MICROTUNE INC
Form 10-Q
August 14, 2003
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SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark one)

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

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2003

OR

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

FOR THE TRANSITION PERIOD FROM TO

Commission file number 000-31029-40

MICROTUNE, INC.

(Exact name of registrant as specified in its charter)

Delaware	**75-2883117**
(State or other jurisdiction of	**(I.R.S. Employer**

Incorporation or organization) **Identification Number)**

2201 10th Street

Plano, Texas 75074

(Address of principal executive office and zip code)

(972) 673-1600

(Registrant s telephone number, including area code)

Indicate by check mark whether the Registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934, as amended, 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 filing requirements for the past 90 days. YES x NO ¨

Indicate by check mark whether the Registrant is an accelerated filer (as defined in Rule 12b-2 of the Exchange Act). YES x NO ¨

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date. As of July 31, 2003, approximately 50,379,084 shares of the Registrant s Common Stock, $0.001 par value per share were outstanding.

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Caution Regarding Forward-Looking Statements

Throughout this quarterly report on this Form 10-Q, there are forward-looking statements that are based upon our current expectations, estimates and projections about our business and our industry, and that reflect our beliefs and assumptions based upon information available to us at the date of this report. In some cases, you can identify these statements by words such as if, may, might, will, should, expects, plans, anti believes, estimates, predicts, potential or continue, and other similar terms. These forward-looking statements include, among other things, projections of our future financial performance, our anticipated growth, our planned improvements to our internal and disclosure controls, our strategies and trends we anticipate in our businesses and the markets in which we operate, and the competitive nature and anticipated growth of those markets.

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PART I.

Financial Information

Item 1. Financial Statements

Microtune, Inc.

Consolidated Balance Sheets

(In thousands, except per share data)

(unaudited)

	June 30, 2003	December 31, 2002
Assets		
Current assets:		
Cash and cash equivalents	$ 94,988	$ 106,278
Accounts receivable, net	2,245	7,625
Inventories	5,832	11,852
Other current assets	4,196	2,008
Total current assets	107,261	127,763
Property and equipment, net	11,476	17,805
Intangible assets, net	8,394	10,599
Other assets and deferred charges	1,303	929
Total assets	$ 128,434	$ 157,096
Liabilities and Stockholders Equity		
Current liabilities:		
Accounts payable	$ 4,935	$ 8,681
Accrued compensation	1,441	1,434
Accrued expenses	8,466	15,009
Total current liabilities	14,842	25,124
Other non-current liabilities	1,308	1,283
Commitments and contingencies		
Stockholders equity:		
Preferred stock, $0.001 par value		
Authorized 25,000 shares		
Issued and outstanding shares none		
Common stock, $0.001 par value		
Authorized 150,000 shares	50	50

Issued and outstanding shares 50,332 and 49,917 respectively		
Additional paid-in capital	436,403	437,787
Unearned stock compensation	(3,276)	(8,865)
Loans receivable from stockholders	(135)	(397)
Accumulated other comprehensive loss	(988)	(988)
Accumulated deficit	(319,770)	(296,898)
Total stockholders equity	112,284	130,689
Total liabilities and stockholders equity	$ 128,434	$ 157,096

See accompanying notes.

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Microtune, Inc.

Consolidated Statements of Operations

(In thousands, except per share data)

(unaudited)

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002 (Restated Note 2)	2003	2002 (Restated Note 2)
Net revenue	$ 13,976	$ 22,034	$ 26,598	$ 40,298
Cost of revenue	9,086	14,091	19,487	25,280
Gross margin	4,890	7,943	7,111	15,018
Operating expenses:				
Research and development:				
Stock option compensation	477	2,577	1,682	5,154
Other	5,664	11,162	12,229	20,239
	6,141	13,739	13,911	25,393
Selling, general and administrative:				
Stock option compensation	1,133	702	1,546	1,460
Other	7,730	4,970	14,177	10,230
	8,863	5,672	15,723	11,690
Restructuring	(1,303)		100	54
Amortization of intangible assets	1,055	2,703	2,136	5,387
Total operating expenses	14,756	22,114	31,870	42,524
Loss from operations	(9,866)	(14,171)	(24,759)	(27,506)
Other income (expense):				
Interest income	181	789	593	1,610
Foreign currency gains (losses), net	1,474	(348)	1,324	(696)
Other	137	47	215	(71)
Loss before provision for income taxes	(8,074)	(13,683)	(22,627)	(26,663)
Income tax expense	82	327	245	398
Net loss	$ (8,156)	$ (14,010)	$ (22,872)	$ (27,061)
Basic and diluted loss per common share	$ (0.16)	$ (0.26)	$ (0.46)	$ (0.51)

Weighted-average shares used in computing basic and diluted loss per common share	50,244	52,953	50,008	52,671

See accompanying notes.

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Microtune, Inc.

Consolidated Statements of Cash Flows

(In thousands)

(unaudited)

	June 30,	
	2003	**2002**
		(Restated Note 2)
Operating activities:		
Net loss	$ (22,872)	$ (27,061)
Adjustments to reconcile net loss to cash used in operating activities,		
Depreciation	3,629	3,119
Amortization of intangible assets	2,135	5,387
Non-cash restructuring costs	762	54
Foreign currency (gains) losses, net	(1,324)	696
Amortization of deferred stock option compensation	3,229	6,614
Loss on sale of Philippine assets	461	
Gain on sale of MHDC	(1,627)	
Other non-cash charges	462	
Changes in operating assets and liabilities:		
Accounts receivable, net	5,380	(1,364)
Inventories	538	(5,757)
Other assets	(11)	505
Accounts payable	(3,457)	224
Accrued expenses	(4,626)	(3,214)
Other liabilities	431	124
Accrued compensation	56	229
Net cash used in operating activities	(16,834)	(20,444)
Investing activities:		
Purchases of property and equipment	(407)	(3,205)
Sale of property and equipment	199	71
Proceeds from sale of Philippine manufacturing assets	5,151	
Sale of MHDC	(934)	
Loans receivable	(130)	(254)
Acquisition of intangible assets	(208)	(262)
Net cash provided by (used in) investing activities	3,671	(3,650)
Financing activities:		
Proceeds from issuance of common stock	549	804
Loans receivable from stockholders		(390)
Other, net		(89)
Net cash provided by financing activities	549	325
Effect of foreign currency exchange rate changes on cash	1,324	(696)

Net decrease in cash and cash equivalents	(11,290)	(24,465)
Cash and cash equivalents at beginning of period	106,278	173,149
Cash and cash equivalents at end of period	$ 94,988	$ 148,684

See accompanying notes.

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Microtune, Inc.

Notes to Consolidated Financial Statements

June 30, 2003

(unaudited)

1. Summary of Significant Accounting Policies

Description of business

Microtune, Inc. was incorporated on May 28, 1996 and commenced operations on August 21, 1996. We operate in a single industry segment, designing and marketing radio frequency (RF) silicon and subsystem module solutions for the worldwide broadband communications and transportation electronics markets. We also design and market selected Bluetooth wireless connectivity products.

General

The accompanying unaudited financial statements as of and for the three and six months ended June 30, 2003 and 2002 have been prepared by us, pursuant to the rules and regulations of the Securities and Exchange Commission (SEC). Certain information and footnote disclosures normally included in financial statements prepared in accordance with accounting principles generally accepted in the United States (GAAP) have been condensed or omitted pursuant to such rules and regulations. These unaudited consolidated financial statements should be read in conjunction with the audited financial statements and the notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2002.

In the opinion of management, all adjustments which are of a normal and recurring nature and are necessary for a fair presentation of the financial position, results of operations, and cash flows as of and for the three and six months ended June 30, 2003 have been made. Results of operations for the three and six months ended June 30, 2003, are not necessarily indicative of results of operations to be expected for the entire year or any other period.

Consolidation

Our Consolidated Financial Statements include the financial statements of Microtune and its wholly-owned subsidiaries. All intercompany balances and transactions have been eliminated in consolidation.

Use of Estimates

We make estimates, judgments and assumptions that affect the amounts reported in the financial statements and the disclosures made in the accompanying notes, including reserves for inventory, warranty costs, determining the collectibility of accounts receivable, the valuation of deferred tax assets and other amounts. We also use estimates, judgments and assumptions to determine the remaining economic lives and carrying values of purchased intangibles, property and equipment and other long-lived assets. We believe that the estimates, judgments and assumptions upon which we rely are appropriate and correct based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect our reported assets and liabilities as of the date of the financial statements, as well as the reported revenue and expense during the periods presented. If there are material differences between these estimates, judgments or assumptions and actual facts, our financial statements will be affected.

Cash and Cash Equivalents

We consider highly liquid investments with original maturities of three months or less to be cash equivalents. Cash and cash equivalents consist of bank deposits, money market funds and asset-backed commercial paper. Our investments in asset-backed commercial paper are comprised of high-quality securities in accordance with our investment policy.

Inventories

Our inventories are stated at the lower of standard cost, which approximates actual cost determined on a first-in, first-out basis, or estimated realizable value. Adjustments to reduce our inventories to estimated realizable value, including allowances for excess and obsolete inventories, are determined quarterly by comparing inventory levels of individual materials and parts to historical usage rates, current backlog and estimated future sales. Actual amounts realized upon the sale of inventories may differ from estimates used to determine inventory valuation allowances due to changes in customer demand, technology changes and other factors.

Property and Equipment

Our property and equipment is stated at cost, net of accumulated depreciation. We calculate depreciation using the straight-line method over the estimated useful lives of the assets, which range from 3 to 7 years. We amortize leasehold improvements using the straight-line method over the lesser of their estimated useful lives or remaining lease terms.

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Intangible Assets

Our intangible assets, which consist primarily of a customer base and patents, have been recorded as the result of our business or asset acquisitions and are being amortized on the straight-line basis over 3 to 7 years.

Impairment of Long-lived Assets

We review long-lived assets, including intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. We evaluate the recoverability of these assets by a comparison of the carrying amount of an asset to projected undiscounted cash flows expected to be generated by the assets or business center. If we determine our long-lived assets are impaired, we recognize the impairment in the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets.

Revenue Recognition

We recognize revenue when we have received a purchase order from our customer, our product has been shipped, title has transferred to our customer, the price that we will receive for our product is fixed or determinable, and collection from our customer is considered probable. Title to our product transfers to our customer either when it is shipped to or received by our customer, based on the specific agreement.

Our revenue is recorded based on the facts currently known to us. If we do not meet the criteria above, we do not recognize revenue. For example, if we are unable to determine the amount that we will ultimately collect once our product has shipped and title has transferred to our customer, we defer recognition of revenue until we can determine the amount that ultimately will be collected. Terms of agreements with customers that impact our ability to determine the amount we will ultimately collect include stock rotation rights, rights to return unsold product, price protection, payment terms conditional on sale or use of the product by our customer or other extended payment terms. In most instances when we defer revenue, the timing and amount of revenue we ultimately recognize is determined upon our receipt of payment. Until we receive payment from our customer, we present deferred revenue as a reduction of the related accounts receivable.

Research and Development Costs

Our research and development expenses consist of personnel-related expenses, lab supplies, training and prototype subcontract materials. We expense all of our research and development costs in the period incurred. Research and development efforts currently are focused primarily on development of our next generation of RF products.

Shipping and Handling Costs

Shipping and handling costs that we incur related to product shipments to customers are included in selling, general and administrative expenses.

Warranty Costs

We provide a minimum of a one-year warranty on all products and record a related provision for estimated warranty costs at the date of sale. Estimated warranty costs are recorded at the date of sale based on a percentage of revenues derived from our historical warranty costs. Additionally, we record specific warranty provisions for any identified individual product issues, which have not been significant to date.

Foreign Currency Gains and Losses

The impact from the re-measurement of accounts not denominated in U.S. dollars is recognized currently in our results of operations as a component of foreign currency gains and losses.

Income Taxes

Our income taxes are computed using the asset and liability method of accounting. Under the asset and liability method, a deferred tax asset or liability is recognized for estimated future tax effects attributable to temporary differences and carryforwards. The measurement of deferred income tax assets is adjusted by a valuation allowance, if necessary, to recognize future tax benefit only to the extent, based on available evidence, it is more likely than not such benefit will be realized.

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Earnings Per Share

Basic earnings (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during each period. Diluted earnings (loss) per common share is computed by dividing net income (loss) by the weighted average number of common shares outstanding during each period and dilutive common equivalent shares consisting of stock options, restricted stock subject to repurchase rights and employee stock purchase plan options.

The following table sets forth anti-dilutive securities that have been excluded from diluted earnings per share (in thousands):

	June 30,	
	2003	2002
Stock options	5,478	7,866
Restricted common stock	45	432
Employee stock purchase plan	37	53
Total anti-dilutive securities excluded	5,560	8,351

Stock-Based Compensation

At June 30, 2003, we have four stock-based compensation plans covering employees and directors. We have elected to follow Accounting Principles Board Opinion (APB) No. 25, *Accounting for Stock Issued to Employees*, and related interpretations in accounting for our employee stock options. We account for stock-based compensation for non-employees under the fair value method prescribed by SFAS No. 123, *Accounting for Stock-Based Compensation* (SFAS No. 123). Through June 30, 2003, there have been no significant grants to non-employees.

Stock option compensation expense results from grants of stock options with deemed exercise prices below the estimated fair value per share of our common stock at the date of grant and as a result of the Transilica acquisition under the provisions of APB No. 25. Deferred stock option compensation is being amortized and charged to operations over the vesting period of the related options. As of June 30, 2003 and December 31, 2002, unearned deferred stock compensation was $3.3 million and $8.9 million, respectively. The weighted average remaining vesting period of outstanding compensatory stock options was 1.3 years at June 30, 2003.

During October 2002, we established a program whereby each employee with outstanding stock options was given the opportunity to cancel some or all of their option grants in exchange for a promise by us to grant a new stock option in six months and two days from the date of the employee s election to cancel options. The new grants were for the same or lesser number of options cancelled and have an exercise price equal to the market at the date of the new grant. Any new grants under this program will be 6/54 vested on the date of the grant and will vest 1/54 each month thereafter. The program ended on October 31, 2002 and 1,884,413 shares were cancelled, resulting in a charge to stock compensation expense of $0.9 million. In April and May of 2003, 1,494,037 new options were granted to employees with fair market value exercise prices ranging from $1.76 to $2.54 per share pursuant to the program. No additional stock compensation expense resulted from the new grants.

Although SFAS 123 allows us to continue to follow the present APB No. 25 guidelines, we are required to disclose pro forma net income (loss) and net income (loss) per share as if we had adopted SFAS No. 123. The pro forma impact of applying SFAS 123 will not necessarily be representative of the pro forma impact in future periods. Our pro forma information is as follows (in thousands, except per share data):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002 (Restated Note 2)	2003	2002 (Restated Note 2)
Net loss, as reported	$ (8,156)	$ (14,010)	$ (22,872)	$ (27,061)
Add stock compensation expense recorded under the intrinsic value method	1,610	3,279	3,228	6,614
Less pro forma stock compensation expense computed under the fair value method	(2,196)	(3,484)	(4,618)	(6,904)
Pro forma net loss	$ (8,742)	$ (14,215)	$ (24,262)	$ (27,351)
Basic and diluted pro forma loss per common share	$ (0.17)	$ (0.27)	$ (0.48)	$ (0.52)

Risk Concentrations

Financial instruments that potentially subject Microtune to concentrations of credit risk consist primarily of trade accounts receivable and notes receivable. Products are sold to customers internationally, principally in Asia Pacific and Europe. Management continually evaluates the creditworthiness of its customers financial condition and generally does not require collateral. At June 30, 2003, approximately 88% of our net accounts receivable were due from five of our customers. We evaluate the collectability of our accounts receivable based on a combination of factors. In circumstances where we are aware of a specific customer s inability to meet its financial obligations to us, we record a specific reserve for bad debts against amounts due. For all other customers, we recognize allowances for doubtful accounts based on the length of time the receivables are outstanding, industry and geographic concentrations,

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the current business environment and our historical experience. If the financial condition of our customers deteriorates or if economic conditions worsen, additional allowances may be required in the future. Historically, our reserves have generally been adequate to cover our actual credit losses.

We depend on third party foundries to manufacture all of our integrated circuit products. We do not have long-term supply agreements with our foundries and obtain integrated circuit products on a purchase order basis. The inability of a third party foundry to continue manufacturing our integrated circuits could have a material adverse effect on our operations. We are also dependent upon third parties, some of whom are competitors, for the supply of components for module manufacturing. Our failure to obtain components for module manufacturing would significantly impact our ability to ship modules to customers in a timely manner.

Risk and Uncertainties

Our future results of operations and financial condition will be impacted by the following factors, among others: the level of difficulty experienced in the integration of acquired businesses, dependence on the broadband and automotive markets, dependence on a few significant customers, lengthy sales cycle, dependence on third party manufacturers and subcontractors, dependence on third party distributors in certain markets, technological change and dependence on the successful development of products and marketing of new products, international operations and foreign currency fluctuations, intellectual property rights, potential litigation costs and product liability.

Recent Accounting Pronouncements

In January 2003, the FASB issued FIN 46, *Consolidation of Variable Interest Entities.* FIN 46 requires us to consolidate a variable interest entity if we are subject to a majority of the risk of loss from the variable interest entity s activities or entitled to receive a majority of the entity s residual returns or both. A variable interest entity is a corporation, partnership, trust or any other legal structure used for business purposes that either does not have equity investors with voting rights or has equity investors that do not provide sufficient financial resources for the entity to support its activities. A variable interest entity often holds financial assets, including loans or receivables, real estate or other property. A variable interest entity may be essentially passive or it may engage in research and development or other activities on behalf of another company. The consolidation requirements of FIN 46 apply immediately to variable interest entities created after January 31, 2003. The consolidation requirements apply to older entities in the first fiscal year or interim period beginning after June 15, 2003. Some of the disclosure requirements apply to all financial statements issued after June 30, 2003, regardless of when the variable interest entity was established. We do not currently have any variable interest entities and, accordingly, we did not have a material impact on our financial position, results of operations or cash flows upon adoption.

In May 2003, the FASB issued SFAS No. 150, *Accounting for Certain Financial Instruments with Characteristics of Both Liabilities and Equity*. SFAS No. 150 requires us to classify and measure certain financial instruments with characteristics of both liabilities and equity. It requires that an issuer classify a financial instrument that requires a transfer of assets and that meets the definition of liabilities in Concepts Statement 6 and other recognition criteria in SFAS No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, be reported as a liability. SFAS No. 150 also requires that certain obligations that could be settled by issuance of an entity s equity but lack other characteristics of equity be reported as liabilities even though the obligation does not meet the definition of liabilities in Concepts Statement No. 6. SFAS No. 150 is effective for financial instruments entered into or modified after May 31, 2003, and otherwise is effective for periods beginning after June 15, 2003. The adoption of SFAS No. 150 did not have a material effect on our consolidated financial position, results of operations or cash flows.

2. Restatement of Financial Statements

In February 2003, our Audit Committee, under the direction of our Board of Directors, retained John M. Fedders, a former Director of the Division of Enforcement of the Securities and Exchange Commission, as independent counsel to inquire into the events related to significant negative adjustments to preliminary recorded revenue for products shipped in the third and fourth quarters of 2002. The inquiry was subsequently expanded to include all of 2001 and 2002 and concluded in July 2003.

The inquiry concluded that in certain instances we recognized revenue earlier than appropriate under accounting principles generally accepted in the United States (GAAP). On April 29, 2003, based on preliminary findings of the inquiry, our Board determined to restate our previously reported financial statements for 2001 and for our quarters ended September 30, 2001, December 31, 2001, March 31, 2002, June 30, 2002 and September 30, 2002. Based on the preliminary findings our Board also determined to revise our financial results that were reported via a press release on February 20, 2003 and a related current report on Form 8-K filed with the SEC.

Our Board s determinations are based upon summary findings from the inquiry set forth in the numbered paragraphs below.

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1. We shipped product to customers at the end of quarters in excess of orders received at the time of shipment, including shipments of unfinished product. We recognized revenue for these shipments even though we had not received purchase orders for the product shipped.

2. We granted extended payment terms, including flexible payment terms, to customers, including customers who were delinquent in their obligations to us. We recognized revenue despite collections of the related accounts receivable being questionable, and reserves were not established.

3. We granted price protection arrangements to distributors whereby (a) profits were guaranteed and (b) credits were promised if the product was resold for less than what we were to be paid. While price protection arrangements are not improper, we recognized revenue when it should not have been under GAAP.

4. We granted rights of return, or extraordinary stock rotation privileges, to distributors. These included the right to return any product not sold. Despite these rights of return, we recognized revenue at the time of shipment.

In addition, in preparing our restated financial statements, we determined that in some cases we recognized revenue in the wrong quarter because of delivery of our products was not in accordance with our customers shipping terms and shipment had been made to a third party warehouse rather than to our customer.

Our financial statements as of and for the three months ended June 30, 2002 and related financial information have been restated as follows, (in thousands, except per share data):

	Three Months Ended June 30, 2002	
	Reported	Restated
Statement of operations data:		
Net revenue	$ 23,179	$ 22,034
Cost of revenue	14,801	14,091
Gross margin	8,378	7,943
Loss from operations	(13,436)	(14,171)
Loss before income taxes	(12,948)	(13,683)
Net loss	(13,275)	(14,010)
Basic and diluted loss per common share	$ (0.25)	$ (0.26)
Balance sheet data:		
Accounts receivable, net	$ 16,432	$ 11,842
Inventories	15,014	15,907
Total current assets	183,347	179,331
Total current liabilities	22,086	20,557
Accumulated deficit	(137,399)	(141,097)
Total stockholders equity	290,423	286,725

3. Accounts Receivable, net

Accounts receivable, net consists of the following (in thousands):

	June 30, 2003	December 31, 2002
Gross accounts receivable	$ 3,579	$ 10,587
Allowance for doubtful accounts	(110)	(375)
Deferred revenue	(1,224)	(2,587)
Accounts receivable, net	$ 2,245	$ 7,625

4. Inventories

Inventories consist of the following (in thousands):

	June 30, 2003	December 31, 2002
Finished goods	$ 3,949	$ 3,736
Work-in-process	1,883	4,279
Raw materials		3,837
Total inventory	$ 5,832	$ 11,852

At June 30, 2003, the carrying value of wireless product inventories totalled $1.2 million. If future demand for these or our other products is less than our current expectations, additional write-offs may be required.

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5. Intangible Assets

Amortization expense on intangible assets was $1.1 million and $2.7 million for the three months ended June 30, 2003 and 2002, respectively, and $2.1 million and $5.4 million for the six months ended June 30, 2003 and June 30, 2002, respectively .

The gross carrying amounts and related accumulated amortization of intangible assets consist of the following (in thousands):

		June 30, 2003		December 31, 2002	
	Remaining Weighted Average Useful Life in Years	Gross Carrying Amount	Accum. Amort.	Gross Carrying Amount	Accum. Amort.
Developed technology		$	$	$ 567	$ 224
Patents	2.1	11,253	4,090	11,046	2,430
Other	1.5	4,309	3,078	4,308	2,668
Total		$ 15,562	$ 7,168	$ 15,921	$ 5,322

The following table sets forth the estimated future amortization of intangible assets as of June 30, 2003 (in thousands):

Year Ending December 31,	
2003	2,076
2004	4,142
2005	2,177

6. Accrued Expenses

Accrued expenses consist of the following (in thousands):

	June 30, 2003	December 31, 2002
Accrued warranty obligation	$ 301	$ 407
Accrued income taxes	3,517	3,084

Accrued restructuring costs (Note 10)	1,006	4,936
Accrued non-cancelable inventory purchase obligations	207	1,671
Other	3,435	4,911
Total accrued expenses	$ 8,466	$ 15,009

7. Income Taxes

We have established a valuation allowance to fully reserve our deferred tax assets at December 31, 2002 due to the uncertainty of the timing and amount of future taxable income. For U.S. federal income tax purposes, at December 31, 2002, we had a net operating loss carryforward of approximately $121.1 million, including operating loss carryforwards of Transilica and an unused research and development credit carryforward of approximately $3.0 million, that begin to expire in 2011. A change in ownership, as defined in Section 382 of the Internal Revenue Code, may limit utilization of the U.S. federal net operating loss and research and development credit carryforwards.

The provision for the three and six months ended June 30, 2003 and 2002, consists of foreign income taxes and U.S. state income taxes.

Our income tax returns and those of our subsidiaries are subject to review and examination in the various jurisdictions in which we operate. We believe that all income tax issues that have been or may be raised as a result of such reviews and examinations will be resolved with no material impact on our financial position or future results of operations.

8. Commitments and Contingencies

Lease Commitments

In March 2000, we entered into a five-year operating lease for office space in Plano, Texas to be used as its headquarters, as well as for certain administrative, sales and marketing and research and development activities. Microtune KG leases its administrative, sales and marketing and research and development facility in Germany under an operating lease with a twenty-two year term, which began in December 1999. We lease our facilities in San Diego, California, which are primarily for research and development activities, under an operating lease that expires in 2004. We also lease certain other facilities, equipment and computer software under operating leases. Future minimum lease payments required under operating leases as of June 30, 2003 are as follows (in thousands):

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Year Ending December 31,	
2003	$ 1,630
2004	2,412
2005	821
2006	443
2007	420
Thereafter	5,777
	$ 11,503

As of June 30, 2003, future minimum payments required under the operating lease for the facility in Germany include $3.1 million guaranteed by Microtune KG relating to obligations issued to finance the land and building.

Rent expense for the three months ended June 30, 2003 and 2002, was $0.6 million and $0.8 million, respectively. Rent expense for the six months ended June 30, 2003 and 2002, was $1.4 million and $1.6 million, respectively.

Purchase Commitments

We have committed with a supplier to purchase a minimum of $2.0 million of silicon wafers during 2003 in return for volume pricing. In addition, under the terms of our agreement with TFS (Note 10), we may become obligated to purchase raw materials during 2003. Our maximum obligation to purchase raw materials inventory under this agreement is approximately $5.4 million. However, we are unable at this time to estimate the amount of inventory which will be repurchased, if any, under the agreement.

Legal Proceedings

From time to time, we may be involved in routine legal proceedings, as well as demands, claims and threatened litigation that arise in the normal course of our business. The ultimate amount of liability, if any, for any pending claims of any type (either alone or combined) may materially and adversely affect our financial position, results of operations or liquidity. Moreover, the ultimate outcome of any litigation is uncertain. Any outcome,whether favorable or unfavorable, may materially and adversely affect Microtune due to legal costs and expenses, diversion of management resources and other factors. Except as described below, we are not currently a party to any material litigation.

Intellectual Property Litigation

On January 24, 2001, we filed a lawsuit alleging patent infringement in the United States District Court for the Eastern District of Texas, Sherman Division, against Broadcom Corporation. The lawsuit alleged that Broadcom s BCM3415 microchip and related products infringe on our U.S. Patent No. 5,737,035. In our complaint, we sought monetary damages resulting from the alleged infringement as well as injunctive relief precluding Broadcom from taking any further action that infringes our patent. On March 20, 2003, a jury found in favor of Microtune. The jury found that certain Broadcom products do infringe Microtune s valid and enforceable patent and that the infringement was willful. On April

17, 2003 a preliminary injunction was issued that prohibits Broadcom from making, using, marketing, selling or distributing in the U.S. any technology found by the jury to infringe our patent. Several post-trial motions are still pending, including Microtune s motion regarding enhanced damages, attorney s fees and permanent injunction issues. Broadcom has announced that it intends to appeal the verdict.

On July 15, 2002, Broadcom Corporation filed a lawsuit alleging patent infringement in the United States District Court for the Eastern District of Texas, Sherman Division, against Microtune. The lawsuit alleges that various Microtune products infringe Broadcom s U.S. Patent No. 6,377,315B1. The complaint alleges seeking monetary damages resulting from the alleged infringement as well as injunctive relief precluding Microtune from taking any further action that infringes the U.S. Patent No. 6,377,315. On June 18, 2003 Broadcom filed a Motion to Dismiss this suit against Microtune with prejudice. We did not oppose the Motion to Dismiss.

On January 24, 2003, Broadcom Corporation filed a lawsuit alleging patent infringement in the United States District Court for the Northern District of California against Microtune. The lawsuit alleges that various Microtune products infringe Broadcom s U.S. Patent Nos. 6,445,039B1, 5,682,379 and 6,359,872. Two of these patents are also the subject of the March 3, 2003 action described below. The complaint seeks monetary damages resulting from the alleged infringement as well as injunctive relief precluding Microtune from taking any further action that infringes any of the listed patents. The case has been stayed pending resolution of the March 3, 2003 action described below. While we intend to vigorously defend this suit, we are unable at this time to determine whether the outcome of this litigation will have a material impact on our business prospects, results of operations or financial condition in any future period.

On March 3, 2003, Broadcom Corporation filed a complaint with the U.S. International Trade Commission (ITC) alleging patent infringement by Microtune products of Broadcom s U.S. Patent Nos. 6,445,039B1 and 5,682,379, which are also the subject of the lawsuit Broadcom filed on January 24, 2003 described above. The complaint seeks permanent injunctive relief excluding from entry into the United States the accused Microtune products. The ITC has appointed Administrative Law Judge Sidney Harris to schedule and hold an evidentiary hearing and make an initial determination. We are unable at this time to determine whether the outcome of the investigation will have a material impact on our business prospects, results of operations or financial condition in any future period.

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On April 24 2003, Broadcom Corporation filed a *Complaint For Declaratory Judgment of Patent Noninfringement* in the United States District Court for the Eastern District of Texas, Sherman Division, against Microtune. Broadcom is alleging that their BCM3416 and BCM93416 reference design do not infringe our U.S. Patent No. 5,737,035. While we intend to vigorously oppose this suit, we are unable at this time to determine whether the outcome of this litigation will have a material impact on our results of operations or financial condition in any future period.

Anti-Trust Litigation

On February 27, 2003 we filed a lawsuit alleging anti-competitive and monopolistic conduct, as well as restraint of trade conducts, in violation of the Texas Anti-Trust Act, in the District Court of Williamson County, Texas, against Broadcom Corporation. On March 28, 2003 the lawsuit was removed to the United States District Court for the Western District of Texas, Austin Division. Microtune amended its complaint to allege violation of the Sherman Act & Clayton Act, as well as the Texas Anti-Trust Act. The lawsuit alleges that Broadcom engaged in various illegal anti-competitive activities, including bundling its tuner together with its demodulator chips, in attempts to exclude Microtune and other competitors from a substantial share of the tuner and cable modem markets. In our complaint, we seek injunctive relief and monetary damages resulting from the alleged unlawful conduct, and treble damages for willful anti-competitive and monopolistic conduct. We are unable at this time to determine whether the outcome of the litigation will have a material impact on our business prospects, results of operations or financial condition in any future period.

Securities Litigation

Starting on July 11, 2001, multiple purported securities fraud class action complaints were filed in the United States District Court for the Southern District of New York. We are aware of at least three such complaints: Berger v. Goldman, Sachs & Co., Inc. et al.; Atlas v. Microtune et al.; and Ellis Investments Ltd. v. Goldman Sachs & Co., Inc. et al. The complaints are brought purportedly on behalf of all persons who purchased our common stock from August 4, 2000 through December 6, 2000 and are related to *In re Initial Public Offering Securities Litigation*. The Atlas complaint names as defendants Microtune, Douglas J. Bartek, our former Chairman and Chief Executive Officer, Everett Rogers, our former Chief Financial Officer and Vice President of Finance and Administration, and several investment banking firms that served as underwriters of our initial public offering. Microtune, Mr. Bartek and Mr. Rogers were served with notice of the Atlas complaint on August 22, 2001, however, they have not been served regarding the other referenced complaints. The Berger and Ellis Investment Ltd. complaints assert claims against the underwriters only. The complaints were consolidated and amended on May 29, 2002. The amended complaint alleges liability under §§ 11 and 15 of the Securities Act of 1933 (1933 Act Claims) and §§ 10(b) and 20(a) of the Securities Exchange Act of 1934 (1934 Act Claims), on the grounds that the registration statement for our initial public offering did not disclose that (1) the underwriters had agreed to allow certain of their customers to purchase shares in the offering in exchange for excess commissions paid to the underwriters, and (2) the underwriters had arranged for certain of their customers to purchase additional shares in the aftermarket at pre-determined prices. The amended complaint also alleges that false analyst reports were issued. No specific amount of damages is claimed. We are aware that similar allegations have been made in other lawsuits filed in the Southern District of New York challenging over 300 other initial public offerings and secondary offerings conducted in 1998, 1999 and 2000. Those cases have been consolidated for pretrial purposes before the Honorable Shira A. Scheindlin. On February 19, 2003, the Court ruled on all defendants motions to dismiss. The Court denied the motions to dismiss the 1933 Act claims. The Court did not dismiss the 1934 Act claims against us and other issuers and underwriters.

We have decided to accept a settlement proposal presented to all issuer defendants. In this settlement, plaintiffs will dismiss and release all claims against the Microtune defendants, in exchange for a contingent payment by the insurance companies collectively responsible for insuring the issuers in all of the IPO cases, and for the assignment or surrender of certain claims Microtune may have against the underwriters. The Microtune defendants will not be required to make any cash payments in the settlement, unless the *pro rata* amount paid by the insurers in the settlement exceeds the amount of the insurance coverage, a circumstance which we do not believe will occur. The settlement will require approval by the Court, which cannot be assured, after class members are given the opportunity to object to the settlement or opt out of the settlement.

Beginning in February 2003, Microtune, our former Chairman of the Board and Chief Executive Officer, Douglas J. Bartek, our former Chief Financial Officer and Vice-President of Finance and Administration, Everett Rogers, our former President and Chief Operating Officer, William L. Housley, and our present Chief Financial Officer and General Counsel, Nancy A. Richardson, were named as defendants in several class action lawsuits alleging violations of federal securities laws and regulations. The claims of the plaintiffs in the various lawsuits include that the defendants violated §§ 10(b) and 20(a) of the Securities Exchange Act of 1934, as well as SEC Rule 10b-5, resulting in damages to persons who purchased, converted, exchanged, or otherwise acquired our common stock between April 23, 2001 and February 20, 2003, inclusive. The plaintiffs specific allegations include that the defendants misrepresented material facts and omitted to state material facts necessary to make other statements made not misleading, and that these misrepresentations or omissions had the effect of artificially inflating Microtune s stock price. At this time, the alleged misrepresentations and omissions include allegations that: Microtune materially overstated revenue by recognizing certain sales immediately as revenue when deferred revenue recognition would have been more appropriate; Microtune failed to disclose that a material portion of its revenue had not been paid for or had not been paid in cash; Microtune lacked adequate internal controls and was therefore unable to ascertain its own true financial condition; Microtune s margins were being squeezed by a dramatic decline in the

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price of low-technology products; Microtune s product advantages were grossly overstated as Microtune was experiencing shortfalls due to the successes of Broadcom and Conexant; Microtune s customers agreed to take product only after receiving generous credits and/or were unable to pay for product; the value of Microtune s acquisition of Transilica was overstated by more than $50 million; the financial statements in Microtune s SEC Form 10-Q submissions did not present, in all material respects, Microtune s true financial condition, and did not reflect all adjustments that were necessary for a fair statement of the periods presented; Microtune s SEC Form 10-Q submissions were not presented in conformity with GAAP or principles of fair reporting; Microtune was shipping non-compliant product to customers to make its quarterly earnings and assuring the customers that it would replace non-compliant product in the future; and Microtune offered customers extended payment terms in exchange for accepting product the customers did not need or want. The relief sought by the plaintiffs in the various lawsuits, both individually and on behalf of shareholders, includes damages, interest, costs, fees, and expenses. The defendants have not yet filed a responsive pleading in any of the lawsuits. The actions have been consolidated into one case and lead plaintiffs have been appointed . We intend to vigorously defend these suits. We are unable at this time to determine whether the outcome of the litigation will have a material impact on our results of operations or financial condition in any future period. Furthermore, there can be no assurance regarding the outcome of the litigation or any related claim for indemnification or contribution.

On August 4, 2003, we received notification that Microtune is the subject of an investigation by the U.S. Securities and Exchange Commission (SEC). The SEC advised that the process under way is a fact-finding investigation and that it has not reached any conclusions regarding the matter. We are cooperating fully with the SEC. We believe the investigation relates directly to our recently concluded internal inquiry commissioned by the Audit Committee of our Board of Directors.

If our directors and officers liability insurance is insufficient or unavailable to cover the amount of any damages that may result from pending and future securities litigation for any reason, we may be required to pay the costs of indemnifying and defending certain of our directors and officers. Directors and officers liability insurance may not be available to us in sufficient amounts to cover any claims made in securities litigation filed against us in the future.

9. Stockholders Equity

On July 19, 2002, our Board authorized a stock repurchase program to acquire outstanding common stock on either the open market or through negotiated transactions. Under the program, we were authorized to purchase up to approximately 5.3 million of our outstanding shares. Since the beginning of the program through January 31, 2003 we have purchased approximately 4.4 million shares for an aggregate cost of approximately $7.7 million pursuant to this program. In February 2003, the Board of Directors suspended the repurchase program. The repurchase program may be reconsidered in the future.

10. Restructuring Costs

Beginning in the third quarter of 2002, we initiated a restructuring of our operations in light of the continued economic downturn. The measures, which included reducing the workforce, consolidating facilities and changing the strategic focus of a number of sites, were largely intended to strengthen our ability to focus on core strategic competencies and reduce our worldwide operating costs.

On March 27, 2003, we signed a manufacturing agreement with Three-Five Systems (TFS), a worldwide supplier of engineering and manufacturing services, whereby TFS will manufacture, assemble and test our RF tuner modules and wireless module products in TFS existing manufacturing facility in Manila, Philippines. As part of the agreement, we sold most of the equipment and most of the raw materials inventories of our Philippines manufacturing facility for approximately $7.9 million, consisting of $1.7 million in cash, an escrow payment of $3.5 million

and a note receivable of $2.7 million, which is due in three installments. We received the escrow amount in the second quarter of 2003. We also contracted with TFS to provide nearly all of our current demand for fully-assembled RF subsystems. As a result of the sale of assets to TFS, we reduced our payroll by approximately 1,000 employees. We charged restructuring costs $1.4 million in the first quarter of 2003 as a result of this sale, including employee severance and benefits, and settlement of our lease obligations and the loss on the disposal of the assets.

Restructuring costs in the second quarter of 2003 include $0.6 million in employee severance and benefits due to additional workforce reductions, principally at our facilities in San Diego, CA. On April 23, 2003, we sold MHDC to the Micronas Group resulting in a gain of approximately $1.6 million, which is included as a credit in restructuring. As a result of this sale, we reduced our payroll by 23 employees.

During the third quarter of 2003, we negotiated a favorable settlement of a software license agreement which reduced future payments for licenses previously used at two of our locations. This resulted in a $0.3 million decrease of the restructuring accrual as of June 30, 2003.

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The following table summarizes the restructuring accrual activity (in thousands):

	Severance and benefits	Lease obligations and facility closure costs	Other exit costs (credits)	Total
Balance at December 31, 2002	$ 1,666	$ 2,165	$ 1,105	$ 4,936
Provision	1,070	407	469	1,946
Changes in prior estimates	12	(572)	341	(219)
Sale of MHDC	(82)	(533)	(1,012)	(1,627)
Non-cash charges	(427)		(116)	(543)
Cash payments	(2,006)	(766)	(715)	(3,487)
Balance at June 30, 2003	$ 233	$ 701	$ 72	$ 1,006

Accruals related to restructuring activities were recorded in accrued expenses in the accompanying consolidated balance sheet. See Note 6. All remaining cash payments related to these restructurings are expected to be made by the end of the first quarter of 2004.

11. Geographic Information and Significant Customers

Our headquarters and main design center are located in Plano, Texas. We have other sales offices and design centers in the United States and other worldwide locations. We also have a design center in Germany. Revenue by geographical area are summarized below (in thousands):

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002 (Restated Note 2)	2003	2002 (Restated Note 2)
North America	$ 4,336	$ 4,835	$ 8,348	$ 10,039
Europe	3,200	4,367	6,716	8,265
Asia Pacific	6,434	12,832	11,480	21,994
Other	6		54	
Total	$ 13,976	$ 22,034	$ 26,598	$ 40,298

Sales to World Peace Industrial, Daimler Chrysler and Panasonic accounted for approximately 29%, 19% and 12%, respectively, of consolidated net revenue for the three months ended June 30, 2003. Sales to Daimler Chrysler, World Peace Industrial and Askey accounted for approximately, 19%, 12% and 11%, respectively, of consolidated net revenue for the three months ended June 30, 2002. Sales to World Peace Industrial and Daimler Chrysler accounted for approximately 21% and 20%, respectively, of consolidated net revenue for the six months ended June 30, 2003. Sales to Daimler Chrysler and Askey accounted for approximately 20% and 12%, respectively, of consolidated net revenue for the six months ended June 30, 2002. During the three months ended June 30, 2003 and 2002, we recognized 41% and 21% of our net revenue upon receipt of payment from our customers. During the six months ended June 30, 2003 and 2002, we recognized 34% and 16% of our net revenue upon receipt of payment from our customers.

Sales to our ten largest customers, including sales to their respective manufacturing subcontractors, accounted for approximately 72% and 76% of our net revenue for the six months ended June 30, 2003 and 2002, respectively.

The locations of property and equipment are summarized below (in thousands):

	June 30, 2003	December 31, 2002
North America	$ 7,143	$ 8,770
Europe	1,630	1,937
Asia Pacific	126	154
Philippines	2,577	6,944
Total	$ 11,476	$ 17,805

12. Resignation of Chairman of the Board, CEO and President

On June 27, 2003, Douglas J. Bartek resigned from his positions as Chairman of the Board, CEO and President. Mr. Bartek and the Board reached an agreement as to his severance terms. Under this agreement, Mr. Bartek s outstanding options became vested as of the date of the agreement. As a result we incurred stock compensation expense of approximately $0.9 million in the second quarter of 2003. In addition, Mr. Bartek was paid approximately $0.5 million for compensation, vacation time, benefits and miscellaneous expense. Mr. Bartek has agreed not to compete with Microtune and not to solicit Microtune customers or employees for a period of two and a half years from the date of his resignation.

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13. Subsequent Events

On August 12, 2003, we announced, James A. Fontaine has joined Microtune, as Chief Executive Officer (CEO) and President. Albert H. Taddiken, formerly our Chief Technical Officer (CTO), has been named to the position of Chief Operating Officer. Rob-Roy J. Graham, formerly the Chief Financial Officer (CFO) of Intervoice, Inc., has been named as our new CFO, effective August 25, 2003. Nancy A. Richardson will remain our Vice President, General Counsel and Secretary and remain our CFO until Mr. Graham s arrival.

Since July 1, 2003, through August 13, 2003, we have granted to our employees 2,514,459 stock options with exercise prices ranging from $2.20 to $2.70 per share. The stock options generally vest over the next four years.

Item 2. Management s Discussion and Analysis of Financial Condition and Results of Operations

Caution Regarding Forward-Looking Statements

Throughout this quarterly report on this Form 10-Q, we make forward-looking statements that are based on our current expectations, estimates and projections about our business and our industry, and that reflect our beliefs and assumptions based upon information available to us at the date of this report. In some cases, you can identify these statements by words such as if, may, might, will, should, expects, plans, anti believes, estimates, predicts, potential or continue, and other similar terms. These forward-looking statements include, among other things, projections of our future financial performance, our anticipated growth, our strategies and trends we anticipate in our businesses and the markets in which we operate and the competitive nature and anticipated growth of those markets.

We caution investors that forward-looking statements are only predictions, based on our current expectations about future events. These forward-looking statements are not guarantees of future performance and are subject to risks, uncertainties and assumptions that are difficult to predict. Our actual results, performance or achievements could differ materially from those expressed or implied by the forward-looking statements. In addition to the other information in this report, we encourage you to review the information regarding risk set forth in our 2002 Form 10-K (filed with the SEC on July 31, 2003) under the caption *Factors Affecting Operating Results and Stock Price* and in our other filings with the SEC, before deciding to invest in our stock or to maintain or change your investment. We caution investors not to rely on these forward-looking statements, which reflect management s analysis only as of the date of this report. We undertake no obligation to revise or update any forward-looking statement for any reason.

Unless otherwise noted, all references to our quarterly results for the quarter ended June 30, 2003 in this Item 2, *Management s Discussion and Analysis of Financial Condition and Results of Operations* will refer to our restated results for such period.

Overview

Microtune, Inc. designs and markets radio frequency (RF) silicon and subsystem module solutions for the worldwide broadband communications and transportation electronics markets. We also design and market selected Bluetooth wireless connectivity products. Our

mission is to develop and sell integrated circuit (IC) and module products and technology for the delivery of broadband video, audio and data to consumers and businesses.

Our expertise in RF, analog and to a lesser extent digital technologies allows us to deliver ICs and complete subsystem module solutions (called Modules or MicroModules) that permit the delivery and exchange of broadband information using terrestrial (off-air) and/or cable communications systems. We also develop and offer niche products to the Bluetooth wireless communications market.

Our products include tuners, amplifiers, transceivers, upconverters and Bluetooth wireless radio and baseband processors. When integrated into our customers commercial or consumer equipment, our products permit the transmission and reception of RF signals that contain video, audio and/or data. Our products are used in a range of applications, including cable high-speed internet access, digital and high-definition television, TV on a PC, in-car audio and video, and cable-based digital phone service.

Today, our products principally are marketed to original equipment manufacturers (OEMs) in the following two markets:

Cable and Terrestrial Broadband Communications

This market includes products that send and receive cable and terrestrial broadband signals. Our Cable Broadband products are designed for use in RF electronics from the cable head-end upconverter to consumer access and gateway devices, including cable modems, digital and analog set-top boxes, digital televisions and cable telephony systems. Our Terrestrial Broadband products are designed for use in off-air applications including digital and analog television sets and their companion appliances (VCRs, High Definition Television (HDTV) projection displays, liquid crystal display (LCDs), digital set-top boxes, digital personal video recorders), and PC/TV-based multimedia products.

Transporation Electronics

This market includes products targeted for mobile environments, such as automobile and airline in-flight entertainment systems. Our Transportation Electronics products range from components for traditional AM/FM radio to components for the emerging entertainment and telematics applications that provide value to mobile customers, including in-car and in-flight video, HD radio (digital radio), and radio data system for traffic avoidance and other services.

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Critical Accounting Policies

Our discussion and analysis of our financial condition and results of operations are based on our Consolidated Financial Statements, which have been prepared in accordance with accounting principles generally accepted in the United States (GAAP). Note 1 of our Consolidated Financial Statements describes the significant accounting policies essential to our Consolidated Financial Statements. Preparation of our financial statements requires estimates, judgments and assumptions. We believe that the estimates, judgments and assumptions upon which we rely are appropriate and correct based upon information available to us at the time that these estimates, judgments and assumptions are made. These estimates, judgments and assumptions can affect our reported assets and liabilities as of the date of the financial statements, as well as the reported revenue and expense during the periods presented. If there are material differences between these estimates, judgments or assumptions and actual facts, our financial statements may be affected.

In many cases, the accounting treatment of a particular transaction is specifically dictated by GAAP and does not require our judgment in its application. There are areas in which our judgment in selecting among available alternatives would not produce a materially different result, but there are some areas in which our judgment in selecting among available alternatives would produce a materially different result. See the Notes to Consolidated Financial Statements that contain additional information regarding our accounting policies and other disclosures.

We believe the following to be our critical accounting policies. That is, they are both important to the portrayal of our financial condition and results, and they require significant estimates, judgments and assumptions about matters that are inherently uncertain.

Revenue Recognition

We recognize revenue when we receive a purchase order from our customer, our product has been shipped, title has transferred to our customer, the price that we will receive for our product is fixed or determinable, and collection from our customer is considered probable. Title to our product transfers to our customer either when it is shipped to or received by our customer, based on the specific agreement.

Our revenue is recorded based on the facts currently known to us. If we do not meet the criteria above, we do not recognize revenue. For example, if we are unable to determine the amount that we will ultimately collect once our product has shipped and title has transferred to our customer, we defer recognition of revenue until we can determine the amount that ultimately will be collected. Terms of agreements with customers that impact our ability to determine the amount we will ultimately collect include stock rotation rights, rights to return unsold product, price protection, payment terms conditional on sale or use of the product by our customer and other extended payment terms. In most instances when we defer revenue, the timing and amount of revenue we ultimately recognize is determined upon our receipt of payment, which can result in significant fluctuations in revenues from period to period. For example, for the three months ending June 30, 2003, we recognized 41% of our net revenue upon receipt of payment compared to 28% of our net revenue for the three months ended March 31, 2003. Until we receive payment from these customers, we present deferred revenue as a reduction of the related accounts receivable.

Allowance for Doubtful Accounts

We evaluate the collectibility of our accounts receivable based on a combination of factors. In cases where we are aware of circumstances that may impair a specific customer s ability to meet its financial obligations to us, we record a specific allowance against amounts due to us and reduce the net recognized receivable to the amount we reasonably believe will be collected. In other instances, we recognize allowances for

doubtful accounts based on the length of time the receivables are outstanding, industry and geographic concentrations, the current business environment and our historical experience. If the financial condition of our customers deteriorates or if economic conditions worsen, increased allowance may be required in the future. We cannot predict future changes in the financial stability of our customers, and there can be no assurance that our allowance will be adequate. If actual credit losses are significantly greater than the allowance we have established, that would increase our general and administrative expenses and increase our reported net loss. Conversely, if our actual credit losses are significantly less than our allowance, this would eventually decrease our general and administrative expenses and decrease our reported net loss.

Inventory Valuation

Our inventories are stated at the lower of standard cost, which approximates actual cost determined on a first-in, first-out basis, or estimated realizable value. Adjustments to reduce our inventories to estimated realizable value, including allowances for excess and obsolete inventories, are determined quarterly by comparing inventory levels of individual materials and parts to historical usage rates, current backlog and estimated future sales. Actual amounts realized upon the sale of inventories may differ from estimates used to determine inventory valuation allowances due to changes in customer demand, technology changes and other factors.

Impairment of Long-lived Assets

We review long-lived assets, including intangible assets, for impairment whenever events or changes in circumstances indicate that the carrying amount of such assets may not be recoverable. We evaluate the recoverability of these assets by a comparison of the

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carrying amount of an asset to projected undiscounted cash flows expected to be generated by the assets or business unit. If we determine our long-lived assets are impaired, we recognize the impairment in the amount by which the carrying amount of the assets exceeds the estimated fair value of the assets.

Deferred Taxes

For U.S. federal income tax purposes, at December 31, 2002, we had a net operating loss carry-forward of approximately $121.1 million and an unused research and development credit carry-forward of approximately $3.0 million, that begin to expire in 2011. Due to the uncertainty of our ability to realize our deferred tax assets, they have been fully reserved. If we generate U.S. taxable income in future periods, reversal of this valuation allowance could have a significant positive impact on net income in the period that it becomes more likely than not that the net operating loss carryforward will be recognized.

Results of Operations

The following table shows certain data from our consolidated statements of operations expressed as a percentage of net revenues:

	Three Months Ended June 30,		Six Months Ended June 30,	
	2003	2002 (Restated)	2003	2002 (Restated)
Net revenue	100%	100%	100%	100 %
Cost of revenue	65	64	73	63
Gross margin	35	36	27	37
Operating expenses:				
Research and development:				
Stock option compensation	3	12	6	13
Other	41	50	46	50
	44	62	52	63
Selling, general and administrative:				
Stock option compensation	8	3	6	4
Other	55	23	54	25
	63	26	60	29
Restructuring costs	(9)			
Amortization of intangible assets and goodwill	7	12	8	13
Total operating expenses	105	100	120	105
Loss from operations	(70)	(64)	(93)	(68)

Other income	13	2	8	2
Loss before income taxes	(57)	(62)	(85)	(66)
Income tax expense	1	2	1	1
Net loss	(58)%	(64)%	(86)%	(67)%

Comparison of the Three and Six Months Ended June 30, 2003 and 2002

Net Revenue

Total net revenue for the three months ended June 30, 2003 was $13.9 million, compared to $22.0 million for the three months ended June 30, 2002, representing a decrease of 37%. Our net revenue for the six months ended June 30, 2003 was $26.6 million, compared to $40.3 million for the six months ended June 30, 2002, representing a decrease of 34%. The decline was primarily experienced in the broadband communications sector due to a combination of a shift in customer purchasing from modules to silicon products which have lower average sales prices and increased competitor pressures. This percentage will fluctuate based on the amount and timing of shipments for which revenue recognition is deferred until we receive payment. Currently, we expect that the percentage of net revenue recognized upon payment from our customers will decrease in the third quarter of 2003 due to the decrease in deferred revenue at June 30, 2003.

Sales to World Peace Industrial, Daimler Chrysler and Panasonic accounted for approximately 29%, 19% and 12%, respectively, of consolidated net revenue for the three months ended June 30, 2003. Sales to Daimler Chrysler, World Peace Industrial and Askey accounted for approximately, 19%, 12% and 11%, respectively, of consolidated net revenue for the three months ended June 30, 2002. Sales to World Peace Industrial and Daimler Chrysler accounted for approximately 21% and 20%, respectively, of consolidated net revenue for the six months ended June 30, 2003. Sales to Daimler Chrysler and Askey accounted for approximately 20% and 12%, respectively, of consolidated net revenue for the six months ended June 30, 2002. During the three months ended June 30, 2003 and 2002, we recognized 41% and 21% of our net revenue upon receipt of payment from our customers. During the six months ended June 30, 2003 and 2002, we recognized 34% and 16% of our net revenue upon receipt of payment from our customers.

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Sales to our ten largest customers, including sales to their respective manufacturing subcontractors, accounted for approximately 83% and 76% of our net revenue for the three months ended June 30, 2003 and 2002, respectively, and 72% and 76% of our net revenue for the six months ended June 30, 2003 and 2002, respectively.

In general, our net revenue from automotive products decreases in the third quarter of each year due to the seasonal nature of our sales to automobile manufacturers and their suppliers. We believe this decrease results from automobile factory shutdowns for re-tooling to accommodate automobile model year changeovers. In addition, since the third quarter of 2002, we believe sales by a competitor of its products that were found to willfully infringe one of our patents had and will continue to have a material and negative effect on our revenues.

Cost of Revenue

Cost of revenue includes the cost of subcontracted materials, integrated circuit assembly, final test, factory labor and overhead, shipping of materials, custom expenses, warranty costs and inventory charges. We also incur cost for the depreciation of our test and handling equipment, labor and logistics. Our raw materials costs may increase due to price fluctuations and cyclical demand for those materials. We may not be able to pass cost increases on to our customers.

Cost of revenue as a percentage of net revenue was 65% and 64% for the three months ended June 30, 2003 and 2002, respectively. Cost of revenue as a percentage of net revenue increased to 73% for the six months ended June 30, 2003 compared to 63% for the six months ended June 30, 2002. Our cost of revenue for the six months ended June 30, 2003 increased compared to the same period for 2002 as a result of a $1.2 million write-down of our Bluetooth wireless inventories, as well as inefficiencies at our former manufacturing facility in the Philippines caused by reduced production volumes prior to the sale of these facilities in March 2003.

Research and Development

Our research and development expenses consist of personnel-related expenses, quality assurance, test development, qualification, lab supplies, training and prototype subcontract materials. We expense all of our research and development costs in the period incurred. Research and development efforts are currently focused primarily on development of the next generation of RF products.

Research and development expenses, including non-cash stock compensation, for the three months ended June 30, 2003 and 2002 were $6.1 million, or 44% of net revenue, and $13.7 million, or 62% of net revenue, respectively. Research and development expenses, including non-cash stock compensation, for the six months ended June 30, 2003 and 2002 were $13.9 million, or 52% of net revenue, and $25.4 million, or 63% of net revenue, respectively. The decrease in research and development is due in part to a reduction in personnel and associated decrease in stock compensation related to those employees. Stock option compensation related to research and development was $0.5 million and $2.6 million for the three months ended June 30, 2003 and 2002, respectively. Stock option compensation related to research and development was $1.7 million and $5.2 million for the six months ended June 30, 2003 and 2002, respectively.

Selling, General and Administrative

Selling, general and administrative expenses include our personnel-related expenses for administrative, finance, human resources, marketing and sales, information technology and legal departments, and include expenditures related to legal, public relations and financial advisors. These expenses also include promotional and marketing costs, sales commissions, shipping costs to customers and allowance for doubtful accounts.

Selling, general and administrative expenses, including non-cash stock compensation, for the three months ended June 30, 2003 and 2002 were $8.9 million, or 63% of net revenue, and $5.7 million, or 26% of net revenue, respectively. Selling, general and administrative expenses, including non-cash stock compensation, for the six months ended June 30, 2003 and 2002 were $15.7 million, or 60% of net revenue, and $11.7 million, or 29% of net revenue, respectively. The increase relates to increases in legal expenses due to our lawsuits regarding various patents and shareholder lawsuits. See Part II Item 1, *Legal Proceedings* . In addition, our cost of obtaining directors and officers insurance has significantly increased. Selling, general and administrative costs for the three and six months ended June 30, 2003, include expense of $0.9 million of stock compensation, and $0.5 million for compensation, vacation time, benefits and miscellaneous expense paid to our former CEO, Douglas J. Bartek pursuant to his separation agreement. Stock option compensation related to selling, general and administrative was $1.1 million and $0.7 million for the three months ended June 30, 2003 and 2002, respectively. Stock option compensation related to selling, general and administrative was $1.5 million for both the six months ended June 30, 2003 and 2002.

Amortization of Intangible Assets

Amortization of intangible assets for the three months ended June 30, 2003 and 2002 was $1.1 million and $2.7 million, respectively. Amortization of intangible assets for the six months ended June 30, 2003 and 2002 was $2.1 million and $5.4 million,

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respectively. Amortization of intangible assets in 2003 results principally from our combinations with Microtune KG and our acquisition of patents from Silicon Wave.

Restructuring Costs

Restructuring costs for the six months ended June 30, 2003 and 2002 were $0.1 million and $54,000, respectively. The change in 2003 resulted primarily from the sale of the assets of our manufacturing facility in Manila, Philippines in the first quarter of 2003, and the sale of MHDC in the second quarter of 2003. Restructuring costs for the six months ended June 30, 2003, included employee severance, settlement of our lease obligation and the loss on the disposal of the assets related to the sale of the manufacturing facility in the Philippines. These charges were taken to reduce operating costs and strengthen our ability to focus on core strategic competencies. Restructuring costs in the second quarter of 2003 include $0.6 million in employee severance and benefits due to additional workforce reductions, principally at our facilities in San Diego, CA. In the second quarter of 2003, we sold MHDC to the Micronas Group, resulting in a gain of approximately $1.6 million, which is included as a credit in restructuring. Restructuring costs in the second quarter of 2003 also include a credit of $0.3 million due to a favorable settlement of a software license agreement. See Note 10 of our Consolidated Financial Statements.

Other Income and Expense

Other income consists of interest income from investment of cash and cash equivalents, foreign currency gains and losses and other non-operating income and expenses.

Interest income for the three months ended June 30, 2003 and 2002 was $0.2 million and $0.8 million, respectively. Interest income for the six months ended June 30, 2003 and 2002 was $0.6 million and $1.6 million, respectively. The decrease in interest income is mainly due to the decrease in interest rates and lower cash and cash equivalents balance for the three months ended June 30, 2003 as compared to the three and six months ended June 30, 2002.

Our functional currency is the U.S. Dollar. The impact from the remeasurement of accounts not denominated in U.S. Dollars is recognized currently in our results of operations as a component of foreign currency gains and losses.

Income Taxes

Our income taxes are computed using the asset and liability method of accounting. Under the asset and liability method, a deferred tax asset or liability is recognized for estimated future tax effects attributable to temporary differences and carryforwards. The measurement of deferred income tax assets is adjusted by a valuation allowance, if necessary, to recognize future tax benefit only to the extent, based on available evidence, it is more likely than not such benefit will be realized.

For U.S. federal income tax purposes, at December 31, 2002, we had a net operating loss carryforward of approximately $121.1 million and an unused research and development credit carryforward of approximately $3.0 million, that begin to expire in 2011. Due to the uncertainty of our

ability to realize our deferred tax assets, they have been fully reserved.

The provision for the three and six months ended June 30, 2003 and 2002 consists of foreign income taxes and U.S. state income taxes.

Liquidity and Capital Resources

As of June 30, 2003, we had net working capital of $92.4 million, including $95.0 million of cash and cash equivalents, compared to net working capital of $102.6 million, including $106.3 million of cash and cash equivalents, at December 31, 2002. We consider highly liquid investments with original maturities of three months or less to be cash equivalents. Cash and cash equivalents consist of bank deposits, money market funds and asset-backed commercial paper. Our investments in asset-backed commercial paper are comprised of high-quality securities in accordance with our investment policy.

On July 19, 2002, our Board authorized a stock repurchase program to acquire outstanding common stock on either the open market or through negotiated transactions. Under the program, we were authorized to purchase up to approximately 5.3 million of our outstanding shares. From the beginning of the program through January 31, 2003 we have purchased approximately 4.4 million shares for an aggregate cost of approximately $7.7 million. In February 2003, our Board of Directors suspended the repurchase program. The repurchase program may be reconsidered in the future.

Operating activities used $16.8 million in cash during the six months ended June 30, 2003 compared to $20.4 million for the six months ended June 30, 2002. For the six months ended June 30, 2003, the decrease in cash used from operations is mostly due to reduced research and development costs and a decrease in working capital requirements, partially offset by higher selling, general and administrative costs.

Investing activities generated $3.7 million in cash during the six months ended June 30, 2003 compared to $3.6 million used in investing activities for the six months ended June 30, 2002. We received approximately $5.2 million from the sale of the assets of our manufacturing facility in Manila, Philippines in the first quarter of 2003. During the second quarter of 2003, the sale of MHDC resulted in the transfer of approximately $0.9 million in cash to Micronas. Investments in property and equipment used $0.4 million in the six months ended June 30, 2003, compared to $3.2 million in the six months ended June 30, 2002.

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compared to $3.2 million in the six months ended June 30, 2002. The reduction in capital expenditures in 2003 resulted primarily from the sale of our manufacturing facility.

Financing activities provided $0.5 million in cash during the six months ended June 30, 2003 compared to $0.3 million for the six months ended June 30, 2002. We received cash of approximately $0.6 million and $0.9 million net of loans, from the sale of our common stock upon the exercise of employee stock options and from shares purchased under our Employee Stock Purchase Plan during the six months ended June 30, 2003 and 2002, respectively. For the six months ended June 30, 2002, we also incurred $0.5 million for the remainder of costs from our December 18, 2001 follow-on public offering when we issued 5 million shares of common stock resulting in net proceeds of approximately $109 million.

Future Operating Commitments

In the normal course of business, we may enter into leases for new or expanded facilities in both domestic and global locations. We also evaluate, on an ongoing basis, the merits of acquiring technology or businesses, or establishing strategic relationships with and investing in other companies. We may decide to use cash and cash equivalents to fund such activities in the future.

Our future cash commitments are primarily for long-term facility leases. Future minimum lease payments required under operating leases as of June 30, 2003 are as follows (in thousands):

Year Ending December 31,	
2003	$ 1,630
2004	2,412
2005	821
2006	443
2007	420
Thereafter	5,777
	$ 11,503

Purchase Commitments

We have committed with a supplier to purchase a minimum of $2.0 million of silicon wafers during 2003 in return for volume pricing. In addition, under the terms of our agreement with TFS, we may become obligated to purchase raw materials inventory during 2003. Our maximum obligation to purchase raw materials inventory under this agreement is approximately $5.4 million. However, we are unable at this time to estimate the amount of inventory which will be repurchased, if any, under the agreement.

We expect to continue to incur significant operating expenses in the foreseeable future, particularly research and development expenses, sales and marketing expenses, and legal costs and expenses to secure, protect and defend our intellectual property. We anticipate that such operating

expenses, as well as planned capital expenditures, will constitute a material use of our cash resources. As a result, our net cash flows will depend heavily on the level of future sales and our ability to manage expenses.

Currently, our expenses significantly exceed our cash receipts, and we expect this trend to continue. Although there can be no assurance, we believe that our current balances of cash and cash equivalents will provide adequate liquidity to fund our operations and meet our other cash requirements for approximately the next two (2) years. We may find it necessary or we may choose to seek additional financing if our investment plans change, or if industry or market conditions are favorable for a particular type of financing. If we raise additional funds through the issuance of equity or convertible debt securities, the percentage ownership of our stockholders will be reduced. There can be no assurance that we will be able to raise additional funds if needed.

Item 3. Qualitative and Quantitative Disclosures About Market Risk

We are exposed to certain market risks in the ordinary course of our business. These risks result primarily from changes in foreign currency exchange rates and interest rates. In addition, our international operations are subject to risks related to differing economic conditions, differing tax structures, and other regulations and restrictions. More detailed information concerning market risk is contained in our 2002 Form 10-K Report and is incorporated by reference to this report.

Item 4. Controls and Procedures

The rules adopted by the Securities and Exchange Commission (SEC) require that we present the conclusions of our Chief Executive Officer (CEO) and our Chief Financial Officer (CFO) regarding the effectiveness of our disclosure controls and procedures and internal controls and procedures as of the filing date of this report (the Evaluation Date). We plan to evaluate our disclosure and internal controls and procedures on a quarterly basis in accordance with the Securities and Exchange Act of 1934, as amended, (Exchange Act) and its regulations so that the conclusions concerning controls effectiveness can be reported in our quarterly reports on Form 10-Q and our annual reports on Form 10-K.

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Our disclosure control system, no matter how well designed and operated, can provide reasonable, but not absolute, assurance that its objectives will be met. Our disclosure controls may be rendered ineffective due to faulty judgments in decision-making, or honest errors and mistakes. In addition, our disclosure controls can be circumvented by the individual acts of a person, or by collusion of two or more people. Management also may fail to observe or may override our disclosure controls and procedures. Due to the inherent limitations in cost-effective control systems, including ours, misstatements caused by error or fraud may occur and not be detected.

We have begun evaluating the effectiveness of the design and operation of our disclosure controls and procedures as of the Evaluation Date for purposes of filing reports under the Exchange Act. Our evaluation is based, in part, on the findings of the recently completed inquiry into the events related to the restatements of our financial statements contained herein and in our annual report on Form 10-K conducted on behalf of our Audit Committee. This disclosure controls evaluation was done under the supervision and with the participation of management, including our CEO and CFO. Our CEO and CFO also considered findings of our auditors.

In past reporting periods, our internal controls related to revenue recognition were not sufficient to ensure that revenue was properly recognized under GAAP, and our controls and procedures over the revenue recognition process were not effective in ensuring that our existing policies and procedures were operating as intended. In some cases, terms contained in agreements with customers were not followed. At times our controls and procedures over revenue recognition did not detect that in some cases representatives of Microtune had circumvented controls and agreed to terms with customers beyond our normal terms, including price protection, rights to return products unsold by customers, payment terms that were conditional on the sale or use of our products by our customer, or payment terms extended beyond our normal terms. In addition, on some occasions our internal controls did not detect occurrences of cases where quantities shipped to customers were in excess of quantities included in customer purchase orders or were shipped without valid customer purchase orders. In past reporting periods, we recognized revenue in the wrong accounting period in some cases because delivery to our customer had not been completed due to the shipping terms of the transaction. Finally, our internal controls did not detect that revenue had been recognized on shipments of products that had not completed certain quality test procedures or were missing certain components. In certain cases these instances were the result of existing controls and procedures being circumvented or overridden by Microtune personnel.

Based upon the controls evaluation, our CEO and CFO have concluded that as of the Evaluation Date our disclosure controls and procedures need further refinement to ensure that material information relating to Microtune and its consolidated subsidiaries is made known to management, including the CEO and CFO, particularly during the period when our periodic reports are being prepared, and to ensure that our disclosure controls and procedures better provide reasonable assurance that our consolidated financial statements are fairly presented in conformity with accounting principles generally accepted in the United States (GAAP).

In accordance with SEC requirements, the CEO and CFO note that, since the Evaluation Date we have begun to make improvements to our internal controls and procedures and other changes were made that could significantly affect our internal controls and procedures.

In June 2003, we implemented a whistleblower policy. This policy provides a means for our employees to anonymously inform us of (a) unethical business practices, (b) illegal activity, (c) deviations from our policies and procedures, (d) erroneous accounting treatment of business transactions, (e) weaknesses in internal controls, (f) disputes with auditors, and (g) disclosures in SEC reports or other public disclosures that are not full, fair, accurate, timely or understandable.

In July 2003, we implemented a Code of Ethics to promote the honest and ethical conduct of all of our officers and financial executives, including the ethical handling of actual or apparent conflicts of interest between personal and professional relationships, to promote full, fair, accurate, timely and understandable disclosure in periodic reports required to be filed by us, and to promote compliance with all applicable rules and regulations that apply to us and our officers. We anticipate that additional internal disclosure controls and new internal auditing controls and procedures will be adopted and implemented as a result of the inquiry.

In addition, we have revised our revenue recognition procedures such that revenue for product sales that is not recognized upon shipment or upon receipt by our customer is deferred and is generally not recognized until we receive payment from our customer.

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Our management, including our CEO and CFO, does not expect that our disclosure controls and procedures or internal controls and procedures will prevent all inaccuracies, errors or fraud. When we evaluated our control systems, we considered alternative controls and their benefits relative to their additional costs. We believe that the inherent limitations in all control systems, including ours, prevent absolute assurance that all inaccuracies, errors or fraud will be detected. In the future, including as a result of conclusions and recommendations from the inquiry of our Audit Committee, we anticipate additional changes may be made to our disclosure controls and procedures and our internal controls and procedures.

Part II Other Information

Item 1. Legal Proceedings

From time to time, we may be involved in routine legal proceedings, as well as demands, claims and threatened litigation that arise in the normal course of our business. The ultimate amount of liability, if any, for any pending claims of any type (either alone or combined) may materially and adversely affect our financial position, results of operations or liquidity. Moreover, the ultimate outcome of any litigation is uncertain. Any outcome whether favorable or unfavorable, may materially and adversely affect us due to legal costs and expenses, diversion of management resources and other factors. Except as described below, we are not currently a party to any mateleft;font-size:10pt;">

—

7,700

156

156
BELEODAQ distribution rights
25,000

(3,281
)

—

—

21,719

160

139
MARQIBO distribution rights
26,900

(9,624

)

—

—

17,276

81

48
FOLOTYN distribution rights
118,400

(31,834
)

—

—

86,566

152

110
ZEVALIN distribution rights – U.S.
41,900

(31,477
)

—

—

10,423

123

36
ZEVALIN distribution rights – Ex-U.S.
23,490

(13,543
)

(3,566
)

—

6,381

96

48
FUSILEV distribution rights (2)
16,778

(9,618
)

—

(7,160
)

—

56

0
FOLOTYN out-license (3)
27,900

(9,789
)

—

(1,023
)

17,088

110

76
Total intangible assets
$
305,668

$
(109,166
)

$
(3,566
)

$
(8,183

)

$
184,753

14

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(Unaudited)

(1) The FDA approval of EVOMELA in March 2016 triggered a $6 million payment due to CyDex Pharmaceuticals, Inc. (a wholly-owned subsidiary of Ligand Pharmaceuticals Incorporated). This event also resulted in a reclassification of our $7.7 million "EVOMELA IPR&D" to "EVOMELA distribution rights" due to our ability to begin its commercialization with this FDA approval. In accordance with our capitalization policy for intangible assets, amortization will commence on the first day of the following month of this reclassification (i.e., April 1, 2016).

(2) On February 20, 2015, the U.S. District Court for the District of Nevada found the patent covering FUSILEV to be invalid, which was upheld on appeal. On April 24, 2015, Sandoz began to commercialize a generic version of FUSILEV. This represented a “triggering event” under applicable GAAP in evaluating the value of our FUSILEV distribution rights as of March 31, 2015, resulting in a $7.2 million impairment charge (non-cash) in the first quarter of 2015. We accelerated amortization expense recognition in 2015 for the remaining net book value of FUSILEV distribution rights.

(3) On May 29, 2013, we amended our FOLOTYN collaboration agreement with Mundipharma. As a result of the amendment, Europe and Turkey were excluded from Mundipharma’s commercialization territory, and their royalty rates and milestone payments to us were modified. This constituted a change under which we originally valued the FOLOTYN out-license as part of business combination accounting, resulting in an impairment charge (non-cash) of $1.0 million in the second quarter of 2013.

	December 31, 2015				
	Historical Cost	Accumulated Amortization	Foreign Currency Translation	Impairment	Net Amount
MARQIBO IPR&D (NHL and other novel indications)	$17,600	$—	$ —	$ —	$ 17,600
EVOMELA IPR&D	7,700	—	—	—	7,700
BELEODAQ distribution rights	25,000	(2,812)	—	—	22,188
MARQIBO distribution rights	26,900	(8,544)	—	—	18,356
FOLOTYN distribution rights	118,400	(29,474)	—	—	88,926
ZEVALIN distribution rights – U.S.	41,900	(30,608)	—	—	11,292
ZEVALIN distribution rights – Ex-U.S.	23,490	(12,632)	(4,353)	—	6,505
FUSILEV distribution rights	16,778	(9,618)	—	(7,160)	—
FOLOTYN out-license	27,900	(9,109)	—	(1,023)	17,768
Total intangible assets	$305,668	$(102,797)	$ (4,353)	$ (8,183)	$ 190,335

Intangible asset amortization expense recognized during the three months ended March 31, 2016 was $5.8 million, as compared to $14.0 million of amortization and impairment expense recognized in the prior year period (of which $7.2 million relates to the impairment of the FUSILEV distribution rights, and the remaining $6.9 million relates to scheduled amortization expense).

Estimated intangible asset amortization expense for the remainder of 2016 and the five succeeding fiscal years and thereafter is as follows:

Years Ending December 31,	
Remainder of 2016	$18,017

2017	24,023
2018	24,023
2019	21,417
2020	16,113
2021	14,634
2022 and thereafter	48,926
	$167,153

“Goodwill” is comprised of the following:

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(Unaudited)

	March 31, 2016	December 31, 2015
Acquisition of Talon (MARQIBO rights)	$ 10,526	$ 10,526
Acquisition of ZEVALIN Ex-U.S. distribution rights	2,525	2,525
Acquisition of Allos (FOLOTYN rights)	5,346	5,346
Foreign currency exchange translation effects	(353)	(437)
Goodwill	$ 18,044	$ 17,960

(g) Other assets

“Other assets” are comprised of the following:

	March 31, 2016	December 31, 2015
Equity securities and secured promissory note - CASI (see Note 10)*	$ 7,520	$ 6,689
Supplies and deposits**	1,165	185
2018 Convertible Notes issuance costs (excluding current portion)***	—	—
Executive officer life insurance – cash surrender value	9,651	9,181
Inventories - non-current portion	6,923	3,156
Other miscellaneous assets	45	—
Other assets	$ 25,304	$ 19,211

* These equity securities were excluded from “marketable securities” (see Note 3(a)) due to our intent to hold these securities for at least one year beyond March 31, 2016, as discussed in Note 10. Unrealized gains from these equity securities were recognized through “unrealized gain on available-for-sale securities" within the Condensed Consolidated Statements of Comprehensive Loss, and were $1.4 million for the three months ended March 31, 2016.

** Of this balance at March 31, 2016, $1.0 million relates to ZEVALIN inventories that we intend to consume in research and development activities in future periods as part of our new contract manufacturer validation process. Accordingly, we have presented this value within "other assets" rather than "inventories" due to our present intention for these units.

*** Beginning January 1, 2016, our debt issuance costs (current and non-current portions) were retrospectively reclassified from “prepaid expenses and other assets” and "other assets" to a reduction of the carrying amount of “convertible senior notes” (i.e., contra-liability - see Note 14) within our accompanying Consolidated Balance Sheets, in accordance with ASU 2015-03. These amounts were $2.0 million and $2.2 million (including current and non-current portions) as of March 31, 2016 and December 31, 2015, respectively.

(h) Accounts payable and other accrued liabilities

“Accounts payable and other accrued liabilities” are comprised of the following:

	March 31, 2016	December 31, 2015
Trade accounts payable and other accrued liabilities	$ 31,922	$ 26,684
Accrued rebates	6,978	18,166
Accrued product royalty	4,076	4,908
Allowance for returns	1,429	1,394
Accrued data and distribution fees	1,126	1,830
Accrued GPO administrative fees	521	1,058
Accrued inventory management fee	210	498

Allowance for chargebacks	1,241	2,001
Accounts payable and other accrued liabilities	$ 47,503	$ 56,539

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(Unaudited)

Amounts presented within “accounts payable and other accrued liabilities” in the accompanying Condensed Consolidated Balance Sheets specifically for gross-to-net ("GTN") estimates (see Note 2(i)) are as follows:

	Rebates and Chargebacks	Data and Distribution, GPO Fees, and Inventory Management Fees	Returns
Balance as of December 31, 2014	$ 45,822	$ 8,284	$1,135
Add: provisions	75,498	15,928	1,486
(Less): credits or actual allowances	(101,153)	(20,826)	(1,227)
Balance as of December 31, 2015	20,167	3,386	1,394
Add: provisions	19,952	2,227	590
(Less): credits or actual allowances	(31,900)	(3,755)	(555)
Balance as of March 31, 2016	$ 8,219	$ 1,858	$1,429

(i) Deferred revenue

Deferred revenue (current and non-current) is comprised of the following:

	March 31, 2016	December 31, 2015
Mundipharma deferred revenue (see Note 11)	$ 2,472	$ —
FUSILEV deferred revenue*	—	6,083
Dr. Reddy's out-license (see Note 16(b)(iii))	436	430
Deferred revenue	$ 2,908	$ 6,513

* In the third quarter 2015, we deferred revenue recognition related to certain FUSILEV product shipments that did not meet our revenue recognition criteria (see Note 2(i)(a)), aggregating $9.9 million. Specifically, this deferral resulted from our inability to concurrently estimate future rebate values (with requisite precision) offered to our customers in order to compete with generic products. During the fourth quarter of 2015, we recognized $3.8 million for these third quarter shipments, and $6.1 million remained deferred as of December 31, 2015. In the first quarter 2016, this $6.1 million of deferred revenue was recognized in full.

(j) Other long-term liabilities

Other long-term liabilities are comprised of the following:

	March 31, 2016	December 31, 2015
Accrued executive deferred compensation	$ 7,117	$ 6,458
Deferred rent (non-current portion)	235	248
Clinical study holdback costs, non-current	19	—
Other tax liabilities	738	738
Other long-term liabilities	$ 8,109	$ 7,444

4. GROSS-TO-NET PRODUCT SALES

The below table presents a GTN product sales reconciliation for the accompanying Condensed Consolidated Statement of Operations:

	Three Months Ended March 31,	
	2016	2015
Gross product sales	$58,011	$62,598
Commercial rebates and government chargebacks	(19,953)	(18,144)
Data and distribution fees, GPO fees, and inventory management fees	(2,227)	(5,571)
Product returns allowance	(590)	(470)
Net product sales	$35,241	$38,413

5. NET PRODUCT SALES BY GEOGRAPHIC REGION AND PRODUCT LINE

The below table presents our net product sales by geography for the three months ended March 31, 2016 and 2015:

	Three Months Ended March 31,					
	2016			2015		
United States	$33,779	95.9	%	$36,546	95.1	%
International:						
Europe	1,462	4.1	%	644	1.7	%
Asia Pacific*	—	—	%	1,223	3.2	%
Total international	1,462	4.1	%	1,867	4.9	%
Net product sales	$35,241	100.0	%	$38,413	100.0	%

* See Note 11 for discussion of our November 2015 out-license for Asia Pacific territory to Mundipharma.

The below table presents our net product sales by product line for the three months ended March 31, 2016 and 2015:

	Three Months Ended March 31,					
	2016			2015		
FUSILEV	$15,209	43.2	%	$20,167	52.5	%
FOLOTYN	13,292	37.7	%	9,316	24.3	%
ZEVALIN	2,783	7.9	%	4,223	11.0	%
MARQIBO	929	2.6	%	1,893	4.9	%
BELEODAQ	3,028	8.6	%	2,814	7.3	%
Net product sales	$35,241	100.0	%	$38,413	100.0	%

6. STOCK-BASED COMPENSATION

We classify our stock-based compensation expense (inclusive of our incentive stock plan, employee stock purchase plan, and 401(k) contribution matching program) in the accompanying Condensed Consolidated Statements of Operations, based on the department to which the recipient belongs. Stock-based compensation expense included within “Total operating costs and expenses” for the three months ended March 31, 2016 and 2015 was as follows:

	Three Months Ended March 31,	
	2016	2015
Cost of product sales	$27	$—
Research and development	381	433
Selling, general and administrative	2,769	2,029
Total stock-based compensation	$3,177	$2,462

7. NET LOSS PER SHARE

Net loss per share was computed by dividing net loss by the weighted average number of common shares outstanding for the three months ended March 31, 2016 and 2015:

	Three Months Ended March 31,	
	2016	2015
Net loss	$(9,321)	$(25,562)
Weighted average shares – basic and diluted	65,597,266	64,880,677
Net loss per share – basic and diluted	$(0.14)	$(0.39)

The below outstanding securities were excluded from the above calculation of net loss per share because their impact would have been anti-dilutive due to net loss per share in the three months ended March 31, 2016 and 2015, as summarized below:

	Three Months Ended March 31,	
	2016	2015
2018 Convertible Notes	11,401,284	11,401,284
Common stock options	982,748	1,825,868
Restricted stock awards	2,592,614	1,528,815
Common stock warrants	—	71,227
Preferred stock	40,000	40,000
Total	15,016,646	14,867,194

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(Unaudited)

8. FAIR VALUE MEASUREMENTS

The table below summarizes certain asset and liability fair values that are included within our accompanying Condensed Consolidated Balance Sheets, and their designations among three fair value measurement categories:

	March 31, 2016 Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
Assets:				
Bank certificates of deposits	$—	$246	$—	$246
Money market currency funds	—	80,146	—	80,146
Equity securities	7,520	—	—	7,520
Secured promissory note	—	—	—	—
Mutual funds	—	45	—	45
Deferred compensation investments, including life insurance cash surrender value	—	9,651	—	9,651
	$7,520	$90,088	$—	$97,608
Liabilities:				
Deferred executive compensation liability	$—	$7,117	$—	$7,117
Deferred drug development liability	—	—	14,510	14,510
Ligand Contingent Consideration	—	—	6,000	6,000
Talon CVR	—	—	1,646	1,646
Corixa Liability	—	—	62	62
	$—	$7,117	$22,218	$29,335

	December 31, 2015 Fair Value Measurements			
	Level 1	Level 2	Level 3	Total
Assets:				
Bank certificates of deposits	$—	$245	$—	$245
Money market currency funds	—	80,116	—	80,116
Equity securities	5,189	—	—	5,189
Deferred compensation investments, including life insurance cash surrender value	—	9,181	—	9,181
	$5,189	$89,542	$—	$94,731
Liabilities:				
Deferred executive compensation liability	$—	$6,458	$—	$6,458
Deferred drug development costs	—	—	14,686	14,686
Ligand Contingent Consideration	—	—	5,227	5,227
Talon CVR	—	—	1,377	1,377
Corixa Liability	—	—	62	62
	$—	$6,458	$21,352	$27,810

We did not have any transfers between Levels 1 and 2 for all periods presented. The following presents a roll forward of our liabilities for which we utilize Level 3 inputs in determining period-end value. These liabilities are included on our Condensed Consolidated Balance Sheets within “acquisition-related contingent obligations” and “drug development liability”. The basis of the various Level 3 valuation inputs are discussed in the Notes to these accompanying

Condensed Consolidated Financial Statements.

Our carrying amounts of financial instruments such as cash equivalents, accounts receivable, prepaid expenses, accounts payable, and accrued liabilities, excluding acquisition-related contingent obligations, approximate their related fair values due to their short-term nature.

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	Fair Value Measurements of Unobservable Inputs (Level 3)
Balance at December 31, 2014	$ 23,127
Deferred drug development costs	(1,099)
Ligand Contingent Consideration	326
Talon CVR	(1,002)
Corixa Liability	—
Balance at December 31, 2015	21,352
Deferred drug development costs (see Note 15)	(176)
Ligand Contingent Consideration (see Note 9(b))	773
Talon CVR (see Note 9(a))	269
Corixa Liability (see Note 16(b)(i))	—
Balance at March 31, 2016*	$ 22,218

* This amount is comprised of the current and non-current portions of “drug development liability” and “acquisition-related contingent obligations” on our accompanying Condensed Consolidated Balance Sheets.

9. BUSINESS COMBINATIONS AND CONTINGENT CONSIDERATION

(a) Acquisition of Talon Therapeutics, Inc. and Related Contingent Consideration

Overview of Talon Acquisition

On July 17, 2013, we purchased all of the outstanding shares of common stock of Talon Therapeutics, Inc. (“Talon”). Through the acquisition of Talon, we gained worldwide rights to MARQIBO. The Talon purchase consideration comprised of (i) an aggregate upfront cash amount of $11.3 million, (ii) issuance of 3.0 million shares of our common stock, then equivalent to $26.3 million (based on a closing price of $8.77 per share on July 17, 2013), and (iii) the issuance of contingent value rights (“CVR”) initially valued at $6.5 million.

The CVR was valued using a valuation model that probability-weights expected outcomes (ranging from 50% to 100%) and discounts those amounts to their present value, using an appropriate discount rate (these represent unobservable inputs and are therefore classified as Level 3 inputs – see Note 2 (xiii)). The CVR has a maximum payout of $195 million if all sales and regulatory approval milestones are achieved, as summarized below:

- $5 million upon the achievement of net sales of MARQIBO in excess of $30 million in any calendar year
- $10 million upon the achievement of net sales of MARQIBO in excess of $60 million in any calendar year
- $25 million upon the achievement of net sales of MARQIBO in excess of $100 million in any calendar year
- $50 million upon the achievement of net sales of MARQIBO in excess of $200 million in any calendar year
- $100 million upon the achievement of net sales of MARQIBO in excess of $400 million in any calendar year
- $5 million upon receipt of marketing authorization from the FDA regarding Menadione Topical Lotion

Talon CVR Fair Value as of March 31, 2016 and December 31, 2015

The CVR fair value will continue to be evaluated on a quarterly basis. Current and future changes in its fair value results from the likelihood and timing of milestone achievement and/or the corresponding discount rate applied thereon. Adjustments to CVR fair value are recognized within “change in fair value of contingent consideration related to acquisitions” in the accompanying Condensed Consolidated Statements of Operations.

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	Fair Value of Talon CVR
December 31, 2015	$ 1,377
Fair value adjustment for the three months ended March 31, 2016	269
March 31, 2016	$ 1,646

(b) Acquisition of Rights to EVOMELA and Related Contingent Consideration

Overview of Acquisition of Rights to EVOMELA

In March 2013, we completed the acquisition of exclusive global development and commercialization rights to Captisol-enabled®, propylene glycol-free MELPHALAN (which we recently branded as “EVOMELA”) for use as a conditioning treatment prior to autologous stem cell transplant for patients with MM. We acquired these rights from CyDex Pharmaceuticals, Inc. a wholly-owned subsidiary of Ligand Pharmaceuticals Incorporated (“Ligand”) for an initial license fee of $3 million.

We accounted for this transaction as a business combination, which requires that assets acquired and liabilities assumed be recognized on the balance sheet at their fair values as of the transaction date.

We are required to pay Ligand additional amounts up to an aggregate $66 million (inclusive of the $6 million milestone payment triggered in March 2016, as further discussed below), upon the achievement of certain regulatory milestones and net sales thresholds, and we also assumed full financial responsibility for its ongoing clinical and regulatory development program. We also must pay royalties of 20% on our future net sales of EVOMELA in all territories.

Consideration Transferred

The acquisition-date fair value of the consideration transferred consisted of the following:

Cash consideration	$3,000
Ligand Contingent Consideration	4,700
Total purchase consideration	$7,700

Fair Value Estimate of Asset Acquired and Liability Assumed

The total purchase consideration is allocated to the acquisition of the net tangible and intangible assets based on their estimated fair values as of the closing date. The allocation of the total purchase price to the net assets acquired is as follows:

EVOMELA IPR&D	$7,700

We estimated the fair value of the in-process research and development using the income approach. The income approach uses valuation techniques to convert future amounts to a single present amount (discounted). Our measurement is based on the value indicated by current market expectations about those future amounts. The fair value estimate took into account our estimates of future incremental earnings that may be achieved upon regulatory approval, promotion, and distribution associated with the rights, and included estimated cash flows of approximately 10 years and a discount rate of approximately 25%.

The fair value of the contingent consideration liability assumed was determined using the probability of success and the discounted cash flow method of the income approach (representing unobservable inputs and are therefore represent Level 3 values - see Note 2(xiii)). In March 2016, the FDA approved EVOMELA, triggering a $6 million milestone payment to Ligand (“Ligand Contingent Consideration”) that was paid in April 2016. "EVOMELA IPR&D" of $7.7 million was reclassified to "EVOMELA distribution rights" within "Intangible assets, net of accumulated amortization and impairment charges" in the accompanying Condensed Consolidated Balance Sheets as of March 31, 2016. Amortization related to this intangible asset will commence on April 1, 2016.

Ligand Contingent Consideration Fair Value as of March 31, 2016 and December 31, 2015

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The fair value of the Ligand Contingent Consideration was the full $6 million payment due as of March 31, 2016. Accordingly, in the first quarter of 2016, we recorded a $0.8 million adjustment to the “change in fair value of contingent consideration related to acquisitions” in the accompanying Condensed Consolidated Statements of Operations.

	Fair Value of Ligand Contingent Consideration
December 31, 2015	$ 5,227
Fair value adjustment for the three months ended March 31, 2016	773
March 31, 2016	$ 6,000

(c) Allos Acquisition
We acquired Allos Therapeutics, Inc. (“Allos”) on September 5, 2012, which was accounted for as a business combination. Our total cash consideration for this acquisition was $205.2 million, through which we acquired FOLOTYN distribution rights. We have no contingent consideration obligations as part of this transaction.

10. OUT-LICENSE OF MARQIBO, ZEVALIN, AND EVOMELA IN CHINA TERRITORY TO CASI
Overview of CASI Out-License
On September 17, 2014, we executed three product out-license agreements with a perpetual term (collectively, the “CASI Out-License”) with CASI Pharmaceuticals, Inc. (“CASI”), a publicly-traded biopharmaceutical company (NASDAQ: CASI) with a primary focus on the China market. Under the CASI Out-License, we granted CASI the exclusive rights to distribute two of our commercialized oncology drugs, ZEVALIN and MARQIBO, and our Phase 3 drug candidate, EVOMELA (“CASI Out-Licensed Products”) in greater China (which includes Taiwan, Hong Kong and Macau). In return, we received CASI equity for the rights related to ZEVALIN and EVOMELA and a secured promissory note for the rights related to MARQIBO. Additionally, under certain conditions which generally expire on September 17, 2019, we have a right to receive additional CASI common stock in order to maintain our post-investment ownership percentage if CASI issues additional securities. In February 2016, we acquired an additional 1.7 million common shares of CASI at par value, resulting in our total holding of 7.1 million common shares as of March 31, 2016.
CASI will be responsible for the development and commercialization of these three drugs, including the submission of import drug registration applications to regulatory authorities and conducting any confirmatory clinical studies in greater China. We will provide CASI with future commercial supply of the CASI Out-Licensed Products under typical market terms.
Proceeds Received in the Third Quarter of 2014
The proceeds we received, and its fair value on the CASI Out-License execution date, consisted of the following:

CASI common stock (5.4 million shares)	$8,649	(a)
CASI secured promissory note due March 17, 2017, net of fair value discount ($1.5 million face value and 0.5% annual coupon)	1,310	(b)
Total consideration received, net of fair value discount	$9,959	

(a) Value determined based on the September 17, 2014 closing price of 5.4 million shares of CASI common stock on the NASDAQ Capital Market of $1.60 per share. Our current intention is to hold these securities on a long-term basis. Accordingly, we have presented its value of $7.5 million as of March 31, 2016 within "other assets" (rather than "marketable securities") on our accompanying Condensed Consolidated Balance Sheets. The change in fair value of these securities is reported within “unrealized gain on available-for-sale securities" on the Condensed

Consolidated Statements of Comprehensive Loss.

(b) Value estimated using the terms of the $1.5 million promissory note, the application of a synthetic debt rating based on CASI's publicly-available financial information, and the prevailing interest yields on similar public debt securities as of September 17, 2014. The face value of the promissory note as of March 31, 2016 is included within "other receivables" on the accompanying Condensed Consolidated Balance Sheets.

In addition, CASI will be responsible for paying any royalties or milestones that we are obligated to pay to our third-party licensors resulting from the achievement of certain milestones and/or sales of CASI Out-Licensed Products, but only to the extent of the greater China portion of such royalties or milestones.

11. OUT-LICENSE OF ZEVALIN IN CERTAIN EX-U.S. TERRITORIES TO MUNDIPHARMA

On November 16, 2015, we entered into an out-license agreement with Mundipharma International Corporation Limited for their commercialization of ZEVALIN in Asia (excluding India and Greater China), Australia, New Zealand, Africa, the Middle East, and Latin America (including the Caribbean). In return, we received $18 million (comprised of $15 million received in December 2015 and $3 million received in January 2016). Of these proceeds, $15 million was recognized within "license fees and service revenue" in the fourth quarter of 2015, and $0.4 million of the $3 million payment was recognized in the same caption in the first quarter of 2016. As of March 31, 2016, $2.5 million remains deferred and is presented within "deferred revenue" (current and non-current) in the accompanying Condensed Consolidated Balance Sheets. As Mundipharma has sales of ZEVALIN kits in their territories, the remaining unrecognized portion of this $3 million payment will be reported by us within "license fees and service revenue" on an established per-unit basis. Mundipharma is required to reimburse us for our payment of royalties due to Bayer from their ZEVALIN sales - see Note 16(b)(ii).

We are also eligible to receive an additional $2 million upon Mundipharma's achievement of a specified sales milestone, that if/when achieved, will also be reported within "license fees and service revenue".

In connection with this out-license, on November 16, 2015, we concurrently sold to Mundipharma K.K., all common stock of Spectrum Pharmaceuticals GK (the legal entity through which we previously sold ZEVALIN in Japan) for $2.2 million (in the form of an unsecured note, payable no later than May 2016), representing its net asset value (excluding inventory) as of November 16, 2015.

12. OUT-LICENSE OF ZEVALIN, FOLOTYN, BELEODAQ, AND MARQIBO IN CANADA TERRITORY TO SERVIER

On January 8, 2016, we entered into a strategic partnership with Servier Canada, Inc. for the out-licenses of ZEVALIN, FOLOTYN, BELEODAQ, and MARQIBO. We received $6 million in upfront payments in the first quarter of 2016 which was recognized within "license fees and service revenue" in the accompanying Condensed Consolidated Statement of Operations. We will also receive development milestone payments if/when achieved, and a high single-digit royalty on their sales of these products.

13. CO-PROMOTION ARRANGEMENT WITH EAGLE PHARMACEUTICALS

On November 4, 2015, we executed an agreement with Eagle Pharmaceuticals, Inc. ("Eagle") whereby designated members of our sales force will concurrently market up to six of Eagle's pharmaceutical products along with our products, in return for fixed monthly payments over the initial 18 month contract term through June 30, 2017, aggregating $12.8 million (the "Eagle Agreement"). We are also eligible to receive milestone payments of up to $5 million for sales made in 2016 that exceed certain thresholds, and up to $4 million for sales made in the first half 2017 that exceed certain thresholds. In addition, for performance above such sales levels in 2016, and in the first half of 2017, we are eligible to receive variable-based payments in the high single-digits on incremental sales of Eagle's products above these established threshold levels.

The fixed payments received by us, as well as reimbursable costs for certain marketing activities that we coordinate with third parties on Eagle's behalf, are recognized within "license fees and service revenue" on our accompanying

Consolidated Statement of Operations. This amount was $1.9 million for the quarter ended March 31, 2016. Any variable payments due to us will be recognized in the period earned and reported within the same revenue caption. An allocation of our sales personnel costs that are dedicated to Eagle sales activities are reported within "cost of service revenue" on our accompanying Consolidated Statement of Operations, as are reimbursable costs for Eagle marketing activities. These were an aggregate $1.3 million for the quarter ended March 31, 2016.

Eagle may extend the initial term of this agreement by six months to December 31, 2017 at its sole election. Any extensions after December 31, 2017 require mutual consent and will be for six months per extension. The Eagle Agreement may be terminated by either party for uncured material breaches and certain other events following a change of control or

insolvency of either party, and solely by Eagle for convenience with 60 days written notice, subject to an established termination fee, as calculated within the Eagle Agreement.

14. CONVERTIBLE SENIOR NOTES

Overview

On December 17, 2013, we entered into an agreement for the sale of $120 million aggregate principal amount of 2.75% Convertible Senior Notes due December 2018 (the “2018 Convertible Notes”). The 2018 Convertible Notes are convertible into shares of our common stock at a conversion rate of 95 shares per $1,000 principal amount of the 2018 Convertible Notes, equating to 11.4 million common shares if fully converted. The in-the-money conversion price is equivalent to $10.53 per common share. The conversion rate and conversion price is subject to adjustment under certain limited circumstances. The 2018 Convertible Notes bear interest at a rate of 2.75% per year, payable semiannually in arrears on June 15 and December 15 of each year. The 2018 Convertible Notes will mature and become payable on December 15, 2018, subject to earlier conversion into common stock at the holders’ option.

The sale of the 2018 Convertible Notes closed on December 23, 2013 and our net proceeds were $115.4 million, after deducting banker and professional fees of $4.6 million. We used a portion of these net proceeds to simultaneously enter into “bought call” and “sold warrant” transactions with Royal Bank of Canada (collectively, the “Note Hedge”). We recorded the Note Hedge on a net cost basis of $13.1 million, as a reduction to “additional paid-in capital” in our accompanying Condensed Consolidated Balance Sheets. Under applicable GAAP, the Note Hedge transaction is not expected to be marked-to-market through earnings or comprehensive income in future reported periods.

Conversion Hedge

We entered into Note Hedge transactions to reduce the potential dilution to our stockholders and/or offset any cash payments that we are required to make in excess of the principal amount, upon conversion of the 2018 Convertible Notes (in the event that the market price of our common stock is greater than the conversion price). The strike price of the “bought call” is equal to the conversion price and conversion rate of the 2018 Convertible Notes, matching the 11.4 million common shares the 2018 Convertible Notes may be converted into. The strike price of our “sold warrant” is $14.03 per share of our common stock, and is also for 11.4 million common shares.

Conversion Events

On and after June 15, 2018, and until the close of business on the second scheduled trading day immediately preceding the maturity date, holders may convert all or a portion of their 2018 Convertible Notes. Prior to June 15, 2018, holders may convert all or a portion of their 2018 Convertible Notes only under any of the following circumstances: (1) during any fiscal quarter (and only during such fiscal quarter), if, for at least 20 trading days (whether or not consecutive) during the 30 consecutive trading day period ending on the last trading day of the immediately preceding fiscal quarter, the last reported sale price of our common stock on such trading day is greater than or equal to 130% of the Notes' conversion price on such trading day; (2) during the five consecutive business day period immediately following any five consecutive trading day period in which, for each trading day of that measurement period, the trading price per $1,000 principal amount of 2018 Convertible Notes for such trading day was less than 98% of the product of (i) the last reported sale price of our common stock on such trading day and (ii) the Notes' conversion rate on such trading day; (3) upon the occurrence of certain corporate transactions; and (4) at any time prior to our stockholders’ approval to settle the 2018 Convertible Notes in our common shares and/or cash. As of March 31, 2016, the 2018 Convertible Notes are not eligible to be converted into our common stock, as none of the above elements (1) through (4) were met. Our stockholders’ approval of "flexible settlement" occurred at our Annual Meeting of Stockholders on June 29, 2015. As a result, we may (at our election) settle any future conversions of the 2018 Convertible Notes by paying or delivering cash, shares of our common stock, or a combination of cash and shares of our common stock. However, if the holders of the Convertible Notes do not elect any conversion into

our common stock, our December 2018 obligation to repay the principal amount of $120 million in cash, plus any accrued and unpaid interest, is unchanged.

Carrying Value and Fair Value

The carrying value of the 2018 Convertible Notes as of March 31, 2016 is summarized as follows:

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Principal amount	$120,000
(Less): Unamortized debt discount (amortized through December 2018)	(17,067)
(Less): Debt issuance costs (see Note 3(d))	(2,000)
March 31, 2016 carrying value	$100,933

As of March 31, 2016 and December 31, 2015, the estimated aggregate fair value of the 2018 Notes is $106.6 million and $105.1 million, respectively. These fair value estimates are less than the principal amount of $120 million, largely since the conversion feature of the 2018 Notes was, and remains, out-of-the-money. These estimated fair values represent a Level 2 measurement (see Note 2(xiii)), based upon the 2018 Convertible Notes' quoted bid price at each date in a thinly-traded market.

Components of Interest Expense on 2018 Convertible Notes

The following table sets forth the components of interest expense recognized in the accompanying Condensed Consolidated Statements of Operations for the 2018 Convertible Notes for the three months ended March 31, 2016:

Contractual coupon interest expense	$825
Amortization of debt issuance costs	171
Accretion of debt discount	1,385
Total	$2,381
Effective interest rate	8.66 %

15. MUNDIPHARMA AGREEMENT AND DRUG DEVELOPMENT LIABILITY

As the result of our acquisition of Allos Therapeutics, Inc. on September 5, 2012 (through which we obtained distribution rights for FOLOTYN), we assumed its obligations under an active strategic collaboration agreement with a third-party, Mundipharma (the “Mundipharma Collaboration Agreement”). Under the Mundipharma Collaboration Agreement, we retained full commercialization rights for FOLOTYN in the U.S. and Canada, with Mundipharma having exclusive rights to commercialize FOLOTYN in all other countries in the world (the “Mundipharma Territories”).

On May 29, 2013, the Mundipharma Collaboration Agreement was amended and restated (the “Amended Mundipharma Collaboration Agreement”), in order to modify: (i) the scope of the licensed territory, (ii) milestone payments, (iii) royalty rates, and (iv) drug development obligations. In connection with the Amended Mundipharma Collaboration Agreement, we received a one-time $7 million payment from Mundipharma for certain research and development activities to be performed by us.

As a result of the Amended Mundipharma Collaboration Agreement, (a) Europe and Turkey were excluded from Mundipharma’s commercialization territory, (b) we may receive regulatory milestone payments of up to $16 million, and commercial progress and sales-dependent milestone payments of up to $107 million, (c) we will receive tiered double-digit royalties based on net sales of FOLOTYN within Mundipharma’s licensed territories, and (d) we and Mundipharma will bear our own FOLOTYN development costs.

On May 29, 2015 and effective as of May 1, 2015, we entered into an amendment to the Amended Mundipharma Collaboration Agreement (the “Amendment”). Pursuant to the Amendment, among other things, the parties revised the conditions to our exercise of the option to gain commercialization rights in Switzerland from Mundipharma, and also revised tiered double digit royalties payable by Mundipharma on net sales in Switzerland.

The fair value of this liability is included in the current and long-term portions of “drug development liability” within the accompanying Condensed Consolidated Balance Sheets, and it includes our assumptions about personnel needed to perform these research and development activities, third party costs for projected clinical trial enrollment, and patient treatment-related follow up through approximately 2031.

The fair value of our “drug development liability” within our accompanying Condensed Consolidated Balance Sheets was estimated using the discounted income approach model. The unobservable inputs (i.e., Level 3 inputs - see Note 2(xiii)) in this valuation model that have the most significant effect on these liabilities include (i) estimates of research and development personnel costs needed to perform the research and development services, (ii) estimates of expected cash outflows to third

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parties for services and supplies during the expected period of performance through 2031, and (iii) an appropriate discount rate for these expenditures. These inputs are reviewed by management on a quarterly basis for continued applicability.

We assess this liability at each reporting date and record its adjustment through "research and development" expense in our accompanying Condensed Consolidated Statements of Operations.

	Drug Development Liability, Current – FOLOTYN	Drug Development Liability, Long Term – FOLOTYN	Total Drug Development Liability – FOLOTYN
Balance at December 31, 2015	$ 259	$ 14,427	$ 14,686
Transfer from long-term to current in 2016	74	(74)	—
(Less): Expenses incurred in 2016	(176)	—	(176)
Balance at March 31, 2016	$ 157	$ 14,353	$ 14,510

16. COMMITMENTS AND CONTINGENCIES

(a) Facility Leases

We lease our principal executive office in Henderson, Nevada under a non-cancelable operating lease expiring April 30, 2019. We also lease our research and development facility in Irvine, California under a non-cancelable operating lease expiring May 31, 2019, in addition to several other administrative office leases. Each lease agreement contains scheduled rent increases which are accounted for on a straight-line basis.

(b) In-Licensing and Out-Licensing Agreements, Co-Development Agreements, and Milestone Payments

Our drug candidates are being developed pursuant to license agreements that provide us with territory-specific rights to its manufacture, sublicense, and sale. We are generally responsible for all development costs, patent filings and maintenance costs, sales and marketing costs, and liability insurance costs. We are also obligated to make certain milestone payments to third parties upon the achievement of regulatory and sales milestones that are specified in these license agreements. We estimate and present a corresponding liability on our Condensed Consolidated Balance Sheets when amounts are probable and reasonably estimable. In addition, we are obligated to pay royalties based on our current and future net sales of in-licensed products.

Our most significant of these agreements are listed and summarized below:

(i) ZEVALIN U.S.: In-Licensing and Development in the U.S.

In December 2008, we acquired rights to commercialize and develop ZEVALIN in the U.S. as the result of a transaction with Cell Therapeutics, Inc. ("CTI") through our wholly-owned subsidiary, RIT Oncology LLC ("RIT"). We assumed certain agreements with various third parties related to ZEVALIN intellectual property for its manufacture, use, and sale in the U.S.

In accordance with the terms of assumed contracts, we are required to meet specified payment obligations, including a milestone payment to Corixa Corporation of $5 million based on ZEVALIN sales in the U.S. (the "Corixa Liability"). This milestone has not yet been met, and $0.1 million for this potential milestone achievement is included within "acquisition-related contingent obligations" in our accompanying Condensed Consolidated Balance Sheet as of March 31, 2016 and December 31, 2015, respectively. Our U.S. net sales-based royalties are in the low to mid-single digits to Genentech, Inc. and mid-teens to Biogen.

(ii) ZEVALIN Ex-U.S.: In-License and Asset Purchase Agreement with Bayer Pharma

In April 2012, through our wholly-owned subsidiary, Spectrum Pharmaceuticals Cayman, L.P., we completed the acquisition of licensing rights to market ZEVALIN outside of the U.S. from Bayer Pharma AG ("Bayer"). ZEVALIN is

currently approved in approximately 40 countries outside the U.S. for the treatment of B-cell non-Hodgkin lymphoma, including countries in Europe, Latin America, and Asia.

In consideration for the rights granted under the agreement, concurrent with the closing, we paid Bayer a one-time fee of €19 million. Our ex-U.S. net sales-based royalty to Bayer ranges between the single digits to mid-teens. We amended the agreement in February 2016. Under the amendment, in the event that we elect to sublicense the rights in certain countries, our applicable royalty on net sales to Bayer would be adjusted to a tiered rate from the single digits to 20% in such countries. Unless earlier terminated, the term of the agreement, as amended, continues until the expiration of the last-to-expire patent covering the sale of a licensed product in the relevant country, or 15 years from the date of first commercial sale of the licensed product in such country, whichever is longer.

(iii) ZEVALIN Ex-U.S.: Out-License Agreement with Dr. Reddy’s

Effective June 27, 2014, we executed an exclusive License Agreement with Dr. Reddy’s Laboratories Ltd. (“Dr. Reddy’s”), for the distribution rights of ZEVALIN within India. The agreement term is 15 years from the receipt of pending approval of ZEVALIN from the Drug Controller General of India. On December 17, 2014, upon the execution of a supply agreement, an upfront and non-refundable payment of $0.5 million was triggered and was paid to us in February 2015. The recognition of this upfront payment is reported on a straight-line basis within “license fee and service revenue” on the Condensed Consolidated Statements of Operations over a 10 year term through December 2024. Additionally, sales and regulatory milestones (aggregating $3 million) will become payable to us when achieved by Dr. Reddy’s, as well as a 20% royalty on net sales of ZEVALIN in India.

(iv) ZEVALIN Ex-U.S.: Out-License Agreement with Mundipharma

On November 16, 2015, we entered into an out-license agreement with Mundipharma International Corporation Limited ("Mundipharma") for their commercialization of ZEVALIN in Asia (excluding India and Greater China), Australia, New Zealand, Africa, the Middle East, and Latin America (including the Caribbean). In return, we received $18 million (comprised of $15 million received in December 2015 and $3 million received in January 2016). Of these proceeds, $15 million was recognized within "license fees and service revenue" in the fourth quarter of 2015, and $0.4 million of the $3 million payment was recognized in the same caption in the first quarter of 2016. As of March 31, 2016, $2.5 million remains deferred and is presented within "deferred revenue" (current and non-current) in the accompanying Condensed Consolidated Balance Sheets. As Mundipharma has sales of ZEVALIN kits in their territories, the remaining unrecognized portion of this $3 million value will be recognized by us in subsequent periods within "license fees and service revenue" on an established per-unit basis. Mundipharma is required to reimburse us for our payment of royalties due to Bayer from their ZEVALIN sales (see Note 16(b)(ii)).

We are also eligible to receive an additional $2 million upon Mundipharma's achievement of a specified sales milestone, that if/when achieved, will also be reported within "license fees and service revenue".

(v) FUSILEV: In-License Agreement with Merck & Cie AG

In May 2006, we amended and restated a license agreement with Merck & Cie AG (“Merck”), which we assumed in connection with our March 2006 acquisition of the assets of Targent, Inc. Pursuant to the license agreement with Merck, we obtained the exclusive license to use regulatory filings related to FUSILEV and a non-exclusive license under certain patents and know-how to develop, manufacture, use, and sell FUSILEV in the field of oncology in North America in return for a royalty percentage (in the mid-single digits) of net sales. Merck is eligible to receive a $0.2 million payment from us upon the achievement of a FDA approval of an oral form of FUSILEV. This milestone has not yet been met, and no amounts have been accrued in our accompanying Condensed Consolidated Balance Sheets for its potential achievement.

(vi) FOLOTYN: In-License Agreement with Sloan-Kettering Institute, SRI International and Southern Research Institute

In December 2002, Allos entered into the FOLOTYN License Agreement with Sloan-Kettering Institute for Cancer Research, SRI International, and Southern Research Institute. As a result of Allos becoming our wholly owned subsidiary in September 2012, we are bound by the FOLOTYN License Agreement under which we obtained exclusive worldwide rights to a portfolio of patents and patent applications related to FOLOTYN and its uses. Under

the terms of the FOLOTYN License Agreement, we are required to fund all development programs and will have sole responsibility for all commercialization activities. In addition, we pay graduated royalties to our licensors based on our (including sub licensees) worldwide annual net sales of FOLOTYN. Royalties are 8% of annual worldwide net sales up to $150 million; 9% of annual worldwide net sales of $150 million through $300 million; and 11% of annual worldwide net sales in excess of $300 million.

(vii) EVOMELA: In-License Agreement with Cydex Pharmaceuticals, Inc.

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In March 2013, we completed the acquisition of exclusive global development and commercialization rights to EVOMELA from Ligand (see Note 9(b)). We filed a New Drug Application ("NDA") with the FDA in December 2015 for its use as a conditioning treatment prior to autologous stem cell transplant for patients with MM. On March 10, 2016, the FDA communicated its approval of the NDA for EVOMELA. In connection with this FDA approval, we made a $6 million milestone payment to Ligand on April 13, 2016.

We are required to pay Ligand additional amounts of up to $66 million (inclusive of the $6 million milestone payment we made for FDA approval), upon the achievement of certain regulatory milestones and net sales thresholds, which we have valued at $6 million and $5.2 million within “acquisition-related contingent obligations” in our accompanying Condensed Consolidated Statements of Operations as of March 31, 2016 and December 31, 2015, respectively. We will also pay royalties of 20% on our net sales of licensed products in all territories.

(viii) MARQIBO: Contingent Consideration Agreement with Talon Therapeutics, Inc.

In July 2013, we completed the acquisition of Talon, through which we obtained exclusive global development and commercialization rights to MARQIBO (see Note 9(a)). As part of this acquisition, we issued the former Talon stockholders contingent value rights (“CVR”) that we have valued and presented on our accompanying Condensed Consolidated Balance Sheets as a $1.6 million and $1.4 million liability within “acquisition-related contingent obligations” as of March 31, 2016 and December 31, 2015, respectively. The CVR has a maximum payout value of $195 million if all sales and regulatory approval milestones are achieved.

(ix) APAZIQUONE: License Agreements with Allergan, Inc. and NDDO Research Foundation

In October 2008, we entered into an exclusive development and commercialization collaboration agreement with Allergan for APAZIQUONE. Pursuant to the terms of the agreement, Allergan paid us an up-front non-refundable fee of $41.5 million at closing (which we have amortized through revenue within “license fees and service revenue” in full as of December 31, 2013). In October 2008, pursuant to a letter agreement with NDDO Research Foundation (“NDDO”), we agreed to pay NDDO the following in relation to APAZIQUONE milestones: (a) upon FDA acceptance of the NDA, the issuance of 25,000 of our common shares (which occurred in March 2016, and the $0.1 million value of these shares is included in "research and development" expense for the three months ended March 31, 2016) and (b) upon FDA approval of the drug (its target decision date is set for December 11, 2016), a one-time payment of $0.3 million.

In January 2013, we entered into a second amendment to the license, development, supply and distribution agreement with Allergan to amend the agreement and reacquire the rights originally licensed to Allergan in the U.S., Europe, and other territories in exchange for a tiered single-digit royalty on certain products containing APAZIQUONE, and relieved Allergan of its development and commercialization obligations.

(x) APAZIQUONE: Collaboration Agreement with Nippon Kayaku Co. LTD.

In November 2009, we entered into a collaboration agreement with Nippon Kayaku Co., LTD. (“Nippon Kayaku”) for the development and commercialization of APAZIQUONE in Asia, except North and South Korea (the “Nippon Kayaku Territory”). In addition, Nippon Kayaku received exclusive rights to APAZIQUONE for the treatment of non-muscle invasive bladder cancer in Asia (other than North and South Korea), including Japan and China. Nippon Kayaku will conduct APAZIQUONE clinical trials in the Nippon Kayaku Territory pursuant to a development plan. Further, Nippon Kayaku will be responsible for all expenses relating to the development and commercialization of APAZIQUONE in the Nippon Kayaku Territory.

Under the terms of this agreement, Nippon Kayaku paid us an upfront fee of $15 million (which we have amortized through revenue within “license fees and service revenue” in full as of December 31, 2013). Nippon Kayaku is also obligated to make additional payments to us based on the achievement of certain development, regulatory and commercialization milestones. Under the terms of the agreement, we are entitled to payment of $10 million and $126 million upon achievement of certain regulatory and commercialization milestones, respectively. Also, Nippon Kayaku

has agreed to pay us royalties based on a percentage of net sales of the subject products in the defined territory in the mid-teen digits.

(xi) BELEODAQ: In-License and Collaboration Agreement with Onxeo

In February 2010, we entered into a licensing and collaboration agreement with TopoTarget A/S (now Onxeo DK) (“Onxeo”), as amended in October 2013, for the development and commercialization of BELEODAQ. The agreement provides

that we have the exclusive right to manufacture, develop, and commercialize BELEODAQ in North America and India, with an option for China. Pursuant to the terms of this agreement, we paid Onxeo an upfront fee of $30 million in 2010.

Under continuing terms, all development, including studies, will be conducted under a joint development plan, which we will fund 70% of such costs, and Onxeo will fund 30%. We have final decision-making authority for all developmental activities in North America and India (and China upon exercise of its option). Onxeo has final decision-making authority for all developmental activities in all other jurisdictions. In February 2014, upon FDA acceptance of our new drug application, we issued one million shares of our common stock, and made a $10 million milestone payment to Onxeo. The aggregate payout value of this first milestone at achievement was $17.8 million, and was recognized within “research and development” in the first quarter of 2014.

In July 2014, we received approval from the FDA for BELEODAQ’s use for injection and treatment of relapsed or refractory peripheral T-cell lymphoma. As a result, we paid a second milestone payment to Onxeo of $25 million in November 2014, which we capitalized as an amortizable intangible asset. Other potential milestone payments due upon BELEODAQ regulatory achievements and sales thresholds (aggregating up to $278 million) are not included within “total liabilities” in our accompanying Condensed Consolidated Balance Sheets.

We will pay Onxeo future royalties in the mid-teen digits based on net sales of BELEODAQ. The agreement will continue until the expiration of the last royalty payment period in the last country in the defined territory with certain provisions surviving, unless earlier terminated in accordance with its terms.

(xii) SPI-2012: Co-Development and Commercialization Agreement with Hanmi Pharmaceutical Company

In January 2012 (and as amended in March 2014 and October 2014), we entered into a License, Development, and Supply Agreement with Hanmi Pharmaceutical Company, Ltd. (“Hanmi”), for SPI-2012, formerly known as “LAPS-GCSF”, a drug based on Hanmi’s proprietary LAPSCOVERY™ technology for the treatment of chemotherapy induced neutropenia. Under the terms of the agreement, as amended, we have primary financial responsibility for the SPI-2012 development plan. We have worldwide rights for SPI-2012, except for Korea, China, and Japan. As of March 31, 2016, we owed Hanmi a milestone payment of $1.9 million (as quantified under GAAP), based on initial patient dosing in January 2016 as part of our Phase III study. This will be settled through the combination of cash paid on Hanmi's behalf to applicable tax authorities, and the issuance of 318,750 of our common shares to Hanmi. This value was recognized within "research and development" expense in accompanying Condensed Consolidated Statement of Operations for the three months ended March 31, 2016. We also will be responsible for milestones relating to regulatory approvals and sales thresholds (aggregating $238 million), which are not included within "total liabilities" in our Condensed Consolidated Balance Sheets. We will pay Hanmi royalties in the mid-teen digits on our net sales of SPI-2012.

(xiii) POZIOTINIB: In-License Agreement with Hanmi

In February 2015, we executed an in-license agreement with Hanmi Pharmaceutical Co., Ltd for POZIOTINIB, a pan-HER inhibitor in Phase 2 clinical trials, requiring our upfront payment for these rights. This drug has shown single agent activity in the treatment of various cancer types during Phase I studies, including breast, gastric, colorectal, and lung cancers.

Under the terms of this agreement, we received the exclusive rights to commercialize POZIOTINIB globally, excluding Korea and China. Hanmi, and its development partners, will bear full responsibility for completion of on-going Phase 2 trials in Korea. We will bear full financial responsibility for all other clinical studies. We will pay Hanmi future regulatory and sales-dependent milestones payments (aggregating $358 million), which are not included within “total liabilities” in our accompanying Condensed Consolidated Balance Sheets. We will pay Hanmi royalties in the low to mid-teen digits on our net sales of POZIOTINIB.

(xiv) ZEVALIN, FOLOTYN, BELEODAQ, and MARQIBO: Out-License Agreement with Servier

In January 2016, we entered into a strategic partnership with Servier Canada, Inc. for the out-licenses of ZEVALIN, FOLOTYN, BELEODAQ, and MARQIBO. We received an aggregate $6 million in upfront payments in the first quarter of 2016 which was recognized within "license fees and service revenue". We will also receive development milestone payments if/when achieved, and a high single-digit royalty on their sales of these products.

(c) Service Agreements

In connection with the research and development of our drug products, we have entered into contracts with numerous third party service providers, such as radio-pharmacies, distributors, clinical trial centers, clinical research organizations, data

monitoring centers, and with drug formulation, development and testing laboratories. The financial terms of these agreements are varied and generally obligate us to pay in stages, depending on achievement of certain events specified in the agreements, such as contract execution, reservation of service or production capacity, actual performance of service, or the successful accrual and dosing of patients.

At each period end, we accrue for all services received, with such accruals based on factors such as estimates of work performed, patient enrollment, completion of patient studies and other events. Should we decide to discontinue and/or slow-down the work on any project, the associated costs for those projects would be limited to the extent of the work completed. Generally, we are able to terminate these contracts due to the discontinuance of the related project(s) and thus avoid paying for the services that have not yet been rendered.

(d) Supply Agreements

We have entered into certain supply agreements, or have issued purchase orders, which require us to make minimum purchases from vendors for the manufacture of our products. These commitments do not exceed our planned commercial requirements, and the contracted prices do not exceed their fair market value.

(e) Employment Agreement

We have entered into an employment agreement with our Chief Executive Officer under which cash compensation and benefits would become payable in the event of termination by us for any reason other than cause, his resignation for good reason, or upon a change in control of our Company.

(f) Deferred Compensation Plan

The Spectrum Pharmaceuticals, Inc. Deferred Compensation Plan (the “DC Plan”) is administered by the Compensation Committee of our Board of Directors and is intended to comply with the requirements of Section 409A of the Internal Revenue Code of 1986, as amended.

The DC Plan is maintained to provide deferred compensation benefits for a select group of our employees (the “DC Participants”). Under the DC Plan, we provide the DC Participants with the opportunity to make annual elections to defer up to a specified amount or percentage of their eligible cash compensation, and we have the option to make discretionary contributions. At March 31, 2016 and December 31, 2015, the aggregate DC Plan deferrals by employees and our discretionary contributions totaled $7.1 million and $6.5 million, respectively, and are included within “other long-term liabilities” in the accompanying Condensed Consolidated Balance Sheets.

(g) Litigation

We are involved from time-to-time with various legal matters arising in the ordinary course of business. These claims and legal proceedings are of a nature we believe are normal and incidental to a pharmaceutical business, and may include product liability, intellectual property, employment matters, and other general claims.

We make provisions for liabilities when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Such provisions are assessed at least quarterly and adjusted to reflect the impact of any settlement negotiations, judicial and administrative rulings, advice of legal counsel, and other information and events pertaining to a particular case. Litigation is inherently unpredictable. Although the ultimate resolution of these various matters cannot be determined at this time, we do not believe that such matters, individually or in the aggregate, will have a material adverse effect on our consolidated results of operations, cash flows, or financial condition.

We are presently responding to Abbreviated New Drug Applications (“ANDAs”) filed by companies seeking to market generic forms of FOLOTYN. We are also responding to certain stockholder suits that purportedly stem from our March 12, 2013 press release, in which we announced anticipated changes in customer ordering patterns of FUSILEV. These complaints allege that, as a result of this press release, our stock price declined.

FUSILEV ANDA Litigation

On June 18, 2014, January 23, 2015, July 17, 2015 and September 3, 2015 respectively, we filed suit against Ben Venue Laboratories, Inc., Amneal Pharmaceuticals, Inc., and Actavis LLC. respectively, following Paragraph IV

certifications in connection with their filing separate ANDAs, to manufacture a generic version of FUSILEV. We filed the lawsuits in the U.S.

District Court for the Districts of Nevada seeking to enjoin the approval of their ANDAs plus recovery of our litigation fees and costs incurred in such matters. On November 24, 2014 the complaint in the Ben Venue case was amended to substitute the original defendant Ben Venue Laboratories, Inc. with successors West-Ward Pharmaceutical Corp. and Eurohealth International SARL. The foregoing matters remain stayed, but unless the Company pursues and is successful in the further appeal of a related case, we anticipate judgment will be entered in favor of the defendants pursuant to stay agreements with such defendants.

On April 27, 2015, we filed suit in the U.S. District Court for the District of Columbia against the FDA seeking a temporary restraining order or preliminary injunction to suspend FDA approval of Sandoz's ANDA. The Company contends that Sandoz's ANDA should not have been approved until the expiry of the Company's Orphan Drug Exclusivity on April 29, 2018. On April 29, 2015, the court denied the temporary restraining order and on May 27, 2015, the court entered summary judgment in favor of the FDA et al. On June 5, 2015, we filed our Notice of Appeal. Oral argument was held October 22, 2015. The ultimate outcome of this proceeding is uncertain.

FOLOTYN ANDA Litigation

On June 19, 2014, we filed a lawsuit against five parties resulting from Paragraph IV certifications in connection with four separate ANDAs to manufacture a generic version of FOLOTYN: (1)Teva Pharmaceuticals USA, Inc., (2) Sandoz Inc., (3) Fresenius Kabi USA, LLC, (4) Dr. Reddy's Laboratories, Ltd., and (5) Dr. Reddy's Laboratories, Inc. We filed the lawsuit in the U.S. District Court for the District of Delaware seeking to enjoin the approval of their ANDAs plus recovery of our litigation fees and costs. The litigation is stayed with respect to the Dr. Reddy's entities pending resolution of the case against the other FOLOTYN ANDA filers. A trial date of September 12, 2016 has been set in the FOLOTYN lawsuit in the U.S. District Court for the District of Delaware. While we believe our patent rights are strong, the ultimate outcome of such action is uncertain.

Stockholder Litigation

John Perry v. Spectrum Pharmaceuticals, Inc. et al. (Filed March 14, 2013 in United States District Court, District of Nevada; Case Number 2:2013-cv-00433-LDG-CWH). This putative consolidated class action raises substantially identical claims and allegations against defendants Spectrum Pharmaceuticals, Inc., Dr. Rajesh C. Shrotriya, Brett L. Scott, and Joseph Kenneth Keller. The alleged class period is August 8, 2012 to March 12, 2013. The lawsuits allege a violation of Section 10(b) of the Securities Exchange Act of 1934 against all defendants and control person liability, as a violation of Section 20(b) of the Securities Exchange Act of 1934, against the individual defendants. The claims purportedly stem from the Company's March 12, 2013 press release, in which it announced that it anticipated a change in ordering patterns of FUSILEV. The complaints allege that, as a result of the March 12, 2013 press release, the Company's stock price declined. The complaints further allege that during the putative class period certain defendants made misleadingly optimistic statements about FUSILEV sales, which inflated the trading price of Company stock. The lawsuits seek relief in the form of monetary damages, costs and fees, and any other equitable or injunctive relief that the court deems appropriate. On March 21, 2014, the Court entered an order appointing Arkansas Teacher Retirement System as lead plaintiff. On May 20, 2014, Arkansas Teacher Retirement System filed a consolidated amended class action complaint. On July 18, 2014, we filed a motion to dismiss the consolidated amended class action complaint. On March 26, 2015, the court denied the motion to dismiss. On June 15, 2015, the Court ordered a stay of the proceedings pending the outcome of mediation between the parties. On October 27, 2015, we reached a $7 million settlement in principle with the lead plaintiff (which involved our insurance carrier, as the reimbursing party in full), subject to preliminary and final court approval. We have included this settlement amount, along with $0.2 million of reimbursable legal expenses for this matter, on our accompanying Condensed Consolidated Balance Sheets as of March 31, 2016 within "other receivables" and "accounts payable and other accrued liabilities." On January 26, 2016, the Court preliminarily approved the settlement. The Court has scheduled a hearing on final approval of the settlement for June 13, 2016.

Timothy Fik v. Rajesh C. Shrotriya, et al. (Filed April 11, 2013 in United States District Court, District of Nevada; Case Number 2:2013-cv-00624-JCM-CWH); Christopher J. Watkins v. Rajesh C. Shrotriya, et al. (Filed April 22, 2013 in United States District Court, District of Nevada; Case Number 2:2013-cv-00684-JCM-VCF); and Stefan Muenchhagen v. Rajesh C. Shrotriya, et al. (Filed May 28, 2013; Case Number 2:2013-cv-00942-APG-PAL). These derivative complaints are brought by the respective purported stockholders on behalf of nominal plaintiff Spectrum against certain current and former directors and officers. The complaints generally allege breaches of fiduciary based on conduct relating to the events alleged in the consolidated Perry action. The complaints seek compensatory damages, corporate governance reforms, restitution and disgorgement of defendants' alleged profits, and costs and fees. These actions are stayed pending resolution of the federal securities class action. Settlement discussions are ongoing, and accordingly, no agreement has yet been reached to resolve these

derivative complaints. If a settlement were reached, it would be reimbursable by our insurance carrier. However, the value of a potential settlement cannot be reasonably estimated given its highly uncertain nature.

Hardik Kakadia v. Rajesh C. Shrotriya, et al. (Filed April 23, 2013 in the Eighth Judicial District Court of the State of Nevada in and for Clark County; Case Number A-13-680643-B); and Joel Besner v. Rajesh C. Shrotriya, et al. (Filed May 31, 2013; Case Number A-13-682668-C) (collectively the "State Derivative Actions"). These consolidated State Derivative Actions are brought by the respective purported stockholders on behalf of nominal plaintiff Spectrum Pharmaceuticals, Inc. and are substantially similar to the consolidated federal derivative actions. These actions are stayed pending resolution of the federal securities class action. Settlement discussions are ongoing, and accordingly, no agreement has yet been reached to resolve these derivative complaints. If a settlement were reached, it would be reimbursable by our insurance carrier. However, the value of a potential settlement cannot be reasonably estimated given its highly uncertain nature.

17. INCOME TAXES

We apply an estimated annual effective tax rate ("ETR") approach for calculating a tax provision for interim periods, as required under GAAP. We recorded a benefit for income taxes of $0.1 million and a provision for income taxes of $0.1 million for the three months ended March 31, 2016 and 2015, respectively. Our ETR differs from the U.S. federal statutory tax rate of 35% primarily as a result of nondeductible expenses, state income taxes, foreign income taxes, and the impact of a valuation allowance on our deferred tax assets.

Our provision for income taxes is computed using the asset and liability method, under which deferred tax assets and liabilities are recognized for the expected future tax consequences of temporary differences between the financial reporting and tax bases of assets and liabilities, and for the expected future tax benefit to be derived from tax loss and credit carryforwards.

Deferred tax assets and liabilities are determined using the enacted tax rates in effect for the years in which those tax assets are expected to be realized. A valuation allowance is established when it is more likely than not the future realization of all or some of the deferred tax assets will not be achieved. The evaluation of the need for a valuation allowance is performed on a jurisdiction by jurisdiction basis, and includes a review of all available positive and negative evidence.

We recognize excess tax benefits associated with share-based compensation to stockholders' equity only when realized. When assessing whether excess tax benefits relating to share-based compensation have been realized, we follow the with-and-without approach, excluding any indirect effects of the excess tax deductions. Under this approach, excess tax benefits related to share-based compensation are not deemed to be realized until after the utilization of all other tax benefits available to us. We recognize the impact of a tax position in our financial statements only if that position is more likely than not of being sustained upon examination by taxing authorities, based on the technical merits of the position. Any interest and penalties related to uncertain tax positions will be reflected in income tax expense.

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

Note Regarding Forward-Looking Statements

This Quarterly Report on Form 10-Q contains certain forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, or the Securities Act, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act, in reliance upon the safe harbor provisions of the Private Securities Litigation Reform Act of 1995. Forward-looking statements include, without limitation, statements regarding our future product development activities and costs, the revenue potential (licensing, royalty and sales) of our products and product candidates, the success, safety and efficacy of our drug products, revenues, development timelines, product

acquisitions, liquidity and capital resources and trends, and other statements containing forward-looking words, such as, “believes,” “may,” “could,” “will,” “expects,” “intends,” “estimates,” “anticipates,” “plans,” “seeks,” “continues,” or the ne or variation thereon or similar terminology (although not all forward-looking statements contain these words). Such forward-looking statements are based on the reasonable beliefs of our management as well as assumptions made by and information currently available to our management. Readers should not put undue reliance on these forward-looking statements. Forward-looking statements are inherently subject to risks and uncertainties, some of which cannot be predicted or quantified; therefore, our actual results may differ materially from those described in any forward-looking statements. Factors that might cause such a difference include, but are not limited to, those discussed in our periodic reports filed with the Securities and Exchange Commission, or the SEC, including our

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Annual Report on Form 10-K for the fiscal year ended December 31, 2015, as well as those discussed elsewhere in this Quarterly Report on Form 10-Q, and the following factors:

- our ability to successfully develop, obtain regulatory approval for and market our products;
- our ability to continue to grow sales revenue of our marketed products;
- risks associated with doing business internationally;
- our ability to generate and maintain sufficient cash resources to fund our business;
- our ability to enter into strategic alliances with partners for manufacturing, development and commercialization;
- efforts of our development partners;
- the ability of our manufacturing partners to meet our timelines;
- the ability to timely deliver product supplies to our customers;
- our ability to identify new product candidates and to successfully integrate those product candidates into our operations;
- the timing and/or results of pending or future clinical trials, and our reliance on contract research organizations;
- our ability to protect our intellectual property rights;
- competition in the marketplace for our drugs;
- delay in approval of our products or new indications for our products by the FDA;
- actions by the FDA and other regulatory agencies, including international agencies;
- securing positive reimbursement for our products;
- the impact of any product liability, or other litigation to which we are, or may become a party;
- the impact of legislative or regulatory reform of the healthcare industry and the impact of recently enacted healthcare reform legislation;
- the availability and price of acceptable raw materials and components from third-party suppliers, and their ability to meet our demands;
- our ability, and that of our suppliers, development partners, and manufacturing partners, to comply with laws, regulations and standards, and the application and interpretation of those laws, regulations and standards, that govern or affect the pharmaceutical and biotechnology industries, the non-compliance with which may delay or prevent the development, manufacturing, regulatory approvals and sale of our products;
- defending against claims relating to improper handling, storage or disposal of hazardous chemical, radioactive or biological materials which could be time consuming and expensive;
- our ability to maintain the services of our key executives and technical and sales and marketing personnel;
- the difficulty in predicting the timing or outcome of product development efforts and regulatory approvals; and
- demand and market acceptance for our approved products.

All subsequent written and oral forward-looking statements attributable to us or by persons acting on our behalf are expressly qualified in their entirety by these cautionary statements. We expressly disclaim any intent or obligation to update information contained in any forward-looking statement after the date thereof to conform such information to actual results or to changes in our opinions or expectations.

Company Overview

Spectrum Pharmaceuticals, Inc. (“Spectrum”, the “Company”, “we”, “our”, or “us”) is a biotechnology company, with a prima strategy comprised of acquiring, developing, and commercializing a broad and diverse pipeline of late-stage clinical and commercial products. In addition to an in-house clinical development organization with regulatory and data management

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capabilities, we have established a commercial infrastructure for our marketed products. Currently, we have six approved oncology/hematology products that target different types of NHL, advanced metastatic colorectal cancer, ALL, and MM.

We also have three drugs in late stage development:

- SPI-2012 for chemotherapy-induced neutropenia in patients with breast cancer.
- APAZIQUONE for immediate intravesical instillation in post-transurethral resection of bladder tumors in patients with non-muscle invasive bladder cancer.
- POZIOTINIB, a novel pan-HER inhibitor used in the treatment of patients with breast cancer.

See Item 1. of our Annual Report on Form 10-K for the year ended December 31, 2015, “Business” section for a discussion of our:

- Company Overview
- Cancer Background and Market Size
- Product Portfolio
- Manufacturing
- Sales and Marketing
- Customers
- Competition
- Research and Development

Recent Highlights in Our Business, Product Development Initiatives, and Regulatory Approvals

During the three months ended March 31, 2016 and through the filing date of this quarterly report, we accomplished various critical business objectives, which included:

- SPI-2012: During January 2016, we initiated our Phase III ADVANCE trial of SPI-2012, being conducted under a Special Protocol Assessment ("SPA") agreement with the FDA. Enrollment in this study is progressing and we have designated more than 100 sites for the study.

- APAZIQUONE: In August 2015, we reached agreement with the FDA on the SPA of the planned Phase 3 clinical trial of APAZIQUONE. This trial commenced with its first patient dosing in October 2015, and is designed to evaluate the intravesical use of this drug for the treatment of patients with non-muscle invasive bladder cancer ("NMIBC") as one or two instillations, immediately following transurethral resection of bladder tumor ("TURBT"). Due to the high rate of recurrence for NMIBC, there is a significant unmet medical need and the overall cost of bladder cancer treatment in the U.S. is $3.4 billion annually, most of which is related to the direct treatment of this disease. Accordingly, this drug represents much-needed therapy for patients and provides a meaningful opportunity to reduce overall medical costs. In December 2015, we submitted our NDA for APAZIQUONE with the FDA, and in February 2016, the FDA communicated its acceptance of this NDA with a target decision date of December 11, 2016.

- POZIOTINIB: In November 2015, we submitted an Investigational New Drug ("IND") application with the FDA. In March 2016, we initiated our Phase 2 breast cancer trial. The Phase 2 study is an open-label study that will enroll approximately 70 patients with HER-2 positive metastatic breast cancer, who have failed at least two HER-2 directed therapies. The dose and schedule of oral POZIOTINIB will be based on clinical experience from the studies in Korea, and in addition include the use of prophylactic therapies to help minimize known side-effects of HER-2 directed therapies.

- EVOMELA (formerly referred to as Captisol-Enabled MELPHALAN): On October 23, 2015, we received a Complete Response Letter ("CRL") from the FDA for our EVOMELA NDA. A CRL is a standard communication from the FDA that informs companies that an application cannot be approved in its present form. Nonclinical deficiencies were identified, however, the FDA did not identify any clinical deficiencies for this drug in the CRL, and we subsequently resubmitted our NDA. On March 10, 2016, the FDA communicated its NDA approval for EVOMELA as a high-dose conditioning treatment prior to hematopoietic progenitor (stem) cell transplantation in

patients with MM, and for the

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palliative treatment of patients with MM for whom oral therapy is not appropriate. In April 2016, we launched EVOMELA, our sixth anti-cancer drug, with our existing sales force.

- Out-license with Servier Canada: On January 8, 2016, we entered into a strategic partnership with Servier Canada, Inc. for the out-licenses of ZEVALIN, FOLOTYN, BELEODAQ, and MARQIBO. We received $6 million in upfront payments in the first quarter of 2016 which was recognized within "license fees and service revenue" in the accompanying Condensed Consolidated Statement of Operations. We will also receive development milestone payments if/when achieved, and a high single-digit royalty on their sales of these products.

CHARACTERISTICS OF OUR REVENUE AND EXPENSES

See Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2015, Characteristics of Our Revenue and Expenses for a discussion of the nature of our revenue and operating expense line items within our accompanying Condensed Consolidated Statements of Operations.

CRITICAL ACCOUNTING POLICIES AND ESTIMATES

See Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2015, Critical Accounting Policies and Estimates for a discussion of significant estimates and assumptions as part of the preparation of our accompanying Condensed Consolidated Financial Statements. These critical accounting policies and estimates arise in conjunction with the following accounts:

- Revenue recognition
- Inventories – lower of cost or market
- Fair value of acquired assets and assumed liabilities
- Goodwill and intangible assets – impairment evaluations
- Income taxes
- Stock-based compensation
- Litigation accruals

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RESULTS OF OPERATIONS

Operations Overview – Three months ended March 31, 2016 and 2015

	Three Months Ended March 31,					
	2016			2015		
	($ in thousands)					
Total revenues	$43,866	100.0	%	$38,618	100.0	%
Operating costs and expenses:						
Cost of product sales (excludes amortization and impairment charges of intangible assets)	5,604	12.8	%	7,071	18.3	%
Cost of service revenue	1,282	2.9	%	—	—	%
Selling, general and administrative	21,962	50.1	%	23,335	60.4	%
Research and development	15,462	35.2	%	15,851	41.0	%
Amortization and impairment charges of intangible assets	5,839	13.3	%	14,022	36.3	%
Total operating costs and expenses	50,149	114.3	%	60,279	156.1	%
Loss from operations	(6,283)	(14.3)	%	(21,661)	(56.1)	%
Interest expense, net	(2,340)	(5.3)	%	(2,228)	(5.8)	%
Change in fair value of contingent consideration related to acquisitions	(1,042)	(2.4)	%	(500)	(1.3)	%
Other income (expense), net	278	0.6	%	(1,035)	(2.7)	%
Loss before income taxes	(9,387)	(21.4)	%	(25,424)	(65.8)	%
Benefit (provision) for income taxes	66	0.2	%	(138)	(0.4)	%
Net loss	$(9,321)	(21.2)	%	$(25,562)	(66.2)	%

THREE MONTHS ENDED MARCH 31, 2016 VERSUS 2015

Total Revenues

	Three months ended March 31,			
	2016	2015	$ Change	% Change
	($ in millions)			
Product sales, net:				
FUSILEV	$15.2	$20.2	$ (5.0)	(24.8)%
FOLOTYN	13.3	9.3	4.0	43.0 %
ZEVALIN	2.8	4.2	(1.4)	(33.3)%
MARQIBO	0.9	1.9	(1.0)	(52.6)%
BELEODAQ	3.0	2.8	0.2	7.1 %
	$35.2	$38.4	$ (3.2)	(8.3)%
License fees and service revenue	8.6	0.2	8.4	>100.0 %
Total revenues	$43.8	$38.6	$ 5.2	13.5 %

Product sales, net. To derive net product sales, gross product revenues in each period are reduced by management's latest estimated provisions for (i) product returns, (ii) government chargebacks, (iii) prompt pay discounts, (iv) commercial rebates, (v) Medicaid rebates, and (vi) distribution, data, and GPO administrative fees. Management considers various factors in the determination of these provisions, which are described in more detail within "Critical Accounting Policies and Estimates" of our 2015 Form 10-K.

FUSILEV revenue decrease is attributable to a significant decline in our unit sales due to the competitive launch in April 2015 of generic levo-leucovorin product - see Note 3(f), and to a lesser extent, a moderate decrease in our net average sales price per unit. Our reported revenue in the current period is inclusive of previously deferred revenue of

$6.1 million as of December 31, 2015 - see Note 3(i).

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FOLOTYN revenue increase is due to a significant increase in units sold in the current period, and to a lesser extent, a moderate increase in our net average sales price per unit.
ZEVALIN revenue decrease is due to a large decline in units sold in the current period in the U.S. and ex-U.S. territories. In November 2015, we entered into an out-license agreement for ZEVALIN within various ex-U.S. territories that contributed to our product revenue decline, particularly in Japan (see Note 11).
MARQIBO revenue decrease is due to a significant decline units sold during the period, and to a lesser extent, a moderate decrease in our net average sales price per unit.
BELEODAQ revenue increased as a result a small increase in the average net sales price per unit, partially offset by a small decrease in the units sold during the period.
License fees and service revenue. Our license fees and service revenue in the current period includes the following: (i) $6.0 million in upfront fees related to the out-license of ZEVALIN, FOLOTYN, MARQIBO, and BELEODAQ to Servier in the Canada territory (see Note 12), (ii) $1.9 million in fees from our co-promotion with Eagle Pharmaceuticals (see Note 13), and (iii) $0.7 million from out-license royalties. The prior period amount is solely attributable to out-license royalties.
Operating Expenses

	Three months ended March 31,			
	2016	2015	$ Change	% Change
	($ in millions)			
Operating costs and expenses:				
Cost of product sales (excludes amortization of intangible assets)	$5.6	$7.1	$ (1.5)	(21.1)%
Cost of service revenue	1.3	—	1.3	100.0 %
Selling, general and administrative	22.0	23.3	(1.3)	(5.6)%
Research and development	15.5	15.9	(0.4)	(2.5)%
Amortization and impairment of intangible assets	5.8	14.0	(8.2)	(58.6)%
Total operating costs and expenses	$50.2	$60.3	$ (10.1)	(16.7)%

Cost of Product Sales. Cost of product sales declined with the decrease in sales in the current period, as well as the impact of product sales mix between the periods.
Cost of Service Revenue. Cost of service revenue exclusively relates to our allocated commercial and marketing expenses for the promotion and sale of Eagle's products (see Note 13).
Selling, General and Administrative. Selling, general and administrative expenses decreased by $1.3 million, largely driven by the allocation of employee costs for Eagle's products to "cost of service revenue," offset by increases in legal expenses related to ongoing FOLOTYN patent litigation.

Research and Development. Research and development expenses remained consistent in the first quarter of 2016 as compared to the prior year period.
Amortization and Impairment of Intangible Assets. Amortization expense decreased $8.2 million in the current year due to (i) $7.2 million impairment charge (non-cash) in the first quarter of 2015 for our FUSILEV distribution rights (see Note 3(f)), and (ii) the sale of certain ex-U.S. ZEVALIN rights to Mundipharma in November 2015 (see Note 11).
Total Other Expenses

Three months ended March 31,			
2016	2015	$ Change	% Change

	($ in millions)				
Total other expenses	$(3.1)	$(3.8)	$ 0.7	18.4	%

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Total other expenses decreased by $0.7 million primarily due to $1.4 million decrease in foreign exchange adjustments on the value of intercompany loans. Beginning April 1, 2015, these adjustments are now recorded in "accumulated other comprehensive loss" in the Condensed Consolidated Balance Sheets (see Note 2(ix)). This decrease was partially offset by a $0.5 million increase in the contingent consideration valuation related to our MARQIBO and EVOMELA products (see Note 9), and a $0.1 million increase in interest expense.

Benefit (Provision) for Income Taxes

	Three months ended March 31, 2016	2015	$ Change	% Change
	($ in millions)			
Benefit (provision) for income taxes	$0.1	$(0.1)	$ 0.2	200.0 %

Our current period benefit for income taxes of $0.1 million is primarily due to our expected 2016 taxable income and an unrealized investment gain recognized in "accumulated other comprehensive loss." Our prior period provision for income taxes primarily represents minimum tax obligations.

LIQUIDITY AND CAPITAL RESOURCES

	March 31, 2016	December 31, 2015	March 31, 2015
	(in thousands, except financial metrics data)		
Cash, cash equivalents and marketable securities	$ 132,552	$ 139,986	$ 126,673
Accounts receivable, net	$ 19,248	$ 30,384	$ 68,755
Total current assets	$ 172,482	$ 190,625	$ 215,966
Total current liabilities	$ 59,526	$ 76,343	$ 109,808
Working capital surplus (a)	$ 112,956	$ 114,282	$ 106,158
Current ratio (b)	2.9	2.5	2.0

(a) Total current assets at period end minus total current liabilities at period end.
(b) Total current assets at period end divided by total current liabilities at period end.

Net Cash Used In Operating Activities

Net cash used in operating activities was $7.1 million for the three months ended March 31, 2016, as compared to cash used in operating activities of $5.3 million in the prior year period.

For the three months ended March 31, 2016 and 2015, our cash collections from customers totaled $47.6 million and $74.0 million, respectively, representing 108.4% and 191.5% of reported net revenue for the same years.

For the three months ended March 31, 2016 and 2015, cash payments to our employees, vendors, and end-users for products, services, chargebacks, and rebates totaled $55.5 million and $82.2 million, respectively.

Net Cash Used In Investing Activities

Net cash used in investing activities of $0.1 million for the three months ended March 31, 2016 primarily relates to $0.1 million of property, plant and equipment purchases. This remains consistent with our cash used in investing activities of $0.1 million in the prior year period.

Net Cash (Used In) Provided by Financing Activities

Net cash used in financing activities was $0.3 million for the three months ended March 31, 2016, as compared to cash provided by financing activities of $0.1 million in the prior year period. Our cash used in financing activities during the first quarter of 2016, relates to $0.4 million for the purchase and retirement of restricted stock at our employees’ election, in order to fund their corresponding minimum employee tax obligations at the time of vesting, partially offset by $0.1 million of proceeds from the issuance of common stock as a result of the exercise of employee stock options.

Convertible Senior Notes Due 2018

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On December 17, 2013, we entered into an agreement for the sale of $120 million aggregate principal amount of 2.75% Convertible Senior Notes due December 2018 (the "2018 Convertible Notes"). The 2018 Convertible Notes are convertible into shares of our common stock at a conversion rate of 95 shares per $1,000 principal amount of the 2018 Convertible Notes, totaling 11.4 million common shares if fully converted. The in-the-money conversion price is equivalent to $10.53 per common share. The conversion rate and conversion price are subject to adjustment under certain limited circumstances. As of March 31, 2016, we may settle conversions of the 2018 Convertible Notes by paying or delivering, as the case may be, cash, shares of our common stock, or a combination of cash and shares, at our election.

The 2018 Convertible Notes bear interest at a rate of 2.75% per year, payable semiannually in arrears on June 15 and December 15 of each year, beginning on June 15, 2014. The 2018 Convertible Notes will mature and become payable on December 15, 2018, subject to earlier conversion into common stock at the holders' option.

The sale of the 2018 Convertible Notes closed on December 23, 2013 and our net proceeds were $115.4 million, after deducting banker and professional fees of $4.6 million. We used a portion of these proceeds to simultaneously enter into "bought call" and "sold warrant" transactions with Royal Bank of Canada (collectively, the "Note Hedge"). We recorded the Note Hedge on a net cost basis of $13.1 million, as a reduction to "additional paid-in capital" in our accompanying Condensed Consolidated Balance Sheets. Under applicable GAAP, the Note Hedge transaction is not expected to be marked-to-market through earnings or comprehensive income in future reporting periods.

Future Capital Requirements

We believe that the future growth of our business will depend on our ability to successfully develop and acquire new drugs for the treatment of cancer and successfully bring these drugs to market.

The timing and amount of our future capital requirements will depend on many factors, including:

- the need for additional capital to fund future development programs;
- the need for additional capital to fund strategic acquisitions;
- the need for additional capital to fund licensing arrangements;
- our requirement for additional information technology infrastructure and systems; and
- adverse outcomes from potential litigation and the cost to defend such litigation.

We believe that our $133 million in aggregate cash and equivalents, and marketable securities as of March 31, 2016 will allow us to fund our current and planned operations for at least the next twelve months. However, we may seek additional capital through the sale of debt or equity securities, if necessary, especially in conjunction with opportunistic acquisitions or licensing arrangements. We may be unable to obtain such additional capital when needed, or on terms favorable to us or our current stockholders and convertible senior note holders.

Off-Balance Sheet Arrangements

We have no off-balance sheet arrangements (except for operating leases) that provide financing, liquidity, market or credit risk support, or involve derivatives. In addition, we have no arrangements that may expose us to liability that are not expressly reflected in the accompanying Condensed Consolidated Financial Statements and/or notes thereto. As of March 31, 2016, we did not have any relationships with unconsolidated entities or financial partnerships, often referred to as "structured finance" or "special purpose entities," established for the purpose of facilitating off-balance sheet arrangements or other contractually narrow or limited purposes. As such, we are not subject to any material financing, liquidity, market or credit risk that could arise if we had engaged in such relationships.

ITEM 3. QUANTITATIVE AND QUALITATIVE DISCLOSURES ABOUT MARKET RISK

In the normal course of business, our operations are exposed to risks associated with fluctuations in interest rates and foreign currency exchange rates.

The primary objective of our investment activities is to preserve principal, while at the same time maximizing yields without significantly increasing risk. We do not utilize hedging contracts or similar instruments. Because of our ability to generally redeem these investments at par at short notice and without penalty, changes in interest rates would have an immaterial effect on the fair value of these investments. If a 10% change in interest rates were to have occurred on March 31, 2016, any decline in the fair value of our investments would not be material in the context of our

accompanying Condensed Consolidated Financial Statements. In addition, we are exposed to certain market risks associated with credit ratings of corporations whose corporate bonds we may purchase from time to time. If these companies were to experience a significant detrimental change in their credit ratings, the fair market value of such corporate bonds may significantly decrease. If these companies were to default on these corporate bonds, we may lose part, or all, of our principal. We believe that we effectively manage this market risk by diversifying our investments, and investing in highly rated securities.

We are exposed to foreign currency exchange rate fluctuations relating to payments we make to vendors, suppliers and license partners using foreign currencies. In particular, some of our obligations are incurred in Euros and Yen. We mitigate such risk by maintaining a limited portion of our cash in Euros and Yen.

ITEM 4. CONTROLS AND PROCEDURES

Evaluation of Disclosure Controls and Procedures

Our management, with the participation of our chief executive officer and chief financial officer, evaluated the effectiveness of our disclosure controls and procedures as of March 31, 2016. The term “disclosure controls and procedures,” as defined in Rules 13a-15(e) and 15d-15(e) under the Exchange Act, means controls and other procedures of a company that are

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designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is recorded, processed, summarized and reported, within the time periods specified in the Securities and Exchange Commission's rules and forms. These include controls and procedures that are designed to ensure that information required to be disclosed by a company in the reports that it files or submits under the Exchange Act is accumulated and communicated to the company's management, including its principal executive and principal financial officers, as appropriate, to allow timely decisions regarding required disclosure.
Based on the evaluation of our disclosure controls and procedures as of March 31, 2016, our chief executive officer and chief financial officer concluded that, as of that date, our disclosure controls and procedures were effective.

Changes in Internal Control Over Financial Reporting
There has been no change in our internal control over financial reporting (as defined in Rules 13a-15(f) and 15d-15(f) under the Exchange Act) during the first quarter of 2016 that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.
Limitations of the Effectiveness of Internal Controls
A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the internal control system are met. Because of inherent limitations in any control systems, no evaluation of controls can provide absolute assurance that all control issues, if any, within a company have been detected. We are continuously seeking to improve the efficiency and effectiveness of our operations and of our internal controls.

PART II. OTHER INFORMATION

ITEM 1. LEGAL PROCEEDINGS
We are involved with various legal matters arising in the ordinary course of business. We make provisions for liabilities when it is both probable that a liability has been incurred and the amount of the loss can be reasonably estimated. Such provisions are reviewed at least quarterly and adjusted to reflect the impact of any settlement negotiations, judicial and administrative rulings, advice of legal counsel, and other information and events pertaining to a particular case. Litigation is inherently unpredictable. Although the ultimate resolution of these various matters cannot be determined at this time, we do not believe that such matters, individually or in the aggregate, will have a material adverse effect on our condensed consolidated results of operations, cash flows or financial condition.

Certain of the legal proceedings in which we are involved are discussed in Note 16, "Commitments and Contingencies," to our accompanying Condensed Consolidated Financial Statements, and are hereby incorporated by reference.

ITEM 1A. RISK FACTORS
As of the date of this filing, there have been no material changes to the RISK FACTORS included in our Annual Report on Form 10-K for the year ended December 31, 2015, filed with the Securities and Exchange Commission on March 14, 2016.

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

On March 18, 2016, pursuant to the terms of a letter agreement dated October 9, 2008, and as a result of a milestone payment obligation triggered by the U.S. Food and Drug Administration's acceptance of the EOquin® (apaziquone for intravesical instillation) New Drug Application for review, we issued an aggregate of 25,000 shares of our common stock to three non-U.S. investors who were licensors (including their successors) under letter agreement. We received no cash proceeds in connection with this issuance. We issued such shares of common stock without registration under the Securities Act in reliance upon the exemption from registration provided under Section 4(2) of the Securities Act. The foregoing transaction did not involve any public offering; we made no solicitation in connection with the issuance; we obtained representations from the investors regarding their investment intent, experience, "accredited

investor" status and sophistication; and the investors either received or had access to adequate information about us in order to make an informed investment decision. Additionally, at the time of the issuance, the shares of common stock were deemed to be restricted securities under the Securities Act and the certificates evidencing such shares bear a legend to that effect. No underwriting discounts or commissions were paid in conjunction with the issuance.

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ITEM 6. EXHIBITS

Exhibit Number	Description
2.1+	Amendment to License and Asset Purchase Agreement by and between Spectrum Pharmaceuticals Cayman, L.P. and Bayer Pharma AG, dated February 29, 2016. Confidential portions omitted and filed separately with the U.S. Securities and Exchange Commission pursuant to Rule 24b-2 promulgated under the Securities Exchange Act of 1934, as amended.
31.1+	Certification of Principal Executive Officer, pursuant to Rule 13a-14(a)/15d-14(a) promulgated under the Securities Exchange Act of 1934.
31.2+	Certification of Principal Financial Officer, pursuant to Rule 13a-14(a)/15d-14(a) promulgated under the Securities Exchange Act of 1934.
32.1*	Certification of Principal Executive Officer pursuant to Rule 13a-14(b)/15d-14(b) promulgated under the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
32.2*	Certification of Principal Financial Officer pursuant to Rule 13a-14(b)/15d-14(b) promulgated under the Securities Exchange Act of 1934 and 18 U.S.C. Section 1350.
101.INS+	XBRL Instance Document.
101.SCH+	XBRL Taxonomy Extension Schema Document.
101.CAL+	XBRL Taxonomy Extension Calculation Linkbase Document.
101.DEF+	XBRL Taxonomy Extension Definition Linkbase Document.
101.LAB+	XBRL Taxonomy Extension Label Linkbase Document.
101.PRE+	XBRL Taxonomy Extension Presentation Linkbase Document.

+ Filed herewith.

* Furnished herewith.

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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.

SPECTRUM PHARMACEUTICALS, INC.

Date: May 6, 2016 By: /s/ Kurt A. Gustafson
Kurt A. Gustafson
Executive Vice President and Chief Financial Officer
(Authorized Signatory and Principal Financial and Accounting Officer)