in a greatly reduced footprint. LENSAR’s recent acquisitions of certain intellectual property uniquely position LENSAR to develop a system that can perform all cataract surgeries in a single platform.

The LENSAR[®] Laser System offers cataract surgeons automation and customization for their astigmatism treatment planning and other essential steps of the refractive cataract surgery procedure with the highest levels of precision, accuracy, and efficiency. These features assist surgeons in managing their astigmatism treatment plans for optimal overall visual outcomes.

The LENSAR[®] Laser System has been approved by the FDA for anterior capsulotomy, lens fragmentation, corneal and arcuate incisions. The LENSAR Laser with Augmented Reality[™] provides an accurate 3-D model of the relevant anatomical features of each patient’s anterior segment, allowing precise laser delivery and to enhance the surgical confidence in performing accurate corneal incisions, precise size, shape and location of free-floating capsulotomies, and efficient lens fragmentation for all grades of cataracts. The LENSAR[®] Laser System - fs 3D (LLS-fs 3D) with Streamline[™] includes the integration with multiple pre-operative diagnostic devices, utilizing automated Iris Registration with automatic cyclorotation adjustment. IntelliAxis-C[™] (corneal) and IntelliAxis-L[™] (lens capsule) markers provide the surgeon tools for simple and precise alignment without errors associated with manually marking the eye for incisions and implantation of Toric IOLs as well as treatment planning tools for precision guided laser treatments. The corneal incision-only mode, expanded remote diagnostics

capabilities, additional pre-programmable preferences, thoughtful ergonomics, and up to 20 seconds faster laser treatment times with Streamline allow for seamless integration and maximum surgical efficiency.

Strategic Positions

Evoform

As described above, in the second quarter of 2019, we invested \$60.0 million in Evoform, representing approximately a 29% ownership interest in the company. In connection with this investment, we appointed one board member and one observer to Evoform's board of directors. Evoform is a clinical-stage biopharmaceutical company committed to developing and commercializing innovative products to address unmet needs in women's sexual and reproductive health. Evoform is leveraging its proprietary Multipurpose Vaginal pH Regulator (MVP-R™) platform to develop Amphora® (L-lactic acid, citric acid and potassium bitartrate) for hormone-free birth control. Evoform plans to resubmit the Amphora New Drug Application for prevention of pregnancy in the fourth quarter of 2019.

Pharmaceutical

Our goal is to deliver shareholder value through the acquisition, growth and potential monetization of a portfolio of actively managed pharmaceutical assets. We are focused on investing in late clinical-stage or early commercial-stage pharmaceutical products and companies with attractive revenue growth potential. Our acquisition strategy focuses on our ability to add value to these assets by giving them access to our capital and commercialization expertise. We have a leadership team with a proven track record of consummating deals and putting businesses on the path to growth and profitability, and we have a strong, liquid balance sheet that can be deployed to finance the right transactions. Our goal is to build growing, profitable revenues from a balanced portfolio of operating companies' cash flows and, when appropriate, to capture further market value through optimally timed exit strategies.

Noden

On July 1, 2016, our subsidiary, Noden Pharma DAC, entered into an asset purchase agreement ("Noden Purchase Agreement") whereby it purchased from Novartis Pharma AG ("Novartis") the exclusive worldwide rights to manufacture, market, and sell the Noden Products and certain related assets and assumed certain related liabilities (the "Noden Transaction"). Noden Pharma DAC and Noden Pharma USA, Inc., together, and including their respective subsidiaries represent deployed capital of \$191.2 million.

Tekturma (or Rasilez outside of the United States) contains aliskiren, a direct renin inhibitor, for the treatment of hypertension. While indicated as a first line treatment, it is more commonly used as a third line treatment in those patients who are intolerant of angiotensin-receptor blockers ("ARBs") or angiotensin converting enzyme inhibitors ("ACEIs"). Studies indicate that approximately 12% of hypertension patients are ARB/ACEI inhibitor-intolerant. It is not indicated for use with ARBs and ACEIs in patients with diabetes or renal impairment and is contraindicated for use by pregnant women. On March 4, 2019, we announced the U.S. commercial launch of an authorized generic ("AG") form of Tekturma, aliskiren hemifumarate 150 mg and 300 mg tablets with the same drug formulation as Tekturma. The AG launch is being carried out by Prasco, LLC d/b/a Prasco Laboratories.

Tekturma HCT is a combination of aliskiren and hydrochlorothiazide, a diuretic, for the treatment of hypertension in patients not adequately controlled by monotherapy and as an initial therapy in patients likely to need multiple drugs to achieve their blood pressure goals. It is not indicated for use with ACEIs and ARBs in patient with diabetes or renal impairment, or for use in patients with known anuria or hypersensitivity to sulfonamide derived drugs and is contraindicated for use by pregnant women.

The Noden Products are protected by multiple patents worldwide, which specifically cover the composition of matter, the pharmaceutical formulations and methods of production. In the United States, the FDA Orange Book lists one patent, U.S. patent No. 5,559,111 (the "'111 Patent"), which covers compositions of matter comprising aliskiren. The '111 Patent expired on January 21, 2019, and was previously extended for six months through a pediatric extension. In addition, the Food and Drug Administration (the "FDA") Orange Book for Tekturma lists U.S. Patent No. 8,617,595, which covers certain compositions comprising aliskiren, together with other formulation components, and will expire on February 19, 2026. The FDA Orange Book for Tekturma HCT lists U.S. patent No. 8,618,172, which covers certain compositions comprising aliskiren, together with other formulation components, and will expire on July 13, 2028. In Europe, European patent No. 678 503B (the "'503B

Patent”) expired in 2015. However, numerous Supplementary Protection Certificates (“SPCs”) have been granted which are based on the ‘503B Patent and which will provide for extended protection. These SPCs generally expire in April of 2020.

The agreement between Novartis and Noden provides for various transition periods for development and commercialization activities relating to the Noden Products. Initially, Novartis distributed the Noden Products on behalf of Noden worldwide and Noden received a profit transfer on such sales. Generally, the profit transfer to Noden was defined as gross revenues less product cost and a low single-digit percentage fee to Novartis. The profit transfer terminated upon the transfer of the marketing authorization from Novartis to Noden in each country. In the United States, the duration of the profit transfer ran from July 1, 2016 through October 4, 2016. Outside the United States, the profit transfer ended in the first quarter of 2018.

Prior to the transfer of the marketing authorization, revenue was presented on a “net” basis; after the transfer of the marketing authorization, revenue is presented on a “gross” basis, meaning product costs are reported separately and there is no fee to Novartis. Except for the sales outside of the United States preceding the final profit transfer that occurred in the first quarter of 2018, revenues of the Noden Products for the periods herein are presented on a gross basis.

Income Generating Assets

We have pursued income generating assets when such assets could be acquired on terms that we believed would allow us to increase return to our stockholders. The income generating assets typically consisted of (i) notes and other long-term receivables, (ii) royalty rights and hybrid notes/royalty receivables, (iii) equity investments and (iv) royalties from the Queen et. al patents. We previously focused our income generating asset acquisition strategy on commercial-stage therapies and medical devices having strong economic fundamentals. We have consummated fifteen transactions in this segment, seven of which are active and outstanding:

Investment	Investment Type	Deployed Capital ⁽³⁾ (in millions)
Assertio ⁽¹⁾	Royalty	\$ 260.5
The Regents of the University of Michigan (“U-M”)	Royalty	\$ 65.6
AcelRx Pharmaceuticals, Inc. (“AcelRx”)	Royalty	\$ 65.0
Viscogliosi Brothers, LLC (“VB”)	Royalty	\$ 15.5
KYBELLA [®]	Royalty	\$ 9.5
CareView Communications, Inc. (“CareView”)	Debt	\$ 20.0
Wellstat Diagnostics ⁽²⁾	Royalty/debt hybrid	\$ 44.0

⁽¹⁾ Assertio Therapeutics, Inc., formerly Depomed, Inc.

⁽²⁾ Wellstat Diagnostics, LLC (also known as Defined Diagnostic, LLC) (“Wellstat Diagnostics”).

⁽³⁾ Excludes transaction costs.

Royalty Rights - At Fair Value

We have entered into various royalty purchase agreements with counterparties, whereby the counterparty conveys to us the right to receive royalties that are typically payable on sales revenue generated by the sale, distribution or other use of the counterparties’ products.

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

While we currently maintain this portfolio of royalty rights, our intention is to no longer pursue these transactions while we focus on acquiring additional pharmaceutical products or companies. At September 30, 2019, we had a total of five royalty rights transactions outstanding.

Notes and Other Long-Term Receivables

We have entered into credit agreements with borrowers across the healthcare industry, under which we made available cash loans to be used by the borrower. Obligations under these credit agreements are typically secured by a pledge of substantially all the assets of the borrower and any of its subsidiaries. While we currently maintain this portfolio of notes receivable, our intention is to no longer pursue these types of transactions. At September 30, 2019, we had two note receivable transactions outstanding.

Equity Investments

In the past, we have received equity instruments, including shares of stock or warrants to acquire shares of stock, in connection with credit agreements we entered into with borrowers in the healthcare industry. Our investment objective with respect to these equity investments is to maximize our return through capital appreciation and, when appropriate, to capture the value through optimally timed exit strategies. At September 30, 2019, we had one equity investment outstanding.

Royalties from Queen et al. 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 was in December 2014, covered, among other things, humanized antibodies, methods for humanizing antibodies, polynucleotide encoding in humanized antibodies and methods of producing humanized antibodies.

We previously entered into licensing agreements under our Queen et al. patents with numerous entities that are independently developing or have developed humanized antibodies. Under our licensing agreements, we are entitled to receive a flat-rate royalty based upon our licensees' net sales of covered antibodies, although the royalties under these agreements have substantially ended.

Economic and Industry-wide Factors

Various economic and industry-wide factors are relevant to our business, including changes to laws and interpretation of those laws that protect our intellectual property rights, our licensees' ability to obtain or retain regulatory approval for products licensed under our patents, fluctuations in foreign currency exchange rates, the ability to attract, retain and integrate qualified personnel, as well as overall global economic conditions. We actively monitor economic, industry and market factors affecting our business; however, we cannot predict the impact such factors may have on our future results of operations, liquidity and cash flows. See also the risk factors included in "Item 1A. Risk Factors" in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018 and in subsequent filings for additional factors that may impact our business and results of operations.

Critical Accounting Policies and Use of Estimates

Our management's discussion and analysis of our financial condition and results of operations is based on our financial statements, which we have prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make estimates and judgments that affect the reported amounts of assets, liabilities and expenses and the disclosure of contingent assets and liabilities in our financial statements. We base our estimates on our historical experience, known trends and events and various other factors that we believe are reasonable under the circumstances, which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

In February 2016, the FASB issued ASU No. 2016-02, *Leases*, that supersedes Accounting Standards Codification ("ASC") 840, *Leases*. Subsequently, the FASB issued several updates to ASU No. 2016-02, codified in ASC Topic 842 ("ASC 842") Effective January 1, 2019, we adopted the requirements of ASC 842 using the modified retrospective method for all leases not substantially completed as of the date of adoption. The reported results for the three and nine month periods ended

September 30, 2019 reflect the application of ASC 842 guidance while the reported results for the three and nine month periods ended September 30, 2018 were prepared under the guidance of ASC 840, which is also referred to herein as “legacy GAAP” or the “previous guidance”. The adoption did not have an effect on the Condensed Consolidated Statements of Operations. However, the new standard required us to establish liabilities and corresponding right-of-use assets on our Consolidated Balance Sheet for operating leases that exist as of January 1, 2019. The cumulative impact of the adoption of ASC 842 was not material, therefore, we did not record any adjustments to retained earnings.

During the three months ended June 30, 2019, we acquired shares of common stock and warrants to acquire additional shares of common stock of Evofem. As of September 30, 2019, we owned approximately 29% of Evofem’s common stock. Our investment in Evofem qualifies for equity method accounting given our percentage ownership in Evofem and our ability to exercise significant influence. We elected the fair value method to account for our investment in Evofem as we believe it better reflects economic reality, the financial reporting of the investment and the current value of the asset. The mark to market valuation of our investment, and resulting changes in fair value, will occur at the end of each quarterly reporting period and will vary based upon the volatility of the stock price.

During the nine months ended September 30, 2019, there have not been any other significant changes to our critical accounting policies and estimates from those presented in Part II, Item 7 of our Annual Report on Form 10-K for the fiscal year ended December 31, 2018, that are of significance, or potential significance, to us.

Recently Issued Accounting Pronouncements

In June 2016, the FASB issued ASU No. 2016-13, *Financial Instruments - Credit Losses: Measurement of Credit Losses on Financial Instruments*. The new guidance amends the impairment model to utilize an expected loss methodology in place of the currently used incurred loss methodology, which will result in more timely recognition of losses. ASU No. 2016-13 has an effective date of the fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. We are currently evaluating the impact of this guidance on our Consolidated Financial Statements.

In August 2018, the FASB issued ASU No. 2018-13, *Fair Value Measurement*. The new guidance modifies disclosure requirements related to fair value measurement. The amendments in ASU No. 2018-13 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019. Implementation on a prospective or retrospective basis varies by specific disclosure requirement. Early adoption is permitted. The standard also allows for early adoption of any removed or modified disclosures upon issuance of ASU No. 2018-13 while delaying adoption of the additional disclosures until their effective date. We are currently evaluating the impact of this guidance on our Consolidated Financial Statement disclosures.

In August 2018, the FASB issued ASU No. 2018-15, *Intangibles-Goodwill and Other-Internal-Use Software*. The new guidance reduces complexity for the accounting for costs of implementing a cloud computing service arrangement and aligns the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal use software license). For public companies, the amendments in ASU No. 2018-15 are effective for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2019, with early adoption permitted. Implementation should be applied either retrospectively or prospectively to all implementation costs incurred after the date of adoption. We are currently evaluating the impact of this guidance on our Consolidated Financial Statements.

Operating Results

Three and nine months ended September 30, 2019, compared to three and nine months ended September 30, 2018

Revenues

<i>(dollars in thousands)</i>	Three Months Ended September 30,		Change from Prior	Nine Months Ended September 30,		Change from Prior
	2019	2018	Year %	2019	2018	Year %
Revenues						
Product revenue, net ⁽¹⁾	\$ 20,345	\$ 24,387	(17%)	\$ 64,868	\$ 79,472	(18%)
Royalty rights - change in fair value	23,865	42,184	(43%)	(4,277)	66,117	(106%)
Royalties from Queen et al. patents	—	533	N/M	9	4,534	N/M
Interest revenue	—	754	N/M	—	2,254	N/M
License and other	(45)	40	(213%)	(48)	614	(108%)
Total revenues	\$ 44,165	\$ 67,898	(35%)	\$ 60,552	\$ 152,991	(60%)

N/M Not meaningful

⁽¹⁾ Our Product revenue, net includes revenue from our Medical Devices and Pharmaceutical segments. We record Product revenue from our Medical Devices segment from our LENSAR product sales which include LENSAR® Laser Systems, disposable consumables, procedures, training, installation, warranty and maintenance services. We record Product revenue for our Pharmaceutical segment net of estimated product returns, pricing discounts, including rebates offered pursuant to mandatory federal and state government programs, chargebacks, prompt pay discounts, distribution fees and co-pay assistance for product sales each period.

Three Months Ended September 30, 2019

Total revenues were \$44.2 million for the three months ended September 30, 2019, compared with \$67.9 million for the three months ended September 30, 2018. Our total revenues decreased by 35%, or \$23.7 million, for the three months ended September 30, 2019, when compared to the same period of 2018. The decrease was primarily due to:

- lower royalty asset revenues due to the increase in fair value in the prior year period that resulted from the acquisition of additional Glumetza royalty rights from Assertio and a decline in fair value of our U-M royalty asset in the three months ended September 30, 2019
- a \$5.5 million decline in product revenue from our Pharmaceutical segment, of which \$3.6 million and \$1.9 million is attributable to the United States and rest of world, respectively,
- a decline in interest revenue from the CareView note receivable asset,
- lower royalties from the Queen et al. patents, and
- lower license and other revenue, partially offset by
- a reduction in the fair value of the AcelRx royalty rights asset in the three months ended September 30, 2018 with no such reduction in the three months ended September 30, 2019, and
- \$1.5 million in higher product revenues from our Medical Devices segment.

Revenue from our Medical Devices segment for the three months ended September 30, 2019 was \$8.1 million, an increase of 22%, compared to the same period in the prior year. The increase in revenue from our Medical Devices segment reflects higher net revenues in both North America and the rest of the world, with the majority of the increase outside of North America.

Revenue from our Pharmaceutical segment for the three months ended September 30, 2019 was \$12.3 million, a decrease of 31%, compared to the same period in the prior year. The decrease in revenue from our Pharmaceutical segment reflects lower net revenues in the United States and the rest of the world. The decrease in revenue from our Pharmaceutical segment in the United States for the three months ended September 30, 2019 is due to the launch of our authorized generic in the first quarter

of 2019 and sales from a third-party generic of aliskiren that was launched late in the first quarter of 2019. The decrease in revenue for the rest of the world is due to lower sales volume of Rasilez in certain territories.

Revenue from our Income Generating Assets segment for the three months ended September 30, 2019 were \$23.8 million, a decrease of 45%, compared to the same period in the prior year. The decrease was primarily due to:

- a larger increase in the estimated fair value of the Assertio royalty asset recognized in Royalty rights - change in fair value revenues in the third quarter of 2018 than in the third quarter of 2019 for the reason noted above and the decline in fair value of our U-M royalty rights in the third quarter of 2019,
- a decrease in interest revenue from our CareView note receivable,
- a decrease in revenue from the Queen et al. patents, and
- lower license and other revenue.

The following tables provides a summary of activity with respect to our royalty rights - change in fair value for the three months ended September 30, 2019 and 2018:

<i>(in thousands)</i>	Three Months Ended September 30, 2019		
	Cash Royalties	Change in Fair Value	Royalty Rights - Change in Fair Value
Assertio	\$ 23,597	\$ 1,058	\$ 24,655
VB	254	89	343
U-M	1,574	(3,063)	(1,489)
AcelRx	80	236	316
KYBELLA	59	(19)	40
Total	\$ 25,564	\$ (1,699)	\$ 23,865

<i>(in thousands)</i>	Three Months Ended September 30, 2018		
	Cash Royalties	Change in Fair Value	Royalty Rights - Change in Fair Value
Assertio	\$ 17,482	\$ 31,631	\$ 49,113
VB	277	(779)	(502)
U-M	1,152	1,375	2,527
AcelRx	70	(9,158)	(9,088)
KYBELLA	77	57	134
Total	\$ 19,058	\$ 23,126	\$ 42,184

Nine Months Ended September 30, 2019

Total revenues were \$60.6 million for the nine months ended September 30, 2019, compared with \$153.0 million for the nine months ended September 30, 2018. Our total revenues decreased by 60%, or \$92.4 million, for the nine months ended September 30, 2019, when compared to the same period of 2018. The decrease was primarily due to:

- lower royalty asset revenues primarily due to the decrease in fair value of the AcelRx royalty asset in the second quarter of 2019,
- lower product revenues from our Pharmaceutical segment,
- lower royalties from the Queen et al. patents,
- a decline in interest revenue from the CareView note receivable asset, and
- lower license and other revenue, partially offset by
- higher product revenues from our Medical Devices segment.

Revenue from our Medical Devices segment for the nine months ended September 30, 2019 was \$22.2 million, an increase of 27%, compared to the same period in the prior year. The increase in revenue from our Medical Devices segment reflects higher net revenues in both North America and the rest of the world, with the majority of the increase outside of North America.

Revenue from our Pharmaceutical segment for the nine months ended September 30, 2019 was \$42.6 million, a decrease of 31%, compared to the same period in the prior year. The decrease in revenue from our Pharmaceutical segment reflects lower net revenues in the United States and the rest of the world. The decrease in revenue from our Pharmaceutical segment in the United States for the nine months ended September 30, 2019 reflects the introduction of our authorized generic of Tekturna and a third-party generic of aliskiren in the current nine-month period. The decrease in revenue for the rest of the world is due to lower sales volume of Rasilez in certain territories.

The following table provides a summary of activity with respect to our sales allowances and accruals for the nine months ended September 30, 2019:

<i>(in thousands)</i>	Discount and Distribution Fees	Government Rebates and Chargebacks	Assistance and Other Discounts	Product Returns	Total
Balance at December 31, 2018	\$ 3,094	\$ 8,901	\$ 3,457	\$ 4,681	\$ 20,133
Allowances for current period sales	4,122	10,020	4,194	1,317	19,653
Allowances for prior period sales	50	1,841	120	33	2,044
Credits/payments for current period sales	(1,944)	(7,401)	(3,105)	(263)	(12,713)
Credits/payments for prior period sales	(3,075)	(10,228)	(3,329)	(2,220)	(18,852)
Balance at September 30, 2019	<u>\$ 2,247</u>	<u>\$ 3,133</u>	<u>\$ 1,337</u>	<u>\$ 3,548</u>	<u>\$ 10,265</u>

Revenue from our Income Generating Assets segment for the nine months ended September 30, 2019 was negative \$4.3 million, a decrease of 106%, compared to the same period in the prior year. The decrease was primarily due to:

- lower royalty asset revenues primarily due to the increase in fair value in the prior year period that resulted from the acquisition of additional Glumetza royalty rights from Assertio in the third quarter of 2018, the \$60.0 million decrease in fair value of the AcelRx royalty asset in the second quarter of 2019 and a \$3.1 million fair value decrease in the U-M royalty asset in the third quarter of 2019,
- a decrease in revenue from the Queen et al. patents, and
- the absence of interest revenue recognized from our CareView note receivable in 2019, partially offset by
- the \$9.2 million decrease in the AcelRx royalty asset in the third quarter of 2018.

The adjustment to the fair value of the AcelRx royalty asset in the second quarter of 2019 was due to the slower than expected adoption of Zalviso® (sufentanil sublingual tablet system) since its initial launch relative to our estimates and the increased variance noted between our forecast model and actual results in the second quarter of 2019. We engaged a third-party expert in the second quarter of 2019 to reassess the market and expectations for the product. Key findings from the third-party study included: the post-surgical PCA (Patient-Controlled Analgesia) market being smaller than previously forecasted; the higher price of the product relative to alternative therapies, the product not being used as a replacement for systemic opioids and the design of the delivery device, which is pre-filled for up to three days of treatment, which restricts its use for shorter recovery time procedures.

The following tables provides a summary of activity with respect to our royalty rights - change in fair value for the nine months ended September 30, 2019 and 2018:

Nine Months Ended September 30, 2019

<i>(in thousands)</i>	Cash Royalties	Change in Fair Value	Royalty Rights - Change in Fair Value
Assertio	\$ 52,980	\$ 599	\$ 53,579
VB	748	354	1,102
U-M	4,212	(4,379)	(167)
AcelRx	241	(57,650)	(57,409)
KYBELLA	109	(1,491)	(1,382)
Total	<u>\$ 58,290</u>	<u>\$ (62,567)</u>	<u>\$ (4,277)</u>

Nine Months Ended September 30, 2018

<i>(in thousands)</i>	Cash Royalties	Change in Fair Value	Royalty Rights - Change in Fair Value
Assertio	\$ 52,077	\$ 13,665	\$ 65,742
VB	820	(494)	326
U-M	3,437	755	4,192
AcelRx	190	(4,619)	(4,429)
Avinger	366	(396)	(30)
KYBELLA	159	157	316
Total	<u>\$ 57,049</u>	<u>\$ 9,068</u>	<u>\$ 66,117</u>

Operating Expenses

<i>(dollars in thousands)</i>	Three Months Ended September 30,		Change from Prior Year %	Nine Months Ended September 30,		Change from Prior Year %
	2019	2018		2019	2018	
Cost of product revenue, (excluding intangible amortization and impairment)	\$ 15,033	\$ 11,926	26%	\$ 40,191	\$ 37,016	9%
Amortization of intangible assets	1,575	1,577	—%	4,745	14,254	(67)%
General and administrative	12,092	13,211	(8)%	33,037	39,401	(16)%
Sales and marketing	1,712	3,469	(51)%	6,515	14,367	(55)%
Research and development	4,310	672	541%	6,065	2,149	182%
Impairment of intangible assets	—	—	N/M	—	152,330	N/M
Change in fair value of contingent consideration	—	302	N/M	—	(22,433)	N/M
Total operating expenses	<u>\$ 34,722</u>	<u>\$ 31,157</u>	11%	<u>\$ 90,553</u>	<u>\$ 237,084</u>	(62)%
Percentage of total revenues	79%	46%		150%	155%	

N/M Not meaningful

Three Months Ended September 30, 2019

Total operating expenses were \$34.7 million for the three months ended September 30, 2019, compared with \$31.2 million for the three months ended September 30, 2018. Our operating expenses increased 11%, or \$3.6 million, for the three month period ended September 30, 2019, when compared to the three-month period ended September 30, 2018. The increase was primarily a result of:

- higher cost of product revenue, due to increased sales in our Medical Devices segment and costs associated with a termination provision involving end of contract fees in the Novartis supply agreement amended in June 2019 for our Pharmaceutical segment,
- higher research and development in our Medical Devices segment, as certain intellectual property was licensed from a third-party for \$3.5 million in cash, partially offset by
- lower general and administrative expenses of \$1.1 million, or 8%, primarily due to lower professional fees,
- lower sales and marketing expenses, reflecting the cost savings from the change in our marketing strategy for the Noden Products to a non-personal promotion strategy in anticipation of a third-party generic launch of aliskiren.

General and administrative expenses for the three months ended September 30, 2019 and 2018 are summarized in the table below:

(in thousands)	Three Months Ended September 30, 2019				Three Months Ended September 30, 2018			
	Medical Device	Pharmaceutical	Income Generating Assets	Total	Medical Device	Pharmaceutical	Income Generating Assets	Total
Compensation	\$ 855	\$ 433	\$ 4,867	\$ 6,155	\$ 868	\$ 477	\$ 5,320	\$ 6,665
Salaries and Wages (including taxes)	454	302	1,449	2,205	411	414	1,603	2,428
Bonuses (including accruals)	261	61	1,465	1,787	269	48	1,148	1,465
Equity	140	70	1,953	2,163	188	15	2,569	2,772
Asset management	—	—	578	578	—	—	962	962
Business development	—	—	614	614	3	175	423	601
Accounting and tax services	6	203	834	1,043	31	325	870	1,226
Other professional services	291	186	450	927	77	724	580	1,381
Other	462	1,048	1,265	2,775	319	813	1,244	2,376
Total general and administrative	\$ 1,614	\$ 1,870	\$ 8,608	\$ 12,092	\$ 1,298	\$ 2,514	\$ 9,399	\$ 13,211

No general and administrative expenses were attributable to the Strategic Positions segment for the three months ended September 30, 2019 or 2018.

Nine Months Ended September 30, 2019

Total operating expenses were \$90.6 million for the nine months ended September 30, 2019, compared with \$237.1 million for the nine months ended September 30, 2018. Our operating expenses decreased 62%, or \$146.5 million, for the nine month period ended September 30, 2019, when compared to the nine-month period ended September 30, 2018. The decrease was primarily a result of:

- the absence of the \$152.3 million Noden intangible asset impairment recorded in the second quarter of 2018,
- lower amortization expense for the Noden intangible assets as a result of the impairment recorded,
- lower general and administrative expenses of \$6.4 million, or 16%, primarily due to lower professional fees, and
- lower sales and marketing expenses, reflecting the cost savings from the change in our marketing strategy for the Noden Products, partially offset by
- higher research and development expenses in our Medical Devices segment, and
- higher cost of product revenue, due to increased sales in our Medical Devices segment and costs associated with the amended Novartis supply agreement in our Pharmaceutical segment, and

- the favorable adjustment to the Noden acquisition related contingent consideration which was reduced in the second quarter of 2018.

General and administrative expenses for the nine months ended September 30, 2019 and 2018 are summarized in the table below:

<i>(in thousands)</i>	Nine Months Ended September 30, 2019				Nine Months Ended September 30, 2018			
	Medical Device	Pharmaceutical	Income Generating Assets	Total	Medical Device	Pharmaceutical	Income Generating Assets	Total
Compensation	\$ 2,798	\$ 1,438	\$ 12,651	\$ 16,887	\$ 2,491	\$ 1,374	\$ 12,538	\$ 16,403
Salaries and Wages (including taxes)	1,426	1,071	4,639	7,136	1,260	1,154	4,446	6,860
Bonuses (including accruals)	831	208	2,894	3,933	725	176	3,365	4,266
Equity	541	159	5,118	5,818	506	44	4,727	5,277
Asset management	—	—	1,262	1,262	—	—	3,229	3,229
Business development	—	—	1,211	1,211	3	203	1,692	1,898
Accounting and tax services	46	990	2,482	3,518	37	1,251	3,778	5,066
Other professional services	993	1,138	1,253	3,384	269	2,657	1,526	4,452
Other	1,316	1,949	3,510	6,775	1,159	3,430	3,764	8,353
Total general and administrative	\$ 5,153	\$ 5,515	\$ 22,369	\$ 33,037	\$ 3,959	\$ 8,915	\$ 26,527	\$ 39,401

No general and administrative expenses were attributable to the Strategic Positions segment for the nine months ended September 30, 2019 or 2018.

Non-operating (Expense) Income, Net

<i>(dollars in thousands)</i>	Three Months Ended September 30,		Change from Prior Year %	Nine Months Ended September 30,		Change from Prior Year %
	2019	2018		2019	2018	
Interest and other income, net	\$ 1,460	\$ 1,581	(8%)	\$ 4,984	\$ 4,871	2%
Interest expense	(3,011)	(2,866)	5%	(8,950)	(9,262)	(3%)
Equity affiliate - change in fair value	(27,378)	—	N/M	18,109	—	N/M
Gain on sale of intangible assets	3,476	—	N/M	3,476	—	N/M
Loss on exchange of convertible notes	(3,900)	—	N/M	(3,900)	—	N/M
Total non-operating (expense) income, net	\$ (29,353)	\$ (1,285)	2,184%	\$ 13,719	\$ (4,391)	(412%)

N/M Not meaningful

Three Months Ended September 30, 2019

Non-operating (expense) income, net, decreased for the three months ended September 30, 2019, as compared to the same period in 2018, primarily due to:

- the change in value of our investment in common stock and warrants of Evofem,
- an increase in interest expense associated with the amortization of the debt issuance costs on our December 2021 Notes and December 2024 Notes and the additional interest provisions of our December 2024 notes,
- a loss recognized on the exchange of our December 2021 Notes, and
- a decrease in interest income from investments as compared to the prior year comparable period, partially offset by
- the gain recognized on the sale of our Direct Flow Medical, Inc. (“DFM”) intangible assets.

Nine Months Ended September 30, 2019

Non-operating (expense) income, net, increased for the nine months ended September 30, 2019, as compared to the same period in 2018, primarily due to:

- the unrealized gain on the value of our investment in common stock and warrants of Evofem,
- the reduction in interest expense after the February 2018 Notes were repaid,
- an increase in interest income from investments as compared to the prior year comparable period, and
- the gain on sale of intangible assets recorded in the nine-month period ended September 30, 2019, partially offset by
- a loss recognized on the exchange of our December 2021 Notes.

Income Taxes

Income tax (benefit) expense for the three months ended September 30, 2019 and 2018, was \$(1.9) million and \$9.9 million, respectively, and for the nine months ended September 30, 2019 and 2018, was \$(0.4) million and \$(3.3) million respectively, which resulted primarily from applying the federal statutory income tax rate to income before income taxes. Our effective tax rate for the current period differs from the U.S. federal statutory rate of 21% due primarily to the effect of state income taxes, non-deductible executive compensation and the foreign tax rate differential associated with our operations of Noden DAC in Ireland.

The uncertain tax positions did not change during the three or nine months ended September 30, 2019 and 2018.

Our income tax returns are subject to examination by U.S. federal, foreign, state and local tax authorities for tax years 2000 forward. We are currently under audit by the California Franchise Tax Board (the "CFTB") for the tax years 2009 through 2015 and the Internal Revenue Service (the "IRS") for the tax year 2016. The timing of the audit resolution and the amount to be ultimately paid, if any, is uncertain. The outcome of these audits could result in the payment of tax amounts that differ from the amounts we have reserved for uncertain tax positions for the periods under audit resulting in incremental expense or a reversal of the reserves in a future period. At this time, we do not anticipate a material change in the unrecognized tax benefits related to the CFTB or IRS audits that would affect the effective tax rate or deferred tax assets over the next 12 months.

Net (Loss) Income Per Share

Net (loss) income per share for the three and nine months ended September 30, 2019 and 2018, is presented below:

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
Net (loss) income per share - basic	\$ (0.16)	\$ 0.18	\$ (0.13)	\$ (0.58)
Net (loss) income per share - diluted	\$ (0.16)	\$ 0.18	\$ (0.13)	\$ (0.58)

Weighted-average basic and diluted shares used in the computation of Net (loss) income per share are as follows (in thousands):

	Three Months Ended		Nine Months Ended	
	September 30,		September 30,	
	2019	2018	2019	2018
Basic	112,986	143,171	119,966	147,159
Diluted	112,986	144,224	119,966	147,159

Liquidity and Capital Resources

We finance our operations primarily through royalty and other license-related revenues, public and private placements of debt and equity securities, interest income on invested capital and revenues from pharmaceutical and medical device product sales. We currently have 20 full-time employees at PDL managing our intellectual property, our asset acquisitions, operations and other corporate activities as well as providing for certain essential reporting and management functions of a public company. In

addition, we have 73 full time employees at our operating subsidiary, LENSAR, who manage the Medical Devices segment business and operations and 14 full-time employees at our operating subsidiary, Noden, who manage the Pharmaceutical segment business and operations.

Our future capital requirements are difficult to forecast and will depend upon many factors, including our ability to identify and acquire pharmaceutical products or companies, the costs and timing of future commercialization activities, including product manufacturing, marketing, sales and distribution, the resources we devote to developing and supporting our products and those of our strategic partners through additional investments and other factors. Additionally, we will continue to evaluate possible acquisitions of new pharmaceutical products or companies, which may require the use of cash or additional financing.

The general cash needs of our Medical Devices, Strategic Positions, Pharmaceutical and Income Generating Assets segments can vary significantly. In our Medical Devices segment, the primary factor determining cash needs is the funding of its operations and enhancing our product offerings through research and development and the development of our next generation device with the objective to integrate the LENSAR® Laser System and a phacoemulsification system in a greatly reduced footprint. In our Pharmaceutical segment, cash needs tend to be driven primarily by material purchases and capital expenditures. In our Strategic Positions segment, cash needs tend to be driven primarily by new investments opportunities. The cash needs of our Income Generating Assets segment tend to be driven by legal and professional service fees.

We had cash and cash equivalents in the aggregate of \$294.3 million and \$394.6 million at September 30, 2019 and December 31, 2018, respectively, representing a decrease of \$100.3 million. The decrease was primarily attributable to:

- the repurchase of common stock for \$75.9 million,
- the investment in Evofem of \$60.0 million,
- payments related to the exchange of convertible notes of \$7.5 million,
- net payments related to capped call transactions of \$3.7 million, and
- cash used for operating activities of \$13.3 million, partially offset by
- proceeds from royalty right payments of \$58.3 million, and
- the sale of intangible assets for \$5.0 million.

On September 17, 2019, we exchanged \$86.1 million of our \$150 million of 2.75% convertible notes due in December 2021 for an equivalent amount of 2.75% convertible notes due in December 2024 and a cash payment of \$70.00 for each \$1,000 principal amount exchanged, totaling approximately \$6.0 million. We will pay interest at 2.75% on the December 2024 Notes semiannually in arrears on June 1 and December 1 of each year, beginning December 1, 2019. The new notes carry an additional accretion charge of 2.375% which will accrue and be paid in cash upon maturity.

Upon the occurrence of a fundamental change, as defined in the December 2024 Notes Indenture, holders have the option to require the Company to repurchase their December 2024 Notes at a purchase price equal to 100% of the accreted principal amount, plus accrued interest on the original principal amount thereon.

In accordance with the terms of the December 2024 Notes Indenture, under specified conditions we have has the right, but not the obligation, to redeem all or any portion of the December 2024 Notes that is equal to \$1,000 original principal amount or an integral multiple of \$1,000 prior to their scheduled maturity on a redemption date beginning on or after December 1, 2021 and on or before the 60th scheduled trading day before December 1, 2024, for a cash purchase price equal to the redemption price. The redemption price for the December 2024 Notes called for redemption is equal to the then accreted principal amount of such December 2024 Notes plus accrued interest on the original principal amount thereon.

On September 24, 2018, we announced that our board of directors authorized the repurchase of issued and outstanding shares of our common stock having an aggregate value of up to \$100.0 million pursuant to a share repurchase program. We repurchased 1.3 million shares of our common stock under this share repurchase program during the three months ended September 30, 2019, for an aggregate purchase price of \$4.1 million, or an average cost of \$3.17 per share, including trading commissions. These purchases concluded this share repurchase program. Under this repurchase authorization, we repurchased 31.0 million shares for an aggregate purchase price of \$100.0 million, or an average cost of \$3.22 per share, including trading commissions. All shares of common stock repurchased under this share repurchase program were retired and restored to authorized but unissued shares of common stock.

We believe that cash on hand and cash from future revenues from acquired medical devices, pharmaceutical products and/or income generating assets, net of operating expenses, debt service and income taxes, will be sufficient to fund our operations over the next several years. Our continued success is dependent on our ability to acquire new pharmaceutical products or companies, and the timing of these transactions, in order to provide recurring cash flows going forward that support our business model, and service our debt.

We continuously evaluate alternatives to create value for our stockholders, including, for example, by investing in late clinical-stage or early commercial-stage therapeutics with attractive revenue growth potential, selling certain assets through optimally timed exit strategies, buying back our convertible notes, repurchasing our common stock or potentially selling our Company.

We may consider additional debt or equity financings to support growth if cash flows from our existing business are not sufficient to fund future pharmaceutical product or company acquisitions.

Off-Balance Sheet Arrangements

As of September 30, 2019, we did not have any off-balance sheet arrangements, as defined under SEC Regulation S-K Item 303(a)(4)(ii).

Contractual Obligations

Convertible Senior Notes

As of September 30, 2019, our outstanding notes consisted of our December 2021 Notes and December 2024 Notes, which in the aggregate totaled \$150.0 million in principal.

We expect that our debt service obligations over the next several years will consist of interest payments and repayment of our December 2021 Notes and December 2024 Notes. We may further seek to exchange, repurchase or otherwise acquire the convertible senior notes in the open market in the future, which could adversely affect the amount or timing of any distributions to our stockholders. We would make such exchanges or repurchases only if we deemed it to be in our stockholders' best interest. We may finance such repurchases with cash on hand and/or with public or private equity or debt financings if we deem such financings to be available on favorable terms.

Guarantees

Redwood City Lease Guarantee

In connection with the Spin-Off of Facet, we entered into amendments to the leases for our former facilities in Redwood City, California, under which Facet was added as a co-tenant, and a Co-Tenancy Agreement, under which Facet agreed to indemnify us for all matters related to the leases attributable to the period after the Spin-Off date. In April 2010, Abbott Laboratories acquired Facet and later renamed the entity AbbVie Biotherapeutics, Inc. ("AbbVie"). If AbbVie were to default under its lease obligations, 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 September 30, 2019, the total lease payments for the duration of the guarantee, which runs through December 2021, are approximately \$25.4 million. For additional information regarding our lease guarantee, see Note 12, *Commitments and Contingencies*.

Purchase Obligation

Noden DAC and Novartis entered into a supply agreement pursuant to which Novartis will manufacture and supply to Noden DAC a bulk tableted form of the Noden Products and the active pharmaceutical ingredient ("API"). In May 2019, Noden DAC and Novartis entered into an amended supply agreement pursuant to which Novartis will supply to Noden DAC a bulk tableted form of the Noden Products through 2020 and API through June 2021. The supply agreement may be terminated by either party for material breach that remains uncured for a specified time period. Under the terms of the amended supply agreement, Noden DAC is committed to purchase certain quantities of bulk product and API that would amount to approximately \$82.7 million through June 2021, of which \$54.3 million is committed over the next twelve months, which are guaranteed by the Company. While the supply agreement provides that the parties will agree to reasonable accommodations with respect to changes in firm orders, we expect that Noden DAC will meet the requirements of the supply agreement, unless otherwise negotiated.

LENSAR entered into various supply agreements for the manufacture and supply of certain components. The supply agreement commits LENSAR to a minimum purchase obligation of approximately \$6.1 million over the next twelve months. We expect that LENSAR will meet this requirement.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

As of September 30, 2019, there have been no material changes in our market risk from that described in “Item 7A. Quantitative and Qualitative Disclosures About Market Risk” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

The Company's management has evaluated, with the participation of the chief executive officer and the acting chief financial officer, the effectiveness of the Company's disclosure controls and procedures (as defined in Rule 13a-15(e) and 15d-15(e) under the Securities Exchange Act of 1934) as of the end of the period covered by this report. Based on this evaluation, management concluded that the Company's disclosure controls and procedures were effective as of September 30, 2019.

Changes in Internal Control over Financial Reporting

During the quarter ended September 30, 2019, there have been no changes in our internal control over financial reporting that have materially affected, or are reasonably likely to materially affect, the Company's internal control over financial reporting.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS

The information set forth in Note 12, *Commitments and Contingencies*, to our Notes to Condensed Consolidated Financial Statements included in Part I, Item 1, of this Quarterly Report on Form 10-Q is incorporated by reference herein.

Class Action Antitrust Lawsuit

On September 18, 2019, the City of Providence filed a civil antitrust suit on behalf of a putative class of payors in the Northern District of California against Bausch Health Companies, Inc., Salix Pharmaceuticals, Inc., Santarus, Inc., Assertio Therapeutics, Inc., Lupin Pharmaceuticals, Inc. and the Company, inter alia, alleging that a patent settlement agreement between Assertio and Lupin unlawfully restrained competition in an alleged market for Glumetza and its AB-rated generic equivalents sold in the United States. The plaintiffs claim that the settlement agreement violated the federal Sherman Act and various state antitrust laws. The Company appears to be a named defendant due to its purchase from Assertio in 2013 of a royalty asset based on sales of Glumetza. To the extent that the Company is required to remain in the lawsuit, the Company intends to vigorously defend this matter.

ITEM 1A. RISK FACTORS

There have been no material changes to the risk factors included in “Item 1A. Risk Factors” in our Annual Report on Form 10-K for the fiscal year ended December 31, 2018, other than as previously disclosed in our Quarterly Report on Form 10-Q for the quarter period ended June 30, 2019 and the risk factors set forth below.

We may use a certain amount of cash from time to time in order to satisfy the obligations relating to our convertible notes. The maturity or conversion of any of our convertible notes could materially and adversely affect our business, results of operations and financial condition.

We are required to repay the full principal amount of approximately \$63.9 million in principal amount outstanding under the 2.75% Convertible Senior Notes due December 1, 2021 (the “December 2021 Notes”) and approximately \$86.1 million in principal amount outstanding plus an additional accreted amount of \$11.3 million under the 2.75% Convertible Senior Notes due December 1, 2024 (the “December 2024 Notes”) if not previously converted.

Our ability to make scheduled payments of the principal of, to pay interest on, to pay any cash due upon conversion of, or to refinance, our indebtedness, depends on our future performance, which is subject to economic, financial, competitive and other factors beyond our control. Our business may not generate cash flow from operations in the future sufficient to service our debt and make necessary capital expenditures. If we are unable to generate such cash flow, we may be required to adopt one or more alternatives, such as selling assets, restructuring debt or obtaining additional equity capital on terms that may be onerous or highly dilutive. Our ability to refinance our indebtedness will depend on the capital markets and our financial condition at such time. We may not be able to engage in any of these activities or engage in these activities on desirable terms, which could result in a default on our debt obligations.

Holder of the December 2021 Notes may convert their notes at their option under the following conditions at any time prior to the close of business on the business day immediately preceding June 1, 2021: (i) during any fiscal quarter (and only during such fiscal quarter) commencing after the fiscal quarter ending June 30, 2017, if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive), in the period of 30 consecutive trading days, ending on, and including, the last trading day of the immediately preceding fiscal quarter, exceeds 130% of the conversion price for the notes on each applicable trading day; (ii) during the five business day period immediately after any five consecutive trading-day period (the measurement period), in which the trading price per \$1,000 principal amount of the December 2021 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 trading day; or (iii) upon the occurrence of specified corporate events. Holder of the December 2024 Notes may convert their notes at their option under the following conditions at any time prior to the close of business on the business day immediately preceding June 1, 2024: (i) during any fiscal quarter (and only during such fiscal quarter) commencing after the fiscal quarter ending December 31, 2019, if the last reported sale price of our common stock for at least 20 trading days (whether or not consecutive), in the period of 30 consecutive trading days, ending on,

and including, the last trading day of the immediately preceding fiscal quarter, exceeds 130% of the conversion price for the notes on each applicable trading day; (ii) during the five business day period immediately after any five consecutive trading-day period (the measurement period), in which the trading price per \$1,000 principal amount of the December 2024 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 trading day; or (iii) upon the occurrence of specified corporate events.

The December 2021 Notes and the December 2024 Notes may be settled by paying or delivering, as applicable, cash, shares of our common stock or a combination of cash and shares of our common stock, at our election. If one or more holders elect to convert their notes when conversion is permitted, we could be required to make cash payments to satisfy up to the face value of our conversion obligation in respect of each note, which could adversely affect our liquidity.

We may use a certain amount of cash from time to time in order to satisfy repurchase or other obligations relating to our convertible notes which could adversely affect the amount or timing of any distribution to our stockholders or any income generating transactions. In addition, we may redeem, repurchase or otherwise acquire the convertible notes in the open market in the future, any of which could adversely affect the amount or timing of any cash distribution to our stockholders.

The conversion or any future exchanges of any of the December 2021 Notes or the December 2024 Notes into shares of our common stock would have a dilutive effect that could cause our stock price to go down.

Until June 1, 2021, the December 2021 Notes are convertible into shares of our common stock only if specified conditions are met and thereafter convertible at any time, at the option of the holder. Until June 1, 2024, the December 2024 Notes are convertible into shares of our common stock only if specified conditions are met and thereafter convertible at any time, at the option of the holder. We have reserved shares of our authorized common stock for issuance upon conversion of the December 2021 Notes and the December 2024 Notes. Upon conversion, the principal amount of our convertible notes may be settled in, at our option, cash, common stock or a combination of cash and common stock. If any or all of these convertible notes are converted into shares of our common stock, our existing stockholders will experience immediate dilution of voting rights and our common stock price may decline. Furthermore, the perception that such dilution could occur may cause the market price of our common stock to decline.

We entered into capped call transactions in connection with the issuance of our December 2021 Notes and our December 2024 Notes that may affect the value of our common stock and any desired dilution mitigation will be limited to the extent that our stock price rises above the cap price of the applicable capped call transactions.

In connection with the issuance of our December 2021 Notes and our December 2024 Notes, we entered into capped call transactions, with hedge counterparties, which we expect to reduce the potential dilution upon conversion of the December 2021 Notes and the December 2024 Notes in the event that the market price per share of our common stock, as measured under the terms of the applicable capped call transaction, at the time of exercise is greater than the strike price of the applicable capped call transaction, which corresponds to the initial conversion price of the applicable notes and is subject to certain adjustments similar to those contained in the applicable notes. If, however, the market price per share of our common stock, as measured under the terms of the applicable capped call transaction, exceeds the cap price of the applicable capped call transaction, there would nevertheless be dilution to the extent that such market price exceeds the cap price of the applicable capped call transaction.

In connection with hedging the capped call transactions, the hedge counterparties or their affiliates:

- expect to purchase our common stock in the open market and/or enter into various derivatives and/or enter into various derivative transactions with respect to our common stock; and
- may enter into or unwind various derivatives and/or purchase or sell our common stock in secondary market transactions.

These activities could have the effect of increasing or preventing a decline in the price of our common stock concurrently with or following the pricing of the applicable notes and could have the effect of decreasing the price of our common stock during the period immediately prior to a conversion of the applicable notes.

The hedge counterparties or their affiliates are likely to modify their hedge positions in relation to the capped call transactions from time to time prior to conversion or maturity of the applicable notes by purchasing and selling our common stock, other of our securities, or other instruments they may wish to use in connection with such hedging.

In addition, we intend to exercise options we hold under the capped call transaction whenever the notes are converted. In order to unwind its hedge positions with respect to those exercised options, the counterparties or affiliates thereof expect to sell our common stock in secondary market transactions or unwind various derivative transactions with respect to our common stock during the period immediately prior to conversion of the applicable notes. We have also agreed to indemnify the hedge counterparties and affiliates thereof for losses incurred in connection with a potential unwinding of their hedge positions under certain circumstances.

The effect, if any, of any of these transactions and activities on the market price of our common stock will depend in part on market conditions and cannot be ascertained at this time, but any of these activities could adversely affect the value of our common stock. For further information regarding the mechanics of our capped call transactions, refer to our discussion in Note 10, *Convertible Senior Notes*, to the Condensed Consolidated Financial Statements included in Item 1.

Despite our current debt levels, we may still incur additional debt; if we incur substantial additional debt, these higher levels of debt may affect our ability to pay the principal of and interest on our convertible notes.

We and our subsidiaries may be able to incur substantial additional debt in the future, some of which may be secured debt. The indentures governing the convertible notes do not restrict our ability to incur additional indebtedness or require us to maintain financial ratios or specified levels of net worth or liquidity. If we incur substantial additional indebtedness in the future, these higher levels of indebtedness may affect our ability to pay the principal of and interest on our convertible notes, or any fundamental change in purchase price or any cash due upon conversion, and our creditworthiness generally.

Our business could be negatively affected as a result of actions of activist stockholders, and such activism could impact the trading value of our securities.

Stockholders may, from time to time, engage in proxy solicitations or advance stockholder proposals, or otherwise attempt to effect changes and assert influence on our board of directors and management. For example, in October 2019, we received a letter from an activist shareholder suggesting various changes to our Company. Activist campaigns that contest or conflict with our strategic direction or seek changes in the composition of our board of directors could have an adverse effect on our operating results and financial condition. A proxy contest would require us to incur significant legal and advisory fees, proxy solicitation expenses and administrative and associated costs and require significant time and attention by our board of directors and management, diverting their attention from the pursuit of our business strategy. Any perceived uncertainties as to our future direction and control, our ability to execute on our strategy, or changes to the composition of our board of directors or senior management team arising from a proxy contest could lead to the perception of a change in the direction of our business or instability which may result in the loss of potential business opportunities, make it more difficult to pursue our strategic initiatives, or limit our ability to attract and retain qualified personnel and business partners, any of which could adversely affect our business and operating results. If individuals are ultimately elected to our board of directors with a specific agenda, it may adversely affect our ability to effectively implement our business strategy and create additional value for our stockholders. We may choose to initiate, or may become subject to, litigation as a result of the proxy contest or matters arising from the proxy contest, which would serve as a further distraction to our board of directors and management and would require us to incur significant additional costs. In addition, actions such as those described above could cause significant fluctuations in our stock price based upon temporary or speculative market perceptions or other factors that do not necessarily reflect the underlying fundamentals and prospects of our business.

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

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

Issuer Purchases of Equity Securities

The following table contains information relating to the repurchases of our common stock made by us in the three months ended September 30, 2019 (in thousands, except per share amounts):

Fiscal Period	Total Number of Shares Repurchased	Average Price Paid Per Share	Total Number of Shares Purchased As Part of a Publicly Announced Program	Approximate Dollar Amount of Shares That May Yet be Purchased Under the Program
July 1, 2019 to July 30, 2019	1,288	\$ 3.17	31,037	\$ — ⁽¹⁾
August 1, 2019 to August 31, 2019	—	\$ —	31,037	—
September 1, 2019 to September 30, 2019	—	\$ —	31,037	—
Total for the three months ended September 30, 2019	<u>1,288</u>	\$ 3.17	31,037	\$ —

⁽¹⁾ On September 24, 2018, we announced that our board of directors authorized the repurchase of issued and outstanding shares of our common stock having an aggregate value of up to \$100.0 million pursuant to a share repurchase program. All shares of common stock repurchased under our share repurchase program were retired and restored to authorized but unissued shares of common stock.

ITEM 3. DEFAULTS UPON SENIOR SECURITIES

None.

ITEM 4. MINE SAFETY DISCLOSURES

None.

ITEM 5. OTHER INFORMATION

Effective as the date of this report, the audit committee of our board of directors appointed Dominique Monnet, our President and Chief Executive Officer, to also serve as our principal financial officer for purposes of this report and future SEC reports while we continue our search for a chief financial officer.

ITEM 6. EXHIBITS

Exhibit Number	Exhibit Title
3.1	Restated Certificate of Incorporation effective March 23, 1993 (incorporated by reference to Exhibit 3.1 to Annual Report on Form 10-K filed March 31, 1993)
3.2	Certificate of Amendment of Certificate of Incorporation effective August 21, 2001 (incorporated by reference to Exhibit 3.3 to Annual Report on Form 10-K filed March 14, 2002)
3.3	Certificate of Amendment of Certificate of Incorporation effective January 9, 2006 (incorporated by reference to Exhibit 99.1 to Current Report on Form 8-K filed January 10, 2006)
3.4	Certificate of Designation, Preferences and Rights of the Terms effective August 25, 2006 (incorporated by reference to Exhibit 3.4 to Registration Statement on Form 8-A filed September 6, 2006)
3.5	Third Amended and Restated Bylaws effective December 4, 2014 (incorporated by reference to Exhibit 99.1 to Current Report on Form 8-K filed December 9, 2014)
3.6	Certificate of Amendment of Restated Certificate of Incorporation effective May 22, 2013 (incorporated by reference to Exhibit 4.4 to Registration Statement on Form S-3 filed June 21, 2013)
4.1	Indenture, dated September 17, 2019, between the Company, as Issuer and The Bank of New York Mellon Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 4.1 to Current Report on Form 8-K filed September 17, 2019)
4.2	Supplemental Indenture, dated September 17, 2019 by and between the Company, as Issuer and The Bank of New York Mellon Trust Company, N.A., as Trustee (incorporated by reference to Exhibit 4.2 to Current Report on Form 8-K filed September 17, 2019)
101.*	Confidential Severance Agreement and Release of All Claims (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed August 19, 2019)
10.2	Form of Exchange Agreement (incorporated by reference to Exhibit 10.1 to Current Report on Form 8-K filed September 13, 2019)
31.1#	Certification of Principal Executive Officer and 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 of Principal Executive Officer and Principal Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002
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

Filed herewith.

* Management contract or compensatory plan or arrangement.

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

SIGNATURES

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

Dated: November 6, 2019
PDL BIOPHARMA, INC. (REGISTRANT)

/s/ DOMINIQUE MONNET

Dominique Monnet
President and Chief Executive Officer
(Principal Executive Officer and Acting Principal
Financial Officer)

/s/ EDWARD A. IMBROGNO

Edward A. Imbrogno
Vice President, Finance and Chief Accounting Officer
(Principal Accounting Officer)

CERTIFICATIONS

I, Dominique Monnet, 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) I am 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 my supervision, to ensure that material information relating to the registrant, including its consolidated subsidiaries, is made known to me 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 my 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 my 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) I have disclosed, based on my most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

Date: November 6, 2019

/s/ DOMINIQUE MONNET

Dominique Monnet

President and Chief Executive Officer

(Principal Executive Officer and Acting Principal Financial Officer)

CERTIFICATIONS

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

- (1) The Company's Quarterly Report on Form 10-Q for the quarter ended September 30, 2019, to which this Certification is attached as Exhibit 32.1 (the "Periodic Report"), fully complies with the requirements of Section 13(a) or Section 15(d) of the Securities Exchange Act of 1934, and
- (2) The information contained in the Periodic Report fairly presents, in all material respects, the financial condition and results of operations of the Company.

Dated: November 6, 2019

By:

/s/ DOMINIQUE MONNET

Dominique Monnet

President and Chief Executive Officer

(Principal Executive Officer and Acting Principal Financial Officer)

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