SALIX PHARMACEUTICALS LTD
Form 10-Q/A
March 02, 2015
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q/A

(Amendment No. 1)

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

For the quarterly period ended March 31, 2014

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: 000-23265

SALIX PHARMACEUTICALS, LTD.

(Exact name of Registrant as specified in its charter)

Delaware	**94-3267443**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

8510 Colonnade Center Drive

Raleigh, NC 27615

(Address of principal executive offices, including zip code)

(919) 862-1000

(Registrant s telephone number, including area code)

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

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

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

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

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

The number of shares of the Registrant s Common Stock outstanding as of May 4, 2014 was 63,408,689.

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Explanatory Note

We are filing this Amendment No. 1 on Form 10-Q/A (Form 10-Q/A) to amend our Quarterly Report on Form 10-Q for the quarter ended March 31, 2014, originally filed with the Securities and Exchange Commission (the SEC) on May 9, 2014 (Original Filing) and restate our unaudited consolidated financial statements and related disclosures for the three months ended March 31, 2014. This Form 10-Q/A also amends certain other items in the Original Filing, as listed in Items Amended in the Form 10-Q/A below as a result of the restatement. Details are discussed below and in Note 1A to the accompanying unaudited consolidated financial statements.

Restatement Background

On January 22, 2015, the Audit Committee of the Board of Directors (the Audit Committee) of Salix Pharmaceuticals, Ltd. (the Company), after discussion with management and the Company s independent registered public accounting firm, Ernst & Young LLP (EY), concluded that the Company s previously issued audited consolidated financial statements for the year ended December 31, 2013 and the previously issued unaudited consolidated financial statements for the fiscal quarters ended March 31, June 30, and September 30, 2014, and the disclosures and related communications for each of those periods, require correction of certain errors and should no longer be relied upon. The Company also determined that management s report on internal controls over financial reporting for the year ended December 31, 2013 should no longer be relied upon. Additionally, EY s opinion on the consolidated financial statements for the year ended December 31, 2013, as well as EY s opinion on the effectiveness of the Company s internal controls over financial reporting as of December 31, 2013, both dated February 28, 2014, should no longer be relied upon.

The impact of these errors are primarily associated with the timing for recognition of certain revenue, revenue-reducing returns and discounts, and expenses on previously reported net income or loss after income taxes. The following are errors that the Audit Committee and the Company recently identified that are corrected through the restatement of the quarter ended March 31, 2014.

The Company incorrectly recognized only an $8.7 million reserve for product returns at December 31, 2013 for certain out-of-policy returns of GIAZO® when it should have recognized a reserve of approximately $16.9 million, as the Company had agreed to accept such returns in the fourth quarter of 2013. The difference of $8.2 million was incorrectly recognized as incremental reserves in the Original Filing. Accordingly, this Form 10-Q/A is corrected to result in approximately $8.2 million of additional net revenue for the first quarter of 2014.

The Company incorrectly recognized gross revenue of approximately $14.4 million in the fiscal quarter ended December 31, 2013 for certain shipments with FOB Destination shipping terms that should have been recognized in the fiscal quarter ended March 31, 2014, based upon delivery in early January 2014. Accordingly, this Form 10-Q/A includes an adjustment to recognize this revenue in the quarter ended March 31, 2014 net of adjustments of approximately $2.5 million pertaining to reserves for discounts, allowances and returns. In addition, cost of goods sold and royalty expenses were increased by approximately $1.6 million on the above sales.

The Company incorrectly recognized gross revenue of approximately $1.0 million in the fiscal quarter ended March 31, 2014 that should have been recognized in the fiscal quarter ended June 30, 2014, based upon delivery in early April 2014. Accordingly, gross revenue was decreased by approximately $1.0 million net of allowances of $0.1 million in the quarter ended March 31, 2014 in this Form 10-Q/A. In addition, cost of goods sold and royalty expenses were decreased by approximately $0.2 million on the above sales.

The Company incorrectly classified certain expenses as related to Research & Development (R&D) instead of Selling, General, and Administrative (SG&A). These errors largely were a result of the Company s historical practice of aligning certain expenses along organizational hierarchy, rather than the business activity. The Company incorrectly recorded expenses of approximately $11.8 million as related to R&D rather than SG&A for the fiscal quarter ended March 31, 2014. The corresponding correction for the fiscal quarter in 2013 was a reduction in R&D and an increase of SG&A of $8.7 million for the fiscal quarter ended March 31, 2013 in this Form 10-Q/A. The foregoing reclassifications do not impact previously reported revenue or net income (loss).

The Company incorrectly accounted for expenditures associated with a sale to a wholesaler in the Original Filing for the fiscal quarter ended March 31, 2014. In connection with the sale transaction, the Company agreed to pay the wholesaler $0.5 million for marketing services and the Company recognized this payment as an expense in the fiscal quarter ended June 30, 2014. The Company has accounted for this $0.5 million payment in this Form 10-Q/A as a revenue reducing discount in the fiscal quarter ended March 31, 2014 rather than as an operating expense in the fiscal quarter ended June 30, 2014.

The Company also recorded a decrease in inventory of approximately $1.27 million with an offsetting increase of approximately $0.27 million in R&D expense and approximately $1.0 million decrease in retained earnings in the fiscal quarter ended March 31, 2014 related to holding fees that were erroneously capitalized as inventory for new product. This error relates to raw material inventory that should not have been capitalized based on a change in the stage of development of the product in 2013.

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The Company failed to accrue interest on its $750 million of 6.00% senior notes due 2021 amounting to $0.25 million and has corrected it in this Form 10-Q/A.

The Company revised the excess purchase price in connection with the Santarus acquisition in this Form 10-Q/A. As a result of the revision, goodwill was increased by $39.7 million, product rights and intangibles were reduced by $64.0 million, and deferred tax liabilities were reduced by $24.7 million on the balance sheet. As a result of this revision, amortization expense was reduced by $1.0 million.

Along with restating our financial statements for the quarter ended March 31, 2014 to correct the errors discussed above, we are making adjustments for certain previously identified immaterial accounting errors related to the periods covered by this Form 10-Q/A. When these financial statements were originally issued, we assessed the impact of these errors and concluded that they were not material to our financial statements for the three months ended March 31, 2014. However, in conjunction with our need to restate our financial statements as a result of the errors noted above, we have determined that it would be appropriate within this Form 10-Q/A to make adjustments for all such previously unrecorded adjustments.

In the Consolidated Statement of Cash Flows for the three months ended March 31, 2014, an approximately $27 million in acquisition-related contingent consideration was improperly classified within cash flows from operating activities that should have been classified as cash flows from investing activities. This change does not impact revenue or income, and increases cash flows used in investing activities. This item was reflected appropriately in the Consolidated Statement of Cash Flows for the six months ended June 30, 2014 as filed.

In the Consolidated Balance Sheet at March 31, 2014, $60 million of a senior secured term loan was improperly classified as long-term that should have been classified as a current liability. This change does not impact revenue or income.

As a result of the above adjustments on a combined basis, income tax benefit for the quarter ended March 31, 2014 was reduced by $8.3 million in this Form 10-Q/A.

Please refer to Note 1A Restatement of Prior Period Financial Statements of this Form 10-Q/A for more information regarding the impact of these adjustments. The revisions to the Company s unaudited consolidated financial statements for the quarter ended March 31, 2014 are considered to be a restatement under U.S. generally accepted accounting principles. Accordingly, this revised financial information included in this Quarterly Report on Form 10-Q/A has been identified as restated .

Internal Control Consideration

Our management has determined that there were deficiencies in our internal control over financial reporting that constitute material weaknesses, as defined by SEC regulations, at March 31, 2014. For a discussion of management s consideration of our disclosure controls and procedures and the material weaknesses identified, see Part I, Item 4 included in this Form 10-Q/A.

Items Amended in the Form 10-Q/A

This Form 10-Q/A sets forth the Original Filing, in its entirety, as modified and superseded as necessary to reflect the restatement. The following items in the Original Filing have been amended as a result of, and to reflect, the

restatement:

Part I, Item 1 Financial Statements (Restated)

Part I, Item 2 Management s Discussion and Analysis of Financial Condition and Results of Operations

Part I, Item 4 Controls and Procedures

Part II, Item 1A Risk Factors

Part II, Item 6 Exhibits

This report on Form 10-Q/A is presented as of the filing date of the Original Filing and does not reflect events occurring after that date, or modify or update the information contained therein other than as required to correct the errors and record the adjustments described above.

In accordance with applicable SEC rules, this Form 10-Q/A includes new certifications required by Sections 302 and 906 of the Sarbanes-Oxley Act of 2002, as amended, from our Acting Chief Executive Officer and Acting Chief Financial Officer dated as of the filing date of this Form 10-Q/A.

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SALIX PHARMACEUTICALS, LTD.

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CAUTIONARY STATEMENT REGARDING FORWARD-LOOKING STATEMENTS

Various statements contained in this report, including those that express a belief, expectation or intention, as well as those that are not statements of historical fact, are forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended, and Section 21E of the Securities Exchange Act of 1934, as amended, or the Exchange Act. Such statements are generally accompanied by words such as anticipate, assume, believe, could, estimate, expect, foresee, goal, intend, may, might, plan, potential, predict, project, seek, s expressions that convey uncertainty as to future events or outcomes. Forward-looking statements are based on assumptions and beliefs that we believe to be reasonable; however, assumed facts almost always vary from actual results, and the differences between assumed facts and actual results can be material depending upon the circumstances. Where we or our management express an expectation or belief as to future results, that expectation or belief is expressed in good faith and based on assumptions believed to have a reasonable basis. We cannot assure you, however, that the stated expectation or belief will occur or be achieved or accomplished. Among the factors that could cause our results to differ materially from those indicated by forward-looking statements are risks and uncertainties inherent in our business including, without limitation:

- our dependence on our pharmaceutical products, particularly Xifaxan ® (rifaximin) tablets 550 mg, and the uncertainty of market acceptance of our products;

- our level of indebtedness could require us to devote a substantial portion of our cash flow to debt service, reducing funds available for other purposes or otherwise constraining our financial flexibility;

- our status as a holding company, which makes us reliant on our subsidiaries to meet our obligations;

- restrictive covenants in our debt agreements could limit our operational and financial flexibility;

- our ability to realize the full extent of the anticipated benefits of our acquisition of Santarus, Inc., or Santarus, including achieving operational cost savings and synergies, in light of potential delays we may encounter in the integration process and additional unforeseen expenses;

- the elevated levels of inventory of our key products held by our wholesale customers, which may result in decreased future sales and/or increased pressure by wholesalers for us to extend greater pricing discounts in order to generate sales;

- intense competition, including from generics, in an increasingly global market;

- the possible impairment of, or inability to obtain intellectual property rights and the costs of obtaining such rights from third parties;

the high cost and uncertainty of the research, clinical trials and other development activities involving pharmaceutical products;

the unpredictability of the duration and results of regulatory review of New Drug Applications, or NDAs, Biologics License Agreements, or BLAs, and Investigational New Drug Applications;

general economic and business conditions;

our need to maintain profitability and acquire new products;

the uncertainty of obtaining, and our dependence on, third parties to supply and manufacture our products;

post-marketing approval regulation, including the ongoing Department of Justice investigation of our marketing practices;

revenue recognition and other critical accounting policies; and

results of ongoing and any future litigation.

Our forward-looking statements are expressly qualified by these cautionary statements, which you should consider carefully, along with the risks discussed under the heading Risk Factors and Management s Discussion and Analysis of Financial Condition and Results of Operations and elsewhere in this report, that could cause actual results to differ materially from historical results or anticipated results. We undertake no obligation to update or revise any forward-looking statements, whether as a result of new information, future events or otherwise, unless required by law.

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PART I. FINANCIAL INFORMATION.

Item 1. Financial Statements (Restated)

SALIX PHARMACEUTICALS, LTD.

Consolidated Balance Sheets

(U.S. dollars, in thousands, except share amounts)

	March 31, 2014 (Restated) (Unaudited)	December 31, 2013 (Restated)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 385,101	$ 1,157,850
Restricted cash		750,000
Accounts receivable, net	437,559	133,581
Inventory	145,775	104,209
Deferred tax assets	233,310	85,788
Prepaid expenses and other current assets	111,635	51,241
Total current assets	1,313,380	2,282,669
Property and equipment, net	30,815	27,312
Goodwill	1,350,376	180,909
Product rights and intangibles, net	1,959,599	397,510
Other assets	94,947	37,551
Total assets	$ 4,749,117	$ 2,925,951
LIABILITIES AND STOCKHOLDERS EQUITY		
Current liabilities:		
Accounts payable	$ 43,318	$ 32,632
Accrued liabilities	171,338	96,909
Income taxes payable		34,820
Reserve for product returns, rebates, chargebacks and patient-focused promotional programs	307,734	252,829
Current portion of capital lease obligations	41	47
Current portion of Term Loan B credit facility	60,000	
Total current liabilities	582,431	417,237
Long-term liabilities:		
Convertible senior notes	891,638	882,050
Lease incentive obligation	9,435	8,610

Term Loan B credit facility	1,125,000	
2021 senior notes	750,000	750,000
Acquisition-related contingent consideration	118,339	87,300
Deferred tax liabilities	550,772	42,446
Other long-term liabilities	13,076	9,665
Total long-term liabilities	3,458,260	1,780,071
Stockholders equity:		
Preferred stock, $0.001 par value; 5,000,000 shares authorized, issuable in series, none outstanding		
Common stock, $0.001 par value; 150,000,000 shares authorized, 63,384,150 and 62,937,966 shares issued and outstanding at March 31, 2014 and December 31, 2013, respectively	63	63
Additional paid-in-capital	681,800	667,428
Accumulated other comprehensive income	1,709	1,721
Retained earnings	24,854	59,431
Total stockholders equity	708,426	728,643
Total liabilities and stockholders equity	$ 4,749,117	$ 2,925,951

The accompanying notes are an integral part of these consolidated financial statements.

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SALIX PHARMACEUTICALS, LTD.

(Unaudited)

Consolidated Statements of Comprehensive Income (Loss)

(U.S. dollars, in thousands, except per share data)

	Three months ended March 31,	
	2014 (Restated)	2013
Revenues:		
Net product revenues	$ 402,979	$ 202,601
Costs and expenses:		
Cost of products sold (excluding $53,897 and $11,167 in amortization of product rights and intangible assets for the three-month periods ended March 31, 2014 and 2013, respectively)	116,940	33,072
Amortization of product rights and intangible assets	53,897	11,167
Research and development (as revised)	41,222	21,605
Selling, general and administrative (as revised)	207,098	84,983
Change in acquisition-related contingent consideration	4,039	2,500
Total cost and expenses	423,196	153,327
Income (loss) from operations	(20,217)	49,274
Interest expense	(42,710)	(15,330)
Interest and other income	309	15
Income (loss) before provision for income tax	(62,618)	33,959
Income tax benefit (expense)	28,041	(11,518)
Net income (loss)	$ (34,577)	$ 22,441
Net income (loss) per share, basic	$ (0.55)	$ 0.37
Net income (loss) per share, diluted	$ (0.55)	$ 0.35
Shares used in computing net income (loss) per share, basic	63,321	61,145
Shares used in computing net income (loss) per share, diluted	63,321	63,420
Comprehensive (loss) income	$ (34,588)	$ 21,505

The accompanying notes are an integral part of these financial statements.

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SALIX PHARMACEUTICALS, LTD.

(Unaudited)

Consolidated Statements of Cash Flows

(U.S. dollars, in thousands)

	Three months ended March 31,	
	2014 (Restated)	2013
Cash flows from operating activities		
Net income (loss)	$ (34,577)	$ 22,441
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:		
Depreciation and amortization	56,068	12,929
Amortization of debt discount	9,588	9,179
Loss (gain) on disposal of property and equipment	(2)	111
Stock-based compensation expense	7,324	5,036
Change in acquisition-related contingent consideration	4,039	2,500
Changes in operating assets and liabilities:		
Accounts receivable, inventory, prepaid expenses and other assets	(287,377)	137,050
Accounts payable, accrued and other liabilities	13,749	8,464
Reserve for product returns, rebates, chargebacks and patient-focused promotional programs	14,013	13,516
Net cash (used) provided by operating activities	(217,175)	211,226
Cash flows from investing activities		
Business acquisition, net of cash and cash equivalents acquired	(2,472,203)	
Sale of short-term investments	44,867	
Purchases of property and equipment	(4,608)	(1,211)
Net cash used in investing activities	(2,431,944)	(1,211)
Cash flows from financing activities		
Proceeds from senior notes	750,000	
Proceeds from Term Loan B credit facility	1,200,000	
Debt issuance costs	(65,682)	
Principal payments on Term Loan B credit facility	(15,000)	
Excess tax benefit from stock-based compensation	9,771	365
Payments related to net settlement of stock-based awards	(5,090)	(1,481)
Proceeds from issuance of common stock upon exercise of stock options	2,367	756
Net cash provided (used) by financing activities	1,876,366	(360)
Effect of exchange rate changes on cash	4	(375)

Net (decrease) increase in cash and cash equivalents	(772,749)	209,280
Cash and cash equivalents at beginning of period	1,157,850	751,006
Cash and cash equivalents at end of period	$ 385,101	$ 960,286
Supplemental Disclosure of Cash Flow Information		
Cash paid for income taxes	$ 42,738	$ 5,610
Cash paid for interest	$ 17,825	$ 5,519

The accompanying notes are an integral part of these financial statements.

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SALIX PHARMACEUTICALS, LTD.

Notes to Consolidated Financial Statements

March 31, 2014

(Unaudited)

1. Organization and Basis of Presentation

Salix Pharmaceuticals, Ltd., a Delaware corporation referred to in this report as Salix or the Company, is a specialty pharmaceutical company dedicated to acquiring, developing and commercializing prescription drugs and medical devices used in the treatment of a variety of gastrointestinal diseases, which are those affecting the digestive tract.

These consolidated financial statements are stated in U.S. dollars and are prepared under accounting principles generally accepted in the United States. The accompanying consolidated financial statements include the accounts of the Company and its wholly owned subsidiaries. All significant inter-company balances and transactions have been eliminated in the consolidation.

The accompanying consolidated financial statements include all adjustments that, in the opinion of management, are necessary for a fair presentation of financial position, results of operations and cash flows. These financial statements should be read in conjunction with the audited consolidated financial statements included in the Company s Annual Report on Form 10-K/A for the fiscal year ended December 31, 2013 filed with the Securities and Exchange Commission. The results of operations for interim periods are not necessarily indicative of results to be expected for a full year or any future period. Certain information and footnote disclosures normally included in annual financial statements prepared in accordance with GAAP have been omitted in accordance with the SEC s rules and regulations for interim reporting.

1A. Restatement of Prior Period Financial Statements

The Company has restated its previously reported unaudited consolidated financial statements for the quarter ended March 31, 2014 in order to correct certain previously reported amounts.

As discussed in Part 1 of this Form 10-Q/A, the Audit Committee of the Board of Directors after discussion with management and the Company s independent registered public accounting firm concluded that the Company s previously issued unaudited consolidated financial statements for the fiscal quarters ended March 31, June 30, and September 30, 2014 and the disclosures and related communications for each of those periods, require correction of certain errors and should no longer be relied upon.

The following tables present the effect of financial statement restatement adjustments on our previously reported unaudited consolidated financial statements at March 31, 2014 and for the three months then ended and at December 31, 2013 and for the year then ended:

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Consolidated Balance Sheets

(U.S. dollars, in thousands, except per share data)

	March 31, 2014 (Unaudited)			December 31, 2013		
	As previously reported	Error Correction	As Restated	As previously reported	Error Correction	As Restated
ASSETS						
Current assets:						
Cash and cash equivalents	$ 385,101	$	$ 385,101	$ 1,157,850	$	$ 1,157,850
Restricted cash				750,000		750,000
Accounts receivable, net	438,545	(986)	437,559	147,933	(14,352)	133,581
Inventory	147,072	(1,297)	145,775	104,395	(186)	104,209
Deferred tax assets	234,215	(905)	233,310	86,693	(905)	85,788
Prepaid expenses and other current assets	110,993	642	111,635	51,241		51,241
Total current assets	1,315,926	(2,546)	1,313,380	2,298,112	(15,443)	2,282,669
Property and equipment, net	30,815		30,815	27,312		27,312
Goodwill	1,310,704	39,672	1,350,376	180,909		180,909
Product rights and intangibles, net	2,023,601	(64,002)	1,959,599	397,510		397,510
Other assets	94,947		94,947	37,551		37,551
Total assets	$ 4,775,993	$ (26,876)	$ 4,749,117	$ 2,941,394	$ (15,443)	$ 2,925,951
LIABILITIES AND STOCKHOLDERS EQUITY						
Current liabilities:						
Accounts payable	$ 43,318	$	$ 43,318	$ 32,632	$	$ 32,632
Accrued liabilities	170,453	885	171,338	97,661	(752)	96,909
Income taxes payable				43,354	(8,534)	34,820
Reserve for product returns, rebates, chargebacks and patient-focused promotional programs	307,749	(15)	307,734	246,838	5,991	252,829
Current portion of capital lease obligations	41		41	47		47
Current portion of Term Loan B credit facility		60,000	60,000			
Total current liabilities	521,561	60,870	582,431	420,532	(3,295)	417,237
Long-term liabilities:						
Convertible senior notes	891,638		891,638	882,050		882,050

Lease incentive obligation	9,435		9,435	8,610		8,610
Term Loan B credit facility	1,185,000	(60,000)	1,125,000			
2021 senior notes	750,000		750,000	750,000		750,000
Acquisition-related contingent consideration	118,339		118,339	87,300		87,300
Deferred tax liabilities	575,436	(24,664)	550,772	42,371	75	42,446
Other long-term liabilities	13,076		13,076	9,665		9,665
Total long-term liabilities	3,542,924	(84,664)	3,458,260	1,779,996	75	1,780,071
Stockholders equity:						
Preferred stock, $0.001 par value; 5,000,000 shares authorized, issuable in series, none outstanding						
Common stock, $0.001 par value; 150,000,000 shares authorized, 63,384,150 and 62,937,966 shares issued and outstanding at March 31, 2014 and December 31, 2013, respectively	63		63	63		63
Additional paid-in capital	681,954	(154)	681,800	667,428		667,428
Accumulated other comprehensive income	1,709		1,709	1,721		1,721
Retained earnings	27,782	(2,928)	24,854	71,654	(12,223)	59,431
Total stockholders equity	711,508	(3,082)	708,426	740,866	(12,223)	728,643
Total liabilities and stockholders equity	$ 4,775,993	$ (26,876)	$ 4,749,117	$ 2,941,394	$ (15,443)	$ 2,925,951

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Consolidated Statements of Comprehensive Income (Loss)

(U.S. dollars, in thousands, except per share data)

	Three Months Ended March 31, 2014 (Unaudited)		
	As previously reported	Error Correction	As Restated
Revenues:			
Net product revenues	$ 384,374	$ 18,605	$ 402,979
Costs and expenses:			
Cost of products sold (excluding $53,897 and $11,167 in amortization of product rights and intangible assets for the three-month period ended March 31, 2014, respectively)	115,566	1,374	116,940
Amortization of product rights and intangible assets	54,895	(998)	53,897
Research and development	52,758	(11,536)	41,222
Selling, general and administrative	195,205	11,893	207,098
Change in acquisition-related contingent consideration	4,039		4,039
Total cost and expenses	422,463	733	423,196
Income (loss) from operations	(38,089)	17,872	(20,217)
Interest expense	(42,460)	(250)	(42,710)
Interest and other income (expense)	309		309
Income (loss) before provision for income tax	(80,240)	17,622	(62,618)
Income tax benefit (expense)	36,368	(8,327)	28,041
Net income (loss)	(43,872)	9,295	(34,577)
Net income (loss) per share, basic	$ (0.69)	$ 0.14	$ (0.55)
Net income (loss) per share, diluted	$ (0.69)	$ 0.14	$ (0.55)
Shares used in computing net income/(loss) per share, basic	63,321		63,321
Shares used in computing net income/(loss) per share, diluted	63,321		63,321
Comprehensive (loss) income	$ (43,883)	$ 9,295	$ (34,588)

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Consolidated Statements of Cash Flows

(U.S. dollars, in thousands)

	Three Months Ended March 31, 2014 (Unaudited)		
	As previously reported	Error Correction	As Restated
Cash Flows from Operating Activities			
Net income (loss)	$ (43,872)	$ 9,295	$ (34,577)
Adjustments to reconcile net income (loss) to net cash provided (used) by operating activities:			
Depreciation and amortization	57,066	(998)	56,068
Amortization of debt discount	9,588		9,588
Loss (gain) on disposal of property and equipment	(2)		(2)
Stock-based compensation expense	7,324		7,324
Change in acquisition-related contingent consideration	31,039	(27,000)	4,039
Changes in operating assets and liabilities:			
Accounts receivable, inventory, prepaid expenses and other assets	(275,069)	(12,308)	(287,377)
Accounts payable, accrued and other liabilities	3,578	10,171	13,749
Reserve for product returns, rebates, chargebacks and patient-focused promotional programs	20,019	(6,006)	14,013
Net cash provided (used) by operating activities	(190,329)	(26,846)	(217,175)
Cash Flows from Investing Activities			
Business acquisition, net of cash and cash equivalents acquired	(2,499,203)	27,000	(2,472,203)
Sale of short-term investments	44,867		44,867
Purchases of property and equipment	(4,608)		(4,608)
Net cash used by investing activities	(2,458,944)	27,000	(2,431,944)
Cash Flows from Financing Activities			
Proceeds from senior notes	750,000		750,000
Proceeds from Term Loan B credit facility	1,200,000		1,200,000
Debt issuance costs	(65,682)		(65,682)
Principal payments on Term Loan B credit facility	(15,000)		(15,000)
Excess tax benefit from stock-based compensation	9,925	(154)	9,771
Payments related to net settlement of stock-based awards	(5,090)		(5,090)
Proceeds from issuance of common stock upon exercise of stock options	2,367		2,367
Net cash provided by financing activities	1,876,520	(154)	1,876,366

Effect of exchange rate changes on cash	4		4
Net increase (decrease) in cash and cash equivalents	(772,749)		(772,749)
Cash and cash equivalents at beginning of period	1,157,850		1,157,850
Cash and cash equivalents at end of period	$ 385,101	$	$ 385,101
Supplemental Disclosure of Cash Flow Information			
Cash paid for income taxes	$ 42,738	$	$ 42,738
Cash paid for interest	$ 17,825	$	$ 17,825

2. Business Combination

On January 2, 2014, the Company completed a tender offer for all outstanding shares of common stock par value $0.0001 per share, including the associated rights to purchase shares of Series A Junior Participating Preferred Stock, par value $0.0001 per share, of Santarus, at a purchase price of $32.00 per share. Following the tender offer, Salix completed the acquisition of Santarus through a

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merger under Section 251(h) of the Delaware General Corporation Law. The aggregate consideration for the acquisition of Santarus was approximately $2.7 billion. The Company financed the acquisition and transaction costs through a combination of (i) the term loan facility in the principal amount of $1.2 billion, or the Term Loan B Credit Facility, (ii) the net proceeds from the Company s issuance of $750.0 million of 6.00% senior notes due 2021, or the 2021 Notes and (iii) cash on hand of approximately $848.1 million.

Among the reasons the Company acquired Santarus and the factors that contributed to the recognition of goodwill are the Company s belief that the transaction will create a leader in the gastroenterology pharmaceuticals space in the United States, offering a complementary portfolio of well-known and profitable drugs, and will allow the Company to expand the size and reach of its sales force. The transaction has been accounted for as a business combination under the acquisition method of accounting. Accordingly, the tangible assets and identifiable intangible assets acquired and liabilities assumed were recorded at fair value as of the date of acquisition, with the remaining purchase price recorded as goodwill.

The Company is amending its purchase price allocation as of the acquisition date to reflect certain measurement period adjustments through the fourth quarter 2014 as further described below.

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SALIX PHARMACEUTICALS, LTD.

Notes to Consolidated Financial Statements Continued

The following table summarizes the fair values of the assets acquired and liabilities assumed at the date of acquisition:

($ in thousands)		January 2, 2014 (Restated)
Total consideration	$	2,671,212
Tangible assets acquired and liabilities assumed:		
Cash and cash equivalents	$	171,259
Restricted cash		750
Investments		44,867
Account receivables, net		50,634
Inventory		49,498
Current deferred tax assets		146,670
Prepaid expenses and other current assets		7,353
Property and equipment, net		1,064
Other assets acquired		731
Accounts payable		(11,142)
Accrued expenses		(20,203)
Reserve for product returns, rebates and chargebacks		(40,892)
Long-term deferred tax liability		(509,801)
Other long-term liabilities		(3,762)
Total tangible assets acquired and liabilities assumed		(112,974)
Intangible assets acquired:		
Currently marketed products (CMPs)		1,489,000
In-process research & development products (IPR&D)		83,000
Contractual agreements		44,000
Total intangible assets acquired		1,616,000
Total tangible and intangible assets acquired and liabilities assumed		1,503,026
Goodwill	$	1,168,186

Goodwill is calculated as the difference between the acquisition-date fair value of the consideration transferred and the fair values of the assets acquired and liabilities assumed. Consideration transferred includes $27 million of acquisition-related contingent consideration. The goodwill is not expected to be deductible for income tax purposes. Goodwill is recorded as an indefinite-lived asset and is not amortized but tested for impairment on an annual basis or when indications of impairment exist.

Inventories

The fair value of inventories acquired included a step-up in the value of inventories of $37.3 million. In the quarter ended March 31, 2014, the Company recognized $18.0 million as a component of cost of sales as the inventory acquired on January 2, 2014 was sold to the Company s customers.

IPR&D and Intangible Assets

IPR&D intangible assets represent the value assigned to acquired R&D projects that, as of the acquisition date, had not established technological feasibility and had no alternative future use. The IPR&D intangible assets are capitalized and accounted for as indefinite-lived intangible assets and will be subject to impairment testing until completion or abandonment of the projects. Upon successful completion of each project and launch of the product, the Company will make a separate determination of the estimated useful life of the IPR&D intangible asset and the related amortization will be recorded as an expense over the estimated useful life. Intangible assets represent CMPs and have an estimated weighted average useful life of 15.4 years.

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The estimated fair value of the IPR&D and identifiable intangible assets was determined using the income approach, which is a valuation technique that provides an estimate of the fair value of an asset based on market participant expectations of the cash flows an asset is expected to generate over its remaining useful life. Some of the more significant assumptions inherent in the development of those asset valuations include the estimated net cash flows for each year for each asset or product (including net revenues, cost of sales, R&D costs, selling and marketing costs and working capital/asset contributory asset charges), the appropriate discount rate to select in order to measure the risk inherent in each future cash flow stream, the assessment of each asset s life cycle, the potential regulatory and commercial success risks, competitive trends impacting the asset and each cash flow stream as well as other factors. The discount rates used to arrive at the present value at the acquisition date of CMPs ranged from 9.0% to 9.5% and for IPR&D ranged from 10.0% to 11.0%, to reflect the internal rate of return and incremental commercial uncertainty in the cash flow projections. No assurances can be given that the underlying assumptions used to prepare the discounted cash flow analysis will remain unchanged. For these and other reasons, actual results may vary significantly from estimated results.

See table in *Pro Forma Financial Information (unaudited)* below for the summarized amounts recognized and the weighted average useful lives of intangible assets:

Deferred Tax

The deferred tax assets of $146.7 million are primarily related to acquired tax attributes and other reserves and accruals. The deferred tax liability of $509.8 million primarily relates to the temporary differences associated with acquired intangible assets, which are not deductible for tax purposes.

Acquiree Results

The operating results of Santarus for the period from January 2, 2014 to March 31, 2014, including net revenues of $245.8 million and operating income of $64.6 million, have been included in the Company s consolidated financial statements as of and for the three months ended March 31, 2014.

Acquisition-Related Expenses

The Company incurred a total of $126.8 million in transaction costs in connection with the acquisition. Of these transaction costs $65.5 million was included in selling, general and administrative expenses for the three months ended March 31, 2014, and $61.3 million was capitalized as debt issuance costs and is being amortized as incremental interest expense over the life of the debt.

Pro Forma Financial Information (unaudited):

The following unaudited pro forma information presents certain results of operations of the combined companies for the periods indicated as if the acquisition had been consummated on January 1, 2013, combining the respective historical results of Salix and Santarus for the three-month period ended March 31, 2013. Santarus results of operations have been included in Salix s financial statements for periods subsequent to the completion of the

acquisition on January 2, 2014. The pro forma results include amortization associated with the acquired intangible assets and interest on funds used for the acquisition. The unaudited pro forma financial information presented below does not reflect the impact of any actual or anticipated synergies expected to result from the acquisition. Accordingly, the unaudited pro forma financial information is not necessarily indicative of the results of operations as they would have been had the transaction been effected on the assumed date.

($ in thousands)	**Three Month Ended March 31, 2013**
Revenue	$ 282,041
Net loss	(40,487)
Basic loss per share	(0.66)
Diluted loss per share	(0.66)

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SALIX PHARMACEUTICALS, LTD.

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The unaudited pro forma data reflect the application of the following adjustments:

Non-recurring transaction expenses of $65.5 million reflected as if they were incurred in the corresponding 2013 period, due to the pro forma assumption of January 1, 2013 as the date of the acquisition consummation.

Incremental amortization expense of $41.2 million for the three months ended March 31, 2013 resulting from the fair value adjustment for purchase accounting for the acquisition of Santarus.

($ in thousands)	Weighted Average Useful Life (years)	Estimated Fair Value As of Acquisition Date	Amortization Expense for the Three Month Period Ended March 31, 2013
IPR&D	N/A	83,000	
Product rights on CMPs	15.4	1,489,000	41,656
Licensing agreements	10.0	44,000	1,100
Total pro forma amortization expense			42,756
Less: historical amortization expense			(1,501)
Net adjustment			41,255

Incremental interest expense of $26.5 for the three months ended March 31, 2013 related to the Company s debt structure after the acquisition of Santarus, comprised of $750 million of 2021 Notes and $1.2 billion in principal amount of borrowings under the Term Loan B Facility as if the debt had been issued on January 1, 2013.

($ in thousands)	Three Month Ended March 31, 2013
Interest on Term Loan B Facility of $1.2 billion and $750 million of 2021 Notes at an assumed weighted average cash interest rate of approximately 5.02%	23,859

Commitment fees on senior revolving credit facility	
Amortization of debt issue costs and original issue discount	2,428
Total adjustment	26,472

The income tax effect of the pro forma adjustments using a combined federal and state statutory income tax rate of 39.0%. The effective tax rate of the combined company could be significantly different (either higher or lower) depending on post-acquisition integration activities, cash needs and the geographical mix of income.

3. Revenue Recognition

The Company recognizes revenue when it is realized or realizable and earned. Revenue is realized or realizable and earned when all of the following criteria are met: (a) persuasive evidence of an arrangement exists; (b) delivery has occurred or services have been rendered; (c) the Company s price to the buyer is fixed or determinable; and (d) collectability is reasonably assured.

The Company recognizes revenues for product sales at the time title and risk of loss are transferred to the customer, which is generally at the time products are shipped (unless products are shipped under FOB Destination shipping terms, in which case risk of loss is transferred to the customer upon delivery). The Company recognizes revenue from sales transactions where the buyer has the right to return the product at the time of sale only if (1) the Company s price to the buyer is substantially fixed or determinable at the date of sale, (2) the buyer has paid the Company, or the buyer is obligated to pay the Company and the obligation is not contingent on resale

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SALIX PHARMACEUTICALS, LTD.

Notes to Consolidated Financial Statements Continued

of the product, (3) the buyer s obligation to the Company would not be changed in the event of theft or physical destruction or damage of the product, (4) the buyer acquiring the product for resale has economic substance apart from any provided by the Company, (5) the Company does not have significant obligations for future performance to directly bring about resale of the product by the buyer, and (6) the amount of future returns can be reasonably estimated. The Company s net product revenue represents the Company s total revenues less allowances for customer credits, including wholesaler discounts, estimated rebates, chargebacks, promotional programs and product returns.

The Company establishes allowances for estimated rebates, chargebacks and product returns based on numerous qualitative and quantitative factors, including:

- the number of and specific contractual terms of agreements with customers;
- estimated levels of inventory in the distribution channel;
- historical rebates, chargebacks and returns of products;
- direct communication with customers;
- anticipated introduction of competitive products or generics;
- anticipated pricing strategy changes by the Company and/or its competitors;
- analysis of prescription data gathered by a third-party prescription data provider;
- the impact of changes in state and federal regulations; and
- estimated remaining shelf life of products.

In its analyses, the Company uses prescription data purchased from a third-party data provider to develop estimates of historical inventory channel pull-through. The Company utilizes an internal analysis to compare historical net product shipments to estimated historical prescriptions written. Based on that analysis, management develops an estimate of the quantity of product in the channel which may be subject to various rebate, chargeback and product return exposures. To estimate months of ending inventory in the distribution channel the Company divides estimated ending

inventory in the distribution channel by the Company s estimate of the succeeding quarter s demand, not taking into account any future anticipated demand growth beyond the succeeding quarter. At least quarterly for each product line, the Company prepares an internal estimate of ending inventory units in the distribution channel by adding estimated inventory in the channel at the beginning of the period, plus net product shipments for the period, less estimated prescriptions written for the period. Based on that analysis, the Company develops an estimate of the quantity of product in the channel that might be subject to various rebate, chargeback and product return exposures. This is done for each product line by applying a rate of historical activity for rebates, chargebacks and product returns, adjusted for relevant quantitative and qualitative factors discussed above, to the potential exposed product estimated to be in the distribution channel. The Company regularly adjusts internal forecasts that are utilized to calculate the estimated number of months in the channel based on input from members of the Company s sales, marketing and operations groups. The adjusted forecasts take into account numerous factors including, but not limited to, new product introductions, direct communication with customers and potential product expiry issues. Adjustments to estimates are recorded in the period when significant events or changes in trends are identified.

The Company offers discounts to the Company s wholesalers and other customers. These discounts are calculated as a percentage of the current published list price and are treated as off-invoice allowances. Accordingly, the discounts are recorded as a reduction of revenue in the period that the discounts are offered. In addition to these discounts, at the time that the Company implements a price increase, it generally offers its existing customer base an opportunity to purchase a limited quantity of product at the previous list price. Shipments resulting from these offers generally are not in excess of ordinary levels, therefore, the Company recognizes the related revenue upon shipment and includes the shipments in estimating various product related allowances. In the event the Company determines that these shipments represent purchases of inventory in excess of ordinary levels for a given wholesaler, the potential impact on product returns exposure would be specifically evaluated and reflected as a reduction in revenue at the time of such shipments.

Allowances for estimated rebates, chargebacks and patient-focused promotional programs were $222.7 million and $184.6 million as of March 31, 2014 and December 31, 2013, respectively. These allowances reflect an estimate of the Company s liability for items such as rebates due to various governmental organizations under the Medicare/Medicaid regulations, rebates due to managed care organizations under specific contracts and chargebacks due to various organizations purchasing products through federal contracts and/or group purchasing agreements. The Company estimates its liability for rebates, chargebacks and patient-focused promotional programs at each reporting period based on a methodology of applying quantitative and qualitative assumptions. Due to the subjectivity of the Company s accrual estimates for rebates and chargebacks, the Company prepares various sensitivity analyses to ensure the Company s final estimate is within a reasonable range as well as reviews prior period activity to ensure that the Company s methodology continues to be appropriate.

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SALIX PHARMACEUTICALS, LTD.

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Allowances for product returns were $85.0 million and $68.2 million as of March 31, 2014 and December 31, 2013, respectively. These allowances reflect an estimate of the Company s liability for products that may be returned by the original purchaser in accordance with the Company s stated return policy. The Company estimates its liability for product returns at each reporting period based on historical return rates, estimated inventory in the channel and the other factors discussed above. Due to the subjectivity of the Company s accrual estimates for product returns, the Company prepares various sensitivity analyses and also reviews prior period activity to ensure that the Company s methodology is still reasonable.

The Company s provision for rebates, chargebacks, patient-focused promotional programs and product returns as a percentage of gross product revenue in the three-month periods ended March 31, 2014 and 2013 was 16.8% and 15.3% for rebates, chargebacks and patient-focused promotional programs and was 3.7% and 2.2% for product returns, respectively,

4. Commitments

Purchase Order Commitments

At March 31, 2014, the Company had binding purchase order commitments for inventory purchases expected to be delivered over the next three years aggregating approximately $222.3 million.

Potential Milestone Payments

The Company has entered into collaborative agreements with licensors, licensees and others. Pursuant to the terms of these collaborative agreements, the Company is obligated to make one or more payments upon the occurrence of certain milestones. The following is a summary of the material payments that the Company might be required to make under its collaborative agreements if certain milestones are satisfied.

Amended and Restated License Agreement with Alfa Wassermann S.p.A. In August 2012 the Company amended its 1996 License Agreement, or the 1996 Agreement, with Alfa Wassermann, S.p.A., or Alfa, to develop and commercialize rifaximin. The restated agreement provides the Company with an exclusive license to develop and commercialize rifaximin products for Crohn s disease in the United States and Canada and a non-exclusive license to develop such products worldwide. The Company paid Alfa a non-refundable upfront fee of $10.0 million in August 2012, and is obligated to make a $25.0 million milestone payment upon receipt of marketing authorization in the United States for a delayed release formulation rifaximin product for Crohn s disease, and additional milestone payments of up to $200.0 million based on net sales of delayed release formulation rifaximin products for Crohn s disease. No milestone payment had been earned or made as of March 31, 2014.

License Agreement with Dr. Falk Pharma GmbH for budesonide In March 2008, the Company entered into a license agreement with Dr. Falk Pharma GmbH, or Dr. Falk Pharma, that provides the Company with an exclusive license to develop and commercialize Dr. Falk Pharma s budesonide rectal foam product in the United States. This product has patent protection in the United States until 2015. Pursuant to the license agreement the Company is obligated to make

an upfront payment and regulatory milestone payments that could total up to $9.5 million to Dr. Falk Pharma, with the majority contingent upon U.S. regulatory approval of a foam product. As of March 31, 2014, the Company had paid $2.0 million of these milestone payments.

Development, Commercialization and License Agreement with Lupin Ltd. In September 2009, the Company entered into a Development, Commercialization and License Agreement with Lupin Ltd, or Lupin, for Lupin s proprietary drug delivery technology for rifaximin. The Company made an upfront payment of $5.0 million to Lupin upon execution of this agreement.

In March 2011, the Company entered into an amendment and restatement of its Development, Commercialization and License Agreement with Lupin, and further amended it in February 2013, as so amended, the Amended License Agreement. The Amended License Agreement replaces in its entirety the September 2009 agreement. This agreement provides that the Company is obligated to pay Lupin an additional upfront payment of $10.0 million, milestone payments that could total up to $53.0 million over the term of the agreement and royalties in connection with the commercialization of relevant products. The milestone payments are contingent upon achievement of certain clinical and regulatory milestones. During the portion of the term of the Amended License Agreement ending September 30, 2019, the Company must pay Lupin a minimum quarterly payment unless specified payments by the Company to Lupin during that quarter exceed that amount. The Company is permitted to charge against such minimum quarterly payments as it makes in respect of quarters beginning on or after January 1, 2012, the purchase price for certain rifaximin to be supplied to it by Lupin pursuant to a Rifaximin Manufacturing and Supply Agreement into which the Company and Lupin entered in September 2009 and subsequently amended. In the event the Company should exercise its right to terminate the Amended License Agreement for convenience, it must pay Lupin as an early termination fee a specified portion of the minimum quarterly payments payable by it to Lupin through September 30, 2019, that have not been paid or otherwise satisfied as of the date of termination. As of March 31, 2014, the Company had paid the additional $10.0 million upfront payment.

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License Agreement with Napo Pharmaceuticals, Inc. In December 2008 the Company entered into a collaboration agreement with Napo Pharmaceuticals, Inc., or Napo. Pursuant to the agreement, the Company has an exclusive, royalty-bearing license to crofelemer (trade name Fulyzaq) for all human uses in North America and much of Europe and for all human uses other than the treatment of HIV-associated diarrhea, pediatric diarrhea and acute infectious diarrhea in other regions. The Company also has a non-exclusive, worldwide, royalty-bearing license to use Napo-controlled trademarks associated with crofelemer. The Company has made an initial payment of $5.0 million to Napo and agreed to make up to $50.0 million in milestone payments to Napo contingent on regulatory approvals and up to $250.0 million in milestone payments contingent on reaching certain sales thresholds. The Company is responsible for the development costs of crofelemer, but costs exceeding $12.0 million for development of crofelemer used for the HIV-associated diarrhea indication have been credited against regulatory milestones and thereafter against sales milestones. On December 31, 2012, the FDA granted marketing approval for this product, under the trade name Fulyzaq and as of that date, development costs exceeded $12.0 million by more than the amount of the milestone due upon FDA marketing approval; therefore there was no payment due to Napo at that time. Additionally, as of March 31, 2014, none of the sales thresholds that would potentially trigger other milestone payments had been satisfied.

License and Supply Agreement with Norgine B.V. In December 2005, the Company entered into a license and supply agreement with Norgine for the rights to sell NRL944, a bowel cleansing product the Company now markets in the United States under the trade name MoviPrep. Pursuant to the terms of this agreement, the Company is obligated to make upfront and milestone payments to Norgine that could total up to $37.0 million over the term of the agreement. As of March 31, 2014, the Company had paid $27.0 million of milestone payments. The remaining milestone payments are contingent upon reaching sales thresholds that have not been satisfied.

License Agreement with Photocure ASA In October 2010, the Company entered into a license agreement with Photocure ASA, or Photocure, for the worldwide exclusive rights, excluding the Nordic region, to develop and commercialize Lumacan™ for diagnosing, staging or monitoring gastrointestinal dysplasia or cancer. The Company made an initial payment of $4.0 million to Photocure, and will be responsible for development costs of Lumacan, but Photocure will reimburse the Company up to $3.0 million for certain out-of-pocket costs. In December 2012 the Company made a $4.5 million milestone payment. In addition, the Company is obligated to make up to $72.0 million in milestone payments to Photocure contingent on development and regulatory milestones, and up to $50.0 million in milestone payments contingent on reaching certain sales thresholds over the term of the agreement. No additional milestone payments had been earned or made as of March 31, 2014.

License Agreement with Progenics Pharmaceuticals, Inc. In February 2011, the Company acquired an exclusive worldwide license to develop and commercialize the products containing methylnaltrexone bromide, or the MNTX Compound, marketed under the name Relistor®, from Progenics Pharmaceuticals, Inc., or Progenics (except in Japan, where Ono Pharmaceutical Co. Ltd. has previously licensed the subcutaneous formulation of the drug from Progenics). The Company paid Progenics an up-front license fee of $60.0 million. In addition, the Company is obligated to pay development milestone payments of up to $90.0 million contingent upon achieving specified regulatory approvals and commercialization milestone payments of up to $200.0 million contingent upon achieving specified targets for net sales over the term of the agreement. No milestone payments had been earned or made as of March 31, 2014.

License Agreements and Stock Purchase Agreement with Q-Med AB In connection with the Company s acquisition of Oceana Therapeutics, Inc., or Oceana, in December 2011, the Company acquired two license agreements with Q-Med AB, or Q-Med, which provide it the worldwide right to commercialize Deflux and Solesta. Under a stock purchase agreement with Q-Med that was assumed in connection with the Oceana transaction, the Company is obligated to pay commercialization milestone payments of up to $45.0 million contingent upon achieving specified targets for net sales of Solesta over the term of the agreement. No milestone payments had been earned or made as of March 31, 2014.

License Agreement with Cosmo Technologies Limited In December 2008, Santarus entered into a strategic collaboration with Cosmo Technologies Limited, or Cosmo, including a license agreement, stock issuance agreement and registration rights agreement, under which Santarus was granted exclusive rights to develop and commercialize Uceris in the United States. In November 2013, Santarus, Cosmo, and Salix amended the original license agreement in connection with Salix s acquisition of Santarus, and Cosmo consented to the development, promotion and marketing in the United States by Salix, Santarus and any of their subsidiaries of budesonide products, provided that Salix, Santarus and their subsidiaries would be prohibited from developing, promoting or marketing an oral formulation budesonide product other than Uceris for human use. In addition, the parties agreed to the termination of the stock issuance and registration rights agreements. To date, Santarus has made upfront licensing and milestone payments to Cosmo under the license agreement, as amended, consisting of $9.5 million in cash. Certain milestone payments under the original license agreement were paid in Santarus stock. In the future, Santarus may be required to pay Cosmo commercial milestones for Uceris of up to $22.5 million. These milestones are payable only in cash.

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License Agreement with University of Missouri In January 2001, Santarus entered into an exclusive, worldwide license agreement with the University of Missouri for patents and pending patent applications relating to specific formulations of proton pump inhibitors with antacids and other buffering agents and methods of using these formulations. Under the terms of the license agreement, Santarus has paid to the University of Missouri $8.5 million in upfront licensing and milestone payments as of March 31, 2014. Santarus remains obligated to make additional commercialization milestone payments to the University of Missouri of up to $83.8 million, the next of which is a one-time $7.5 million milestone payment upon initial achievement of $250.0 million in annual calendar year net product sales of Zegerid.

License Agreement and Supply Agreement with Pharming Group NV In September 2010, Santarus entered into a license agreement and a supply agreement with Pharming Group NV, or Pharming, under which Santarus was granted certain non-exclusive rights to develop and manufacture, and certain exclusive rights to commercialize Ruconest in the U.S., Canada and Mexico for the treatment of hereditary angioedema, or HAE, and other future indications. In partial consideration of the licenses granted under the license agreement, Santarus paid Pharming a $15 million upfront fee. In addition, in November 2012, Santarus paid Pharming a $10 million milestone following successful achievement of the primary endpoint of the phase 3 clinical study. Santarus paid a $5 million milestone to Pharming in July 2013 upon FDA acceptance for review of a Biologics License Application, or BLA, for Ruconest. Santarus may also be required to pay Pharming additional success-based regulatory and commercial milestones totaling up to an aggregate of $25 million, including a $20 million milestone upon the earlier of first commercial sale of Ruconest in the U.S. or 90 days following receipt of FDA approval and commercialization milestone payments of up to $45.0 million contingent upon achieving specified targets for net sales of Ruconest over the term of the agreement.

License Agreement and Supply Agreement with Biogen Idec MA In September 2010, in connection with Santarus s acquisition of Covella, Santarus acquired the exclusive worldwide rights to SAN-300, a product candidate and humanized anti-VLA-1 monoclonal antibody, or mAb, for the treatment of certain inflammatory and autoimmune diseases. Under the terms of an amended and restated license agreement entered into among Santarus, Covella and Biogen Idec MA, or Biogen, at the time of the acquisition, Biogen has granted to Santarus an exclusive, worldwide license to patents and certain know-how and other intellectual property owned and controlled by Biogen relating to SAN-300 and the anti-VLA-1 mAb development program. The amounts of the clinical and regulatory milestone payments that Santarus will be obligated to pay to Biogen vary depending on the type of product, the number of indications, and other specifically negotiated milestones. If SAN-300 is the first to achieve all applicable milestones for three indications, Santarus will be required to pay to Biogen maximum aggregate clinical and regulatory milestone payments of $97.2 million. The maximum aggregate commercialization milestone payments to Biogen total $105.5 million for SAN-300, assuming cumulative net sales of at least $5.0 billion of such product, and total $60.25 million for products containing certain other compositions as described in the amended and restated license agreement, assuming cumulative net sales of at least $5.0 billion of such products.

License Agreement with RedHill Biopharma Ltd. In February 2014, the Company entered into an agreement with RedHill Biopharma Ltd., or RedHill, whereby it licensed the worldwide exclusive rights to RedHill s RHB-106 encapsulated formulation for bowel preparation and rights to other purgative developments. Concurrently the Company licensed additional related intellectual property from four individuals. In connection with these agreements, the Company made upfront payments of $11.5 million and is obligated to make development milestone payments of up to $12.5 million contingent upon achieving specified regulatory approvals and commercialization milestone

payments of up to $15.0 million contingent upon achieving specified targets for net sales over the term of the agreement. No milestone payments had been earned or made as of March 31, 2014.

5. Financial Instruments, Recurring and Nonrecurring Fair Value Measurements
Recurring Fair Value Measurements

The carrying amounts of the Company s financial instruments, which include cash and cash equivalents, approximated their fair values as of March 31, 2014 and December 31, 2013 due to the short-term nature of these financial instruments and are considered Level 1 investments. Level 1 investments are investments where there are quoted prices in active markets available for identical assets or liabilities. Accounts receivable, accounts payable, accrued liabilities and capital lease obligations approximated their fair values at March 31, 2014 and December 31, 2013 due to the short-term nature of these financial instruments.

The Company s convertible senior notes and 2021 senior notes are considered Level 1 instruments. The fair values of the convertible senior notes and 2021 senior notes were estimated based on the most recent quoted prices for such notes.

The fair value of the contingent consideration liability, consisting of future potential milestone payments related to the Oceana, Progenics, Santarus and Alfa delayed release acquisitions was $118.3 million and $87.3 million at March 31, 2014 and December 31, 2013, respectively. The Company considers this liability a Level 3 instrument in the fair value hierarchy, which is defined as one with significant unobservable inputs. The Company determined fair values based on the income approach using probability-weighted

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Notes to Consolidated Financial Statements Continued

discounted cash flows that included probability assessments of occurrence of triggering events appropriately discounted considering the uncertainties associated with the obligation, calculated in accordance with the terms of the acquisition agreement based on management s forecasts, and Monte-Carlo simulation models. The most significant unobservable inputs are the probability of receiving FDA approval for the relevant compounds and the subsequent commercial success of these compounds, if approved. The fair value of the related contingent consideration would be minimal if a compound does not receive FDA approval. The Company reviews the fair value of contingent consideration quarterly or whenever events or changes in circumstances occur that indicate there has been a change in the fair value.

The change in the fair value of the contingent consideration liability during the three-month period ended March 31, 2014 was a result of the reduction of the discount period due to the passage of time.

Nonrecurring Fair Value Measurements

The Company s non-financial assets, such as intangible assets and property and equipment, are measured at fair value when there is an indicator of impairment and recorded at fair value only when an impairment charge is recognized. In the event of an impairment, the Company determines the fair value of the indefinite lived intangible asset using a discounted cash flow approach, which contains significant unobservable inputs and therefore is considered a Level 3 fair value measurement. The unobservable inputs in the analysis generally include future cash flow projections and a discount rate.

6. Cash and Cash Equivalents

The Company considers all highly liquid investments with maturities from date of purchase of three months or less to be cash equivalents. The Company maintains its cash and cash equivalents in several different financial instruments with various banks and brokerage houses. This diversification of risk is consistent with Company policy to maintain liquidity and ensure the safety of principal. At March 31, 2014 and December 31, 2013, cash and cash equivalents consisted primarily of demand deposits, overnight investments in Eurodollars, certificates of deposit and money market funds at reputable financial institutions and did not include any auction rate securities. Restricted cash of $750 million at December 31, 2013 represented the gross proceeds from the sale of our 2021 Notes on December 27, 2013, which was held in escrow to finance a portion of the consideration for our acquisition of Santarus, and was disbursed in connection with the closing on January 2, 2014.

7. Inventory

The Company states raw materials, work-in-process and finished goods inventories at the lower of cost (which approximates actual cost on a first-in, first-out cost method) or market value. In evaluating whether inventory is stated at the lower of cost or market, management considers such factors as the amount of inventory on hand and in the distribution channel, estimated time required to sell such inventory, remaining shelf life, and current and expected market conditions, including levels of competition, and generic competition. The Company measures inventory

adjustments as the difference between the cost of the inventory and estimated market value based upon assumptions about future demand and charged to the provision for inventory, which is a component of cost of sales. At the point of the loss recognition, the Company establishes a new, lower-cost basis for that inventory, and any subsequent improvements in facts and circumstances do not result in the restoration or increase in that newly established cost basis.

The Company expenses pre-approval inventory unless the Company believes it is probable that the inventory will be saleable. The Company capitalizes inventory costs associated with marketed products and certain products prior to regulatory approval and product launch, based on management s judgment of probable future commercial use and net realizable value. Capitalization of this inventory does not begin until the product candidate is considered to have a high probability of regulatory approval, which is generally after the Company has analyzed Phase 3 data or filed an NDA. If the Company is aware of any specific risks or contingencies that are likely to impact the expected regulatory approval process or if there are any specific issues identified during the research process relating to safety, efficacy, manufacturing, marketing or labeling of the product candidate, the Company does not capitalize the related inventory. Once the Company capitalizes inventory for a product candidate that is not yet approved, the Company monitors, on a quarterly basis, the status of this candidate within the regulatory approval process. The Company could be required to expense previously capitalized costs related to pre-approval inventory upon a change in its judgment of future commercial use and net realizable value, due to a denial or delay of approval by regulatory bodies, a delay in the timeline for commercialization or other potential factors. On a quarterly basis, the Company evaluates all inventory, including inventory capitalized for which regulatory approval has not yet been obtained, to determine if any lower of cost or market adjustment is required. As it relates to pre-approval inventory, the Company considers several factors including expected timing of FDA approval, projected sales volume and estimated selling price. At March 31, 2014 and December 31, 2013, there were no amounts included in inventory related to pre-approval inventory.

Inventory at March 31, 2014 consisted of $73.6 million of raw materials, $13.2 million of work-in-process, and $59.0 million of finished goods, and the March 31, 2014 finished goods inventory balance includes a step-up in the value of inventories acquired in the acquisition of Santarus of $19.3 million. Inventory at December 31, 2013 consisted of $61.0 million of raw materials, $11.7 million of work-in-process, and $31.5 million of finished goods.

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8. Intangible Assets and Goodwill

The Company s intangible assets consist of license agreements, product rights and other identifiable intangible assets, which result from product and business acquisitions. Goodwill represents the excess purchase price over the fair value of assets acquired and liabilities assumed in a business combination.

When the Company makes product acquisitions that include license agreements, product rights and other identifiable intangible assets, it records the purchase price of such intangibles as intangible assets, in addition to recording the value of the product related liabilities that it assumes. The Company allocates the aggregate purchase price to the fair value of the various tangible and intangible assets in order to determine the appropriate carrying value of the acquired assets and then amortizes the cost of finite lived intangible assets as an expense in its consolidated statements of comprehensive income over the estimated economic useful life of the related assets. Finite lived intangible assets consist primarily of product rights for currently marketed products and are amortized over their expected economic life. The Company accounts for acquired in-process research and development as indefinite lived intangible assets until regulatory approval or discontinuation. The Company assesses the impairment of identifiable intangible assets whenever events or changes in circumstances indicate that the carrying value might not be recoverable. The Company believes that the following factors could trigger an impairment review: significant underperformance relative to expected historical or projected future operating results; significant changes in the manner of the Company s use of the acquired assets or the strategy for the Company s overall business; approval of generic products; and significant negative industry or economic trends.

In assessing the recoverability of its intangible assets, the Company must make assumptions regarding estimated future cash flows and other factors. If the estimated undiscounted future cash flows do not exceed the carrying value of the intangible assets, the Company must determine the fair value of the intangible assets. If the fair value of the intangible assets is less than the carrying value, the Company will recognize an impairment loss in an amount equal to the difference. The Company reviews goodwill and indefinite lived intangibles for impairment on an annual basis in the fourth quarter, and goodwill and other intangible assets for impairment whenever events or changes in circumstances indicate that the carrying amount of an asset may not be recoverable. As of March 31, 2013, management believed that the reporting unit was not at risk of failing step one of the goodwill impairment test.

The following table reflects the components of all specifically identifiable intangible assets as of March 31, 2014 and December 31, 2013 (in thousands):

	March 31, 2014 (Restated)				December 31, 2013			
	Gross Amount	Accumulated Amortization	Foreign Exchange Translation	Net Carrying Value	Gross Amount	Accumulated Amortization	Foreign Exchange Translation	Net Carrying Value
Goodwill	$ 1,350,376	$	$	$ 1,350,376	$ 180,905	$	$ 4	$ 180,909
Finite lived intangible assets	2,023,366	(203,439)	1,072	1,820,999	490,367	(149,322)	865	341,910

Indefinite lived intangible assets	138,600			138,600	55,600			55,600
Total	$ 3,512,342	$ (203,439)	$ 1,072	$ 3,309,975	$ 726,872	$ (149,322)	$ 869	$ 578,419

The weighted-average remaining life of our finite lived intangible assets was thirteen years and eight years at March 31, 2014 and December 31, 2013, respectively.

The Company recorded goodwill of $95.7 million in connection with the Oceana acquisition in December 2011.

As described in Note 2, on January 2, 2014 the Company completed its acquisition of Santarus. Finite lived intangible assets valued at $1,533.0 million indefinite lived intangible assets valued at $83.0 million and goodwill of $1,168.2 million were recorded in connection with this acquisition.

Amortization expense is calculated on a straight-line basis over the estimated useful life of the asset. Amortization expense for the three-month periods ended March 31, 2014 and 2013 was $53.9 million and $11.2 million, respectively.

In February 2011, the Company acquired an exclusive worldwide license to develop and commercialize the products containing methylnaltrexone bromide, or the MNTX Compound, marketed under the name Relistor, from Progenics Pharmaceuticals, Inc. (except in Japan, where Ono Pharmaceutical Co. Ltd. has previously licensed the subcutaneous formulation of the drug from

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Progenics) and a non-exclusive license to manufacture the MNTX Compound and products containing that compound in the same territory. The Company paid Progenics an up-front license fee payment of $60.0 million. The Company also agreed to pay development milestone payments of up to $90.0 million contingent upon achieving specified regulatory approvals and commercialization milestone payments of up to $200.0 million contingent upon achieving specified targets for net sales. The Company must pay Progenics 60% of any revenue received from sublicensees in respect of any country outside the United States. The Company must pay Progenics royalties based on a percentage ranging from the mid- to high-teens of net sales by the Company and its affiliates of any product containing the MNTX Compound (excluding sales by ex-U.S. sublicensees).

The Company accounted for the Progenics transaction as a business combination under the acquisition method of accounting. Under the acquisition method of accounting, the Company recorded the assets acquired and liabilities assumed at their respective fair values as of the acquisition date in its consolidated financial statements. The determination of estimated fair value required management to make significant estimates and assumptions. As of the acquisition date, the estimated fair value of the assets acquired was $113.0 million. The Company estimated the fair value of the contingent consideration related to this transaction at $53.0 million, which was booked as a long-term liability on the consolidated balance sheet. The Company determined this liability amount using a probability-weighted discounted cash flow model based on the current regulatory status of the methylnaltrexone bromide development programs. The Company assesses the fair value of the contingent consideration quarterly, or whenever events or changes in circumstances indicate that the fair value may have changed, primarily as a result of clinical or regulatory results in the related in-process development programs. In December 2011, the Company announced positive Phase 3 data from the OIC Oral development program. Based on this information, the Company reassessed the fair value of the contingent consideration and recorded a $27.0 million increase in the contingent consideration and a corresponding charge to earnings in the fourth quarter of 2011. At March 31, 2014 and December 31, 2013, accumulated amortization for the intangible related to the currently approved indication for Relistor was $7.8 million and $7.2 million, respectively.

On July 27, 2012, the Company received a Complete Response Letter, or CRL, from the FDA following its review of a Supplemental New Drug Application, or sNDA for methylnaltrexone bromide injection for subcutaneous use for the treatment of OIC in adult patients with chronic, non-cancer pain. The CRL requested additional clinical data. In October 2012 the Company and Progenics held an End-of-Review meeting with the FDA s Division of Gastroenterology and Inborn Errors Products to better understand the contents of the CRL. Based on the results of this meeting, the Company reassessed the value of the indefinite lived intangible asset related to methylnaltrexone bromide injection for subcutaneous use for the treatment of OIC in chronic non-cancer pain and recorded a non-cash charge to earnings of $41.6 million in the three-month period ended September 30, 2012. Based on these events, the Company reassessed the fair value of the contingent consideration related to the Progenics transaction and recorded a $33.0 million decrease in the contingent consideration and a corresponding non-cash benefit to earnings in the three-month period ended September 30, 2012. The Company is currently evaluating the Oral OIC development program and currently believes it will continue this program. However, additional information and additional guidance from the FDA could result in the termination of the oral OIC development program, which would result in impairment of the related intangible asset and a decrease in the related contingent consideration.

In December 2011, the Company completed its acquisition of Oceana for a purchase price of approximately $303 million. Oceana has license agreements with Q-Med that provide us the worldwide right to commercialize Deflux and Solesta. Under a stock purchase agreement with Q-Med that was assumed in connection with this transaction, the Company is obligated to pay commercialization milestone payments of up to $45.0 million contingent upon achieving specified targets for net sales of Solesta. Additionally, the Company must pay low double-digit royalties under these license agreements based on a percentage of net sales of both Deflux and Solesta by the Company and its affiliates in the U.S. and a fixed per-unit royalty of the products outside the U.S.

The Company accounted for the Oceana transaction as a business combination under the acquisition method of accounting. Under the acquisition method of accounting, the Company recorded the assets acquired and liabilities assumed at their respective fair values as of the acquisition date in its consolidated financial statements. The determination of estimated fair value required management to make significant estimates and assumptions. As of the acquisition date, the estimated fair value of the assets acquired was approximately $342.8 million. The Company estimated the fair value of the contingent consideration related to this transaction at $39.7 million, which was booked as a long-term liability on the consolidated balance sheet. The Company determined this liability amount using a probability-weighted discounted cash flow model. The Company assesses the fair value of the contingent consideration quarterly, or whenever events or changes in circumstances indicate that the fair value may have changed, primarily as a result of significant changes in our forecast of net sales for Solesta. At March 31, 2014 accumulated amortization for the Deflux intangible was $9.9 million and $65.4 million for the Solesta intangible. At December 31, 2013 accumulated amortization for the Deflux intangible was $9.3 million and $58.1 million for the Solesta intangible.

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In August 2012, the Company amended its 1996 Agreement with Alfa. The Amended Agreement does not alter any of the terms for the traveler s diarrhea, or TD, or HE indications developed under the 1996 Agreement or IBS. The Company remains obligated to pay Alfa royalties, at the same range of rates as under the 1996 Agreement, on net sales of such products. In addition, the Amended Agreement provides the Company with an exclusive license to develop and commercialize rifaximin products for Crohn s disease in the United States and Canada and a non-exclusive license to develop such products worldwide. The Company paid Alfa a non-refundable upfront fee of $10.0 million in August 2012, and is obligated to make a $25.0 million milestone payment upon receipt of marketing authorization in the United States for a delayed release formulation product for Crohn s disease, and additional milestones based on net sales of delayed release formulation products for Crohn s disease of up to $200.0 million. In addition, the Company is required to pay Alfa royalties on sales of rifaximin products for Crohn s at percentage rates ranging from the low to mid-double digits.

The Company accounted for the Alfa Wassermann transaction as a business combination under the acquisition method of accounting. Under the acquisition method of accounting, the Company recorded the assets acquired and liabilities assumed at their respective fair values as of the acquisition date in its consolidated financial statements. The determination of estimated fair value required management to make significant estimates and assumptions. As of the acquisition date, the estimated fair value of the assets acquired was $23.4 million which is included as an indefinite lived intangible asset on the consolidated balance sheet. The Company estimated the fair value of the contingent consideration related to this transaction at $13.4 million, which was booked as a long-term liability on the consolidated balance sheet. The Company determined this liability amount using a probability-weighted discounted cash flow model based on the current regulatory status of the rifaximin delayed release development program. The Company assesses the fair value of the contingent consideration quarterly, or whenever events or changes in circumstances indicate that the fair value may have changed, primarily as a result of clinical or regulatory results in the related in-process development programs.

From 2002 through 2007, the Company acquired the rights to several compounds and products from various pharmaceutical companies and recorded intangible assets with a gross value of $147.2 million. At March 31, 2014 and December 31, 2013, accumulated amortization for these assets was $76.3 million and $74.4 million, respectively, and their carrying value was $36.3 million and $38.2 million, respectively.

9. Notes

Convertible Senior Notes Due 2028

On August 22, 2008 the Company closed an offering of $60.0 million in Convertible Senior Notes due 2028, or the 2028 Notes. Net proceeds from the offering were $57.3 million. The 2028 Notes were governed by an indenture, dated as of August 22, 2008, between the Company and U.S. Bank National Association, as trustee.

The 2028 Notes bore interest at a rate of 5.5% per year, payable semiannually in arrears on February 15 and August 15 of each year. The 2028 Notes were to mature on August 15, 2028, unless previously converted or repurchased in accordance with their terms prior to such date.

In March 2012, the Company entered into a note repurchase agreement with the holder of a majority in principal amount of the 2028 Notes. The Company used a portion of the proceeds from its offering of the 2019 Notes discussed below to purchase from this holder and another holder approximately 42.1% of the 2028 Notes for an aggregate purchase price of approximately $137.2 million. The Company incurred a loss on extinguishment of debt during the three-month period ended March 31, 2012 of $14.4 million, which primarily consists of $9.3 million in estimated fair market value of the put option granted to the majority holder, $2.5 million in estimated fair market value of the notes extinguished over their book value at the extinguishment date, and $2.0 million paid to the note holder for interest that the note holders would have received through August 2013, the first date the Company could call the debt under the original debt indenture. In December 2012 one of the holders of the 2028 Notes converted notes with a par value of $22.3 million under the terms of the note indenture, and received cash equal to the par value of the notes and interest on these notes through February 15, 2013, and 1.9 million shares of common stock. The Company incurred a loss on extinguishment of debt during the three-month period ended December 31, 2012 of $1.2 million, which primarily consists of $1.1 million in estimated fair market value of the notes extinguished over their book value at the extinguishment date, and $0.1 million paid to the note holder for interest that the note holders would have received through February 2013.

In connection with the issuance of the 2028 Notes, the Company incurred $2.7 million of issuance costs, which primarily consisted of investment banker, legal and other professional fees. These costs are being amortized and were recorded as additional interest expense through August 2013, the first scheduled date on which holders have the option to require the Company to repurchase the 2028 Notes.

The Company separately accounted for the liability and equity components of the convertible debt instrument by allocating the proceeds from issuance of the 2028 Notes between the liability component and the embedded conversion option, or equity component. This allocation was done by first estimating an interest rate at the time of issuance for similar notes that do not include the embedded conversion option. This interest rate of 12.5% was used to compute the initial fair value of the liability component of $44.1 million.

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The excess of the initial proceeds received from the convertible 2028 Notes over the initial amount allocated to the liability component, of $15.9 million, is allocated to the embedded conversion option, or equity component. This excess is reported as a debt discount and subsequently amortized as interest cost, using the interest method, through August 2013, the first scheduled date on which the holders had the option to require the Company to repurchase the 2028 Notes.

The Company had the right to redeem the 2028 Notes, in whole or in part, at any time after August 15, 2013 for cash equal to the principal amount of the Notes to be redeemed, plus any accrued and unpaid interest. The Company called the 2028 Notes for redemption in September 2013, but before the redemption date, the holders elected to convert the remaining 2028 Notes with a par value of $12.5 million under the terms of the note indenture, and the holders received cash equal to the par value of the notes and interest on these notes through August 15, 2013, and 1.2 million shares of common stock.

The carrying value of the equity component at December 31, 2013 was $6.6 million. For the year ended December 31, 2013, the effective interest rate on the liability component was 12.6%, and total interest expense of $1.1 million was recognized, including $0.6 million of amortization of debt discount.

Convertible Senior Notes Due 2015

On June 3, 2010 the Company closed an offering of $345.0 million in convertible senior notes due May 15, 2015, or the 2015 Notes. Net proceeds from the offering were approximately $334.2 million. The 2015 Notes are governed by an indenture, dated as of June 3, 2010 between the Company and U.S. Bank National Association, as trustee.

The 2015 Notes bear interest at a rate of 2.75% per year, payable semiannually in arrears on May 15 and November 15 of each year. The 2015 Notes will mature on May 15, 2015, unless earlier converted or repurchased in accordance with their terms prior to such date.

The 2015 Notes are senior unsecured obligations, and rank (i) equally to any of the Company s existing and future unsecured senior debt, (ii) senior to any of the Company s future indebtedness that is expressly subordinated to these 2015 Notes, and (iii) effectively junior to any secured indebtedness to the extent of the value of the assets securing such indebtedness.

The 2015 Notes are convertible into approximately 7,439,000 shares of the Company s common stock under certain circumstances prior to maturity at a conversion rate of 21.5592 shares per $1,000 principal amount of 2015 Notes, which represents a conversion price of approximately $46.38 per share, subject to adjustment under certain conditions. Holders may submit convert their 2015 Notes for conversion at their option at specified times prior to the maturity date of May 15, 2015 only if: (1) during any fiscal quarter commencing after June 30, 2010, if the last reported sale price of the Company s common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is equal to or more than 130% of the conversion price of the 2015 Notes on the last day of such preceding fiscal quarter; (2) the trading price for the 2015 Notes, per $1,000 principal amount, for each such trading day was less than 98% of the product of the last reported sale price of the Company s common stock and the conversion rate of the 2015 Notes on such date; or (3) the Company enters into

specified corporate transactions. The first of these conditions had been met as of the fiscal quarter ended March 31, 2014. The 2015 Notes will be convertible, at the option of the noteholders, regardless of whether any of the foregoing conditions have been satisfied, on or after January 13, 2015 at any time prior to the close of business on the second scheduled trading day immediately preceding the stated maturity date of May 15, 2015. Upon conversion, the Company may pay cash, shares of the Company s common stock or a combination of cash and stock, as determined by the Company in its discretion.

The Company is required to separately account for the liability and equity components of the convertible debt instrument by allocating the proceeds from issuance of the 2015 Notes between the liability component and the embedded conversion option, or equity component. This allocation was done by first estimating an interest rate at the time of issuance for similar notes that do not include the embedded conversion option. This interest rate of 8.35% was used to compute the initial fair value of the liability component of $265.6 million. The excess of the initial proceeds received from the convertible 2015 Notes over the initial amount allocated to the liability component, of $79.4 million, is allocated to the embedded conversion option, or equity component. This excess is reported as a debt discount and subsequently amortized as interest cost, using the interest method, through May 2015, the maturity date of the 2015 Notes.

In connection with the issuance of the 2015 Notes, the Company incurred $10.8 million of issuance costs, which primarily consisted of investment banker, legal and other professional fees. The portion of these costs related to the equity component of $2.5 million was charged to additional paid-in capital. The portion of these costs related to the debt component of $8.3 million is being amortized and are recorded as additional interest expense through May 2015, the maturity date of the 2015 Notes.

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In connection with the issuance of the 2015 Notes, the Company entered into capped call transactions with certain counterparties covering approximately 7,439,000 shares of the Company s common stock. The capped call transactions have a strike price of $46.38 and a cap price of $62.44, and are exercisable when and if the 2015 Notes are converted. If upon conversion of the 2015 Notes, the price of the Company s common stock is above the strike price of the capped calls, the counterparties will deliver shares of the Company s common stock and/or cash with an aggregate value approximately equal to the difference between the price of the Company s common stock at the conversion date (as defined, with a maximum price for purposes of this calculation equal to the cap price) and the strike price, multiplied by the number of shares of the Company s common stock related to the capped call transactions being exercised. The Company paid $44.3 million for these capped calls and charged this to additional paid-in capital.

The carrying value of the equity component related to the 2015 Notes at March 31, 2014 and December 31, 2013 was $79.4 million. The effective interest rate on the liability component for the three-month periods ended March 31, 2014 and 2013 was 8.35%. Total interest cost of $7.1 million and $6.8 million was recognized during the three-month periods ended March 31, 2014 and 2013, respectively, including $4.4 million and $4.0 million of amortization of debt discount, respectively. The fair value of the 2015 Notes was approximately $764.2 million at March 31, 2014.

Convertible Senior Notes Due 2019

On March 16, 2012 the Company closed an offering of $690.0 million in convertible senior notes due March 15, 2019, or the 2019 Notes. Net proceeds from the offering were approximately $668.3 million. The 2019 Notes are governed by an indenture, dated as of March 16, 2012 between the Company and U.S. Bank National Association, as trustee.

The 2019 Notes bear interest at a rate of 1.50% per year, payable semiannually in arrears on March 15 and September 15 of each year. The 2019 Notes will mature on March 15, 2019, unless earlier converted or repurchased in accordance with their terms prior to such date.

The 2019 Notes are senior unsecured obligations, and rank (i) equally to any of the Company s existing and future unsecured senior debt, (ii) senior to any of the Company s future indebtedness that is expressly subordinated to these 2019 Notes, and (iii) effectively junior to any secured indebtedness to the extent of the value of the assets securing such indebtedness.

The 2019 Notes are convertible into approximately 10,484,000 shares of the Company s common stock under certain circumstances prior to maturity at a conversion rate of 15.1947 shares per $1,000 principal amount of 2019 Notes, which represents a conversion price of approximately $65.81 per share, subject to adjustment under certain conditions. Holders may submit convert their 2019 Notes for conversion at their option at specified times prior to the maturity date of March 15, 2019 only if: (1) during any fiscal quarter commencing after June 30, 2012, if the last reported sale price of the Company s common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is equal to or more than 130% of the conversion price of the 2019 Notes on the last day of such preceding fiscal quarter; (2) the trading price for the 2019 Notes, per $1,000 principal amount, for each such trading day was less than 98% of the product of the last reported sale price of the Company s common stock and the conversion rate of the 2019 Notes on such date; or (3) the Company enters into specified corporate transactions. The first of these conditions had been met as of the fiscal quarter ended March 31,

2014. The 2019 Notes will be convertible, at the option of the noteholders, regardless of whether any of the foregoing conditions have been satisfied, on or after November 9, 2018 at any time prior to the close of business on the second scheduled trading day immediately preceding the stated maturity date of March 15, 2019. Upon conversion, the Company may pay cash, shares of the Company s common stock or a combination of cash and stock, as determined by the Company in its discretion.

The Company is required to separately account for the liability and equity components of the convertible debt instrument by allocating the proceeds from issuance of the 2019 Notes between the liability component and the embedded conversion option, or equity component. This allocation was done by first estimating an interest rate at the time of issuance for similar notes that do not include the embedded conversion option. This interest rate of 5.50% was used to compute the initial fair value of the liability component of $529.3 million. The excess of the initial proceeds received from the convertible 2019 Notes over the initial amount allocated to the liability component, of $160.7 million, is allocated to the embedded conversion option, or equity component. This excess is reported as a debt discount and subsequently amortized as interest cost, using the interest method, through March 2019, the maturity date of the 2019 Notes.

In connection with the issuance of the 2019 Notes, the Company incurred $21.7 million of issuance costs, which primarily consisted of investment banker, legal and other professional fees. The portion of these costs related to the equity component of $5.1 million was charged to additional paid-in capital. The portion of these costs related to the debt component of $16.6 million is being amortized and is recorded as additional interest expense through March 2019, the maturity date of the 2019 Notes.

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In connection with the issuance of the 2019 Notes, the Company entered into convertible bond hedge transactions with certain counterparties covering approximately 10,484,000 shares of the Company s common stock. The convertible bond hedge transactions have a strike price of $65.81 and are exercisable when and if the 2019 Notes are converted. If upon conversion of the 2019 Notes, the price of the Company s common stock is above the strike price of the convertible bond hedge transactions, the counterparties will deliver shares of the Company s common stock and/or cash with an aggregate value approximately equal to the difference between the price of the Company s common stock at the conversion date and the strike price, multiplied by the number of shares of the Company s common stock related to the convertible bond hedge transaction being exercised. The Company paid $167.0 million for these convertible bond hedge transactions and charged this to additional paid-in capital.

Simultaneously with entering into the convertible bond hedge transactions, the Company entered into privately negotiated warrant transactions whereby the Company sold the counterparties to these transactions warrants to acquire, subject to customary adjustments, approximately 10,484,000 shares of the Company s common stock at a strike price of $85.31 per share, also subject to adjustment. The Company received $99.0 million for these warrants and credited this amount to additional paid-in capital.

The carrying value of the equity component related to the 2019 Notes at March 31, 2014 and December 31, 2013 was $160.7 million. The effective interest rate on the liability component for the three-month periods ended March 31, 2014 and 2013 was 5.50%. Total interest cost of $8.4 million and $8.1 million was recognized during the three-month periods ended March 31, 2014 and 2013, respectively, including $5.2 million and $5.0 million of amortization of debt discount, respectively. The fair value of the 2019 Notes was approximately $1,168.0 million at March 31, 2014.

The following table summarizes information on the convertible senior notes as of (in thousands):

	March 31, 2014	December 31, 2013
Convertible Senior Notes due 2015:		
Principal amount of the liability component	$ 345,000	$ 345,000
Unamortized discount	(22,005)	(26,356)
Net carrying amount	$ 322,995	$ 318,644
Convertible Senior Notes due 2019:		
Principal amount of the liability component	$ 690,000	$ 690,000
Unamortized discount	(121,357)	(126,594)
Net carrying amount	$ 568,643	$ 563,406
Total Convertible Senior Notes		
Principal amount of the liability component	$ 1,035,000	$ 1,035,000

Unamortized discount	(143,362)	(152,950)
Net carrying amount	$ 891,638	$ 882,050

Notes Due 2021

On December 27, 2013, the Company, completed the issuance and sale of $750.0 million in aggregate principal amount of 6.00% senior notes due 2021, or the 2021 Notes, in a private placement. The 2021 Notes will mature on January 15, 2021 and bear interest at a rate of 6.00% per annum, accruing from December 27, 2013. Interest is payable on the 2021 Notes on each January 15 and July 15, commencing July 15, 2014. The 2021 Notes were issued at 100% of face value and the net proceeds to the Company from the sale of the 2021 Notes were $723.0 million after deducting the initial purchasers discounts and offering expenses, which were recorded in 2014 upon the completion of our acquisition of Santarus. The 2021 Notes are governed by terms contained in an indenture, dated as of December 27, 2013, between the Company and U.S. Bank National Association, as trustee.

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Upon closing, the Company placed the gross proceeds from the sale of the 2021 Notes into a secured escrow account, and they were recorded as restricted cash on the consolidated balance sheet at December 31, 2013. As discussed in Note 2, the Company completed its previously announced tender offer for all outstanding shares of common stock of Santarus, at a purchase price of $32.00 per share on January 2, 2014. Concurrently with completion of the tender offer, the proceeds in the escrow account were released to fund the acquisition. The 2021 Notes are unsecured obligations of the Company. Promptly following the acquisition of Santarus, Santarus and certain current subsidiaries of the Company became guarantors of the 2021 Notes on a senior unsecured basis.

At any time prior to January 15, 2017, the Company may, at its option, redeem some or all of the 2021 Notes at a redemption price of 100% of the principal amount thereof, plus a make-whole premium set forth in the indenture and accrued and unpaid interest, if any, to the redemption date. Beginning January 15, 2017, the Company may redeem the 2021 Notes, in whole or in part, at redemption prices (expressed as percentages of principal amount) equal to 104.5%, 103.0%, 101.5% and 100.0% for the 12-month periods beginning on January 15, 2017, January 15, 2018, January 15, 2019 and January 15, 2020, respectively, plus accrued and unpaid interest, if any. At any time prior to January 15, 2017, the Company also may redeem up to 35% of the principal amount of the 2021 Notes at a redemption price equal to 106.00% of the principal amount thereof plus accrued and unpaid interest, if any, with the net cash proceeds of certain equity offerings.

The indenture contains covenants that restrict the ability of the Company and certain of its subsidiaries to, among other things: (i) borrow money or issue preferred stock; (ii) pay dividends or make other payments or distributions on equity or purchase, redeem or otherwise acquire equity; (iii) make principal payments on, or purchase or redeem subordinated indebtedness prior to any scheduled principal payment or maturity; (iv) make certain investments; (v) create liens on their assets; (vi) sell their assets; (vii) enter into certain transactions with affiliates; (viii) engage in unrelated businesses and (ix) consolidate, merge or sell substantially all of the Company s assets. These covenants are subject to a number of exceptions and qualifications, including the fall away of certain of these covenants if the 2021 Notes receive an investment grade credit rating in the future. The indenture also requires the Company to make an offer to repurchase the 2021 Notes upon the occurrence of certain events constituting either a change of control that reduces the Company s credit rating or asset sales in specified circumstances. The fair value of the 2021 Notes was approximately $800.3 million at March 31, 2014.

10. Credit Agreement

On January 2, 2014, the Company entered into a credit agreement, or the Credit Agreement, with Jefferies Finance LLC, as collateral agent , or the Collateral Agent, and administrative agent, and the lenders party thereto, providing for (i) the $1.2 billion Term Loan B Facility) and (ii) a $150.0 million five year senior secured revolving credit facility, or the Revolving Credit Facility, and together with the Term Loan B Facility, the Senior Secured Facilities. The proceeds of the Term Loan B Facility were used to fund a portion of the purchase price of the tender offer for Santarus. The proceeds of the Revolving Credit Facility can be used in the future for working capital and general corporate purposes, including permitted investments and acquisitions.

In connection with the entry by the Company into the Credit Agreement, the Company and the Guarantors have entered into a Guarantee and Collateral Agreement, dated January 2, 2014, or the Guarantee and Collateral Agreement, with the Collateral Agent, pursuant to which (i) each of the Guarantors has guaranteed the obligations of the Company under the Credit Agreement and the obligations of each of the other Guarantors under the Guarantee and Collateral Agreement and (ii) the Company and each of the Guarantors has granted to the Collateral Agent, for the benefit of the lenders under the Credit Agreement, a first priority security interest in substantially all of its assets.

The term loans under the Term Loan B Facility are subject to quarterly amortization equal to 1.25% of the original aggregate principal amount thereof and the remaining principal balance is due and payable on January 2, 2020 unless earlier prepaid. The Senior Secured Facilities bear interest at an annual rate of, at the Company s option, either (i) Adjusted LIBOR (as defined by the Credit Agreement), with a floor of 1.00%, plus a margin of 3.25% or (ii) the highest of (A) the Wall Street Journal s published U.S. Prime Lending Rate, (B) the Federal Funds Effective Rate (as defined by the Credit Agreement) in effect on such day plus 0.50%, (C) one-month Adjusted LIBOR plus 1.00% per annum and (D) 2.00%, in each case plus a margin of 2.25%. If the ratio of the Company s consolidated total debt to consolidated EBITDA, or the Total Leverage Ratio, is less than 3.75 to 1.00, the margins will be reduced by 25 basis points.

The Company is required to prepay term loans under the Term Loan B Facility with (i) 100% of the proceeds of asset sales not reinvested within generally one year, (ii) 100% of the proceeds from certain debt financings and (iii) 50% of Excess Cash Flow (as defined in the Credit Agreement). The percentage of Excess Cash Flow that must be used to prepay the Term Loan B Facility decreases to 25% if the Total Leverage Ratio is less than 3:50 to 1:00 and to zero if the Total Leverage Ratio is less than 2:50 to 1:00.

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The Credit Agreement includes customary affirmative and negative covenants, including restrictions on additional indebtedness, liens, investments, asset sales, stock buybacks and dividends, mergers, consolidations, and transactions with affiliates and capital expenditures. The negative covenants are generally subject to various exceptions. The Credit Agreement does not include any financial maintenance covenants, with the exception that if 25% or more of the Revolving Credit Facility is being utilized, a Total Leverage Ratio requirement (measured as of the last day of each quarter), which decreases over time, must be satisfied. The Company was in compliance with these covenants as of March 31, 2014.

11. Research and Development

The Company expenses research and development costs, both internal and externally contracted, as incurred. For nonrefundable advance payments for goods or services that will be used or rendered for future research and development activities, the Company initially capitalizes the advance payment. The Company then recognizes such amounts as an expense as the related goods are delivered or the related services are performed. At March 31, 2014 and December 31, 2013, the net liability related to on-going research and development activities was $17.5 million and $11.8 million, respectively.

12. Comprehensive Income

Other comprehensive income is composed entirely of adjustments resulting from the translation of the financial statements of the Company s foreign subsidiary, Oceana Therapeutics, Limited into U.S. dollars.

13. Stockholders Equity

Additional Paid-In Capital

The following table summarizes the activity in additional paid-in-capital for the three-month periods ended March 31 (in thousands):

	2014 (Restated)	2013
Balance at December 31	$ 667,428	$ 631,364
Issuance of common stock upon exercise of stock options	2,367	756
Payments related to net settlement of stock-based awards	(5,090)	(1,481)
Income tax benefit from non-qualified stock option exercises	9,771	365
Compensation expense related to restricted stock awards	7,324	5,036

Balance at March 31	$ 681,800	$ 636,040

Share-Based Compensation

At March 31, 2014, the Company had one active share-based compensation plan, the 2005 Stock Plan, allowing for the issuance of stock options and restricted stock. The Company estimates the fair value of share-based payment awards on the date of the grant. The Company recognizes cost over the period during which an employee is required to provide service in exchange for the award.

Starting in 2006, the Company began issuing restricted shares to employees, executives and directors of the Company. The restrictions on the restricted stock lapse according to one of two schedules. For employees and executives of the Company, restrictions lapse 25% annually over four years or 33% over 3 years. For Board members of the Company, restrictions lapse 100% after approximately one year. The fair value of the restricted stock was estimated using an assumed forfeiture rate of 9.5% and is being expensed on a straight-line basis over the period during which the restrictions lapse. For the three-month periods ended March 31, 2014 and 2013, the Company recognized $7.3 million and $5.0 million in share based compensation expense related to the restricted shares, respectively. As of March 31, 2014, the total amount of unrecognized compensation cost related to nonvested restricted stock awards, to be recognized as expense subsequent to March 31, 2014, was approximately $62.2 million, and the related weighted-average period over which it is expected to be recognized is approximately 3 years.

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Aggregate stock plan activity is as follows:

		Stock Options		Restricted Shares		Stock Options and Restricted Shares	
	Total Shares Available For Grant	Number	Weighted Average Price	Number Subject to Issuance	Weighted Average Price	Number	Weighted Average Price
Balance at December 31, 2013	3,031,539	498,493	$ 18.23	1,472,255	$ 46.91	1,970,748	$ 39.66
Granted	(337,724)			337,724	$ 93.48	337,724	$ 93.48
Exercised		(127,172)	$ 18.61			(127,172)	$ 18.61
Vested				(319,012)	$ 37.64	(319,012)	$ 37.64
Canceled	68,334			(68,334)	$ 86.26	(68,334)	$ 86.26
Balance at March 31, 2014	2,762,149	371,321	$ 18.10	1,422,633	$ 58.15	1,793,954	$ 49.86

For the three-month period ended March 31, 2014, the Company issued 0.1 million shares of the Company s outstanding stock with a market value of $12.1 million upon the exercise of stock options. For the three-month period ended March 31, 2013, the Company issued 0.1 million shares of the Company s outstanding stock with a market value of $2.6 million upon the exercise of stock options. The Company recognized no share-based compensation expense related to stock options for the three-month periods ended March 31, 2014 or 2013, nor any income tax benefit. The total intrinsic value of options exercised for the three-month periods ended March 31, 2014 and 2013 was $9.7 million and $1.6 million, respectively. As of March 31, 2014, there was no unrecognized compensation cost for stock options because all stock options were fully vested. For the three-month periods ended March 31, 2014 and 2013 the Company received $2.4 million and $0.8 million in cash from stock option exercises, respectively.

The following table summarizes stock-based compensation expense incurred (in thousands):

	Three months ended March 31,	
	2014 (Restated)	2013
Research and development (as revised)	$ 1,647	$ 671
Selling, general and administrative(as revised)	5,677	4,365
Total	$ 7,324	$ 5,036

14. Income Taxes

The Company provides for income taxes under the liability method. This approach requires the recognition of deferred tax assets and liabilities for the expected future tax consequences of differences between the tax basis of assets or liabilities and their carrying amounts in the consolidated financial statements. The Company provides a valuation allowance for deferred tax assets if it is more likely than not that these items will either expire before the Company is able to realize their benefit or if future deductibility is uncertain.

The Company applies the provision of ASC 740-10 with respect to Accounting for Uncertainty in Income Taxes. As of March 31, 2014, the Company s unrecognized tax benefits totaled $10 million. If recognized, the entire amount would impact the Company s effective tax rate. The Company recognizes interest and penalties related to unrecognized tax benefits in income tax expense. The Company has recorded $0.7 million of interest expense and no penalties have been recorded by the Company through March 31, 2014. During the three months ended March 31, 2014, the Company recorded interest expense of $0.3 million to the Company s unrecognized tax benefit. The Company s net unrecognized tax benefits could change significantly due to tax benefits and liabilities that may be effectively settled within the next 12 months. The results and timing of the settlements is highly uncertain and the Company is unable to estimate the range of the possible changes to the balance of unrecognized tax benefits.

The Company files a consolidated U.S. federal income tax return and consolidated and separate company income tax returns in many U.S. state jurisdictions. Generally, the Company is no longer subject to federal and state income tax examinations by U.S. tax authorities for years prior to 1994. During the three-month period ended March 31, 2014, the Internal Revenue Service commenced an audit for the 2011 tax year. At this time we are not aware of any potential audit adjustments that will materially impact the Company s financial statements.

The provision for income taxes reflects the Company s estimate of the effective tax rate expected to be applicable for the full fiscal year. The Company s effective tax rate for the three-month period ended March 31, 2014 and 2013 were 44.8% and 33.9%, respectively. The increase in our effective tax rate for the three-month period ended March 31, 2014, as compared to the same periods in 2013, is due primarily to non-deductible acquisition costs that occurred during the first quarter of 2014. The Company re-evaluates

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this estimate each quarter based on the Company s estimated tax expense for the year. The Company s effective tax rate might fluctuate throughout the year due to various items including, but not limited to, certain transactions the Company enters into, settlement of uncertain tax positions, the implementation of tax planning strategies, and changes in the tax law. The Company s effective tax rates differ from the statutory rate of 35% primarily due to state income taxes and expenses and losses which are non-deductible for federal and state income tax purposes.

15. Net Income (Loss) per Share

The Company computes basic net income (loss) per share by dividing net income (loss) by the weighted average number of common shares outstanding. The Company computes diluted net income (loss) per share by dividing net income (loss) by the weighted average number of common shares and dilutive common share equivalents then outstanding. Common share equivalents consist of the incremental common shares issuable upon the exercise of stock options and the impact of unvested restricted stock grants. The Company accounts for the effect of the convertible notes on diluted net income (loss) per share using the treasury stock method. As a result, the convertible notes have no effect on diluted net income per share until the Company s stock price exceeds the conversion price of $9.25 per share for the 2028 Notes, $46.38 for the 2015 Notes, and $65.81 for the 2019 Notes. For the three-month period ended March 31, 2013, weighted average common shares, diluted, includes the effect of approximately 6,486,000 shares issuable upon conversion of the 2028 Notes calculated using the treasury stock method, taking into effect the repurchase in March and December 2012 of 2028 Notes convertible into approximately 2,730,000 and 2,405,000 shares, respectively, since the Company s average stock price exceeded $9.25 during this period. For the three-month period ended March 31, 2013, weighted average common shares, diluted, includes the effect of approximately 7,439,000 share issuable upon conversion of the 2015 Notes calculated using the treasury stock method, since the Company s average stock price exceeded $46.38 during this period. For the three-month period ended March 31, 2013, weighted average common shares, diluted, excludes the effect of the approximately 10,484,000 shares issuable upon conversion of the 2019 Notes calculated using the treasury stock method since the Company s average stock price did not exceed $65.81 during this period. For the three-month period ended March 31, 2014, weighted average common shares, diluted, equaled weighted average common shares, basic, because inclusion of 1,010,364 shares of restricted stock and stock options, and 9,562,499 shares issuable upon conversion of the 2015 and 2019 Notes would have been anti-dilutive.

For the three-month period ended March 31, 2014 and 2013, there were 14,690 and 23,205, respectively, potential common shares outstanding that were excluded from the diluted net income per share calculation because their effect would have been anti-dilutive.

The following table reconciles the numerator and denominator used to calculate diluted net income per share (in thousands):

	Three months ended March 31,

	2014 (Restated)	2013
Numerator:		
Net income (loss)	$ (34,577)	$ 22,441
Denominator:		
Weighted average common shares, basic	63,321	61,145
Dilutive effect of restricted stock		455
Dilutive effect of convertible debt		1,355
Dilutive effect of stock options		465
Weighted average common shares, diluted	63,321	63,420

16. Segment Reporting

The Company operates in a single industry acquiring, developing and commercializing prescription drugs used in the treatment of a variety of gastrointestinal diseases. Accordingly, the Company s business is classified as a single reportable segment.

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The following table presents net product revenues by product category (in thousands):

	Three months ended March 31,	
	2014 (Restated)	2013
Xifaxan	123,335	153,315
Inflammatory Bowel Disease Apriso/Uceris/Giazo/Colazal	76,978	18,460
Diabetes Glumetza and Cycloset	139,883	
Purgatives OsmoPrep/MoviPrep	7,614	14,062
Zegerid	37,506	
Other Fenoglide/Anusol/Azasan/Diuril/Pepcid/Proctocort/Relistor/ Deflux/ Solesta/Fulyzaq/Metozolv	17,663	16,764
Net product revenues	$ 402,979	$ 202,601

17. Legal Proceedings

From time to time, the Company is involved in various litigation matters that are being defended and handled in the ordinary course of business. The assessment of whether a loss is probable or reasonably possible, and whether the loss or a range of loss is estimable, often involves a series of complex judgments about future events. Management maintains accruals for such losses that are probable of being incurred and subject to reasonable estimation. For current matters not specifically reported herein, management does not anticipate that the ultimate liabilities, if any, arising from the resolution of such current matters would have a material effect on the Company s financial condition or results of operations. It is possible, however, that future results of operations for any particular period could be materially affected by changes in the Company s assessment related to any of these matters.

Product Liability Claims

The Company is currently and might continue to be subject to product liability claims that arise through the testing, manufacturing, marketing and sale of its products. The Company is vigorously defending these claims and intends to continue to do so. The Company has product liability coverage for all of its products other than with regard to claims filed prior to August 31, 2010 relating to OsmoPrep and Visicol, a first generation purgative product that the company no longer markets, but it is possible that this coverage, and any future coverage, will be insufficient to satisfy any liabilities that arise. The Company would have to assume defense of the lawsuits and be responsible for damages, fees and expenses, if any, that are awarded against it or for amounts in excess of the Company s product liability coverage.

Napo Litigation

On May 5, 2011, Napo filed a lawsuit against the Company in the Supreme Court of the State of New York, County of New York, alleging that the Company had engaged in fraudulent conduct, breached its collaboration agreement with Napo dated December 9, 2008, and breached its duty of good faith and fair dealing. Napo also sought a declaratory judgment that it had the right to terminate the collaboration agreement and sought unspecified damages in excess of $150 million. On or about December 28, 2011, Napo filed an amended complaint seeking an unspecified amount of damages for alleged breaches of the collaboration agreement by the Company. Napo s amended complaint no longer sought a declaratory judgment that Napo had the right to terminate the collaboration agreement and rendered moot the need for the court to rule on the Company s motion to dismiss the original complaint. Discovery concluded last year, and, on May 31, 2013 the Company filed a motion for partial summary judgment. The court heard oral arguments on the motion in August 2013. On December 24, 2013, the court entered a short-form order granting the Company s motion for partial summary judgment, narrowing the issues in the case. Napo timely appealed that decision to the Appellate Division of the Supreme Court of the State of New York. On January 29, 2014 the Court vacated and replaced portions of the short-form order with an order continuing to grant the Company s motion for partial summary judgment, narrowing the issues in the case. Napo appealed that decision. Trial on the claims remaining in the case commenced on February 10, 2014 and on February 25, 2014 the Jury rendered its verdict, concluding that Salix had complied with its contractual obligations in commercializing Fulyzaq in the United States, and thus did not breach the collaboration agreement. On May 1, 2014, Napo filed an appeal of the jury verdict. The Company continues to advance its development and commercialization plans for crofelemer in accordance with the collaboration agreement and continues to believe that Napo s allegations are without merit and its lawsuit baseless.

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Lupin Litigation

Currently, there are four patents that the Company believes provide coverage for Apriso, including for methods of production and use, until 2018 (U.S. Patent Nos. 6,551,620, or the 620 patent, 7,547,451, or the 451 patent, 8,337,886, or the 886 patent, and 8,496,965, or the 965 patent). On September 7, 2012, the Company and Dr. Falk Pharma filed a patent infringement complaint against Lupin Ltd. and Lupin Pharmaceuticals, Inc., collectively Lupin, in the U.S. District Court for the District of Delaware. The complaint alleges infringement of the 620 patent, based on Lupin s filing of an Abbreviated New Drug Application, or ANDA, seeking approval to market and sell a generic version of Apriso before the expiration of the 620 patent. The filing of this suit within the 45 day response period provided by the Hatch-Waxman Act imposes a 30-month stay of approval of Lupin s ANDA unless the court finds in Lupin s favor prior to that time. On March 4, 2013, the Company and Dr. Falk Pharma filed an amended complaint to enforce the issued 886 patent in the pending suit. On July 30, 2013 the USPTO issued the 965 patent, which further protects the Apriso product. On August 19, 2013 the Company and Dr. Falk Pharma filed a second amended complaint to enforce the 965 patent and the 451 patent against Lupin. The court conducted a pretrial evidentiary hearing, known as a Markman hearing, on November, 21, 2013. The court adopted each of Salix s claim construction positions in its order issued December 17, 2013. The trial is scheduled for September, 2014. The Company continues to evaluate its intellectual property protecting Apriso, in which the Company has full confidence. The Company intends to vigorously enforce its intellectual property rights. Currently, the Company cannot predict or determine the timing or outcome of this inquiry or its impact on financial condition or results of operations.

Novel Litigation

On February 18, 2014, the Company and Dr. Falk Pharma filed a patent infringement complaint against Novel Laboratories, Inc., or Novel, in the U.S. District Court for the District of Delaware. The complaint alleges infringement of the 620 patent, the 886 patent, and the 965 patent based on Novel s filing of an ANDA seeking approval to market and sell a generic version of Apriso before the expiration of these patents. The filing of this suit within the 45-day response period provided by the Hatch-Waxman Act imposes a 30-month stay of approval of Novel s ANDA unless the court finds in Novel s favor prior to that time. The Company continues to evaluate its intellectual property protecting Apriso, in which the Company has full confidence. The Company intends to vigorously enforce its intellectual property rights. Currently, the Company cannot predict or determine the timing or outcome of this inquiry or its impact on financial condition or results of operations.

DOJ Subpoena

On February 1, 2013, the Company s wholly owned subsidiary Salix Pharmaceuticals, Inc., or Salix, Inc., received a subpoena from the U.S. Attorney s Office for the Southern District of New York requesting documents regarding our sales and promotional practices for Xifaxan, Relistor and Apriso. The Company is continuing to respond to the subpoena and intends to cooperate fully with the subpoena and related government investigation. Currently, the Company cannot predict or determine the timing or outcome of this inquiry or its impact on its financial condition or results of operations.

Santarus Shareholder Litigation

Beginning on November 12, 2013, eleven putative class action lawsuits were filed by shareholders of Santarus seeking to challenge our proposed acquisition of Santarus, which was announced on November 7, 2013. Nine of these actions were filed in the Delaware Court of Chancery, one was filed in California Superior Court (San Diego County) and one was filed in the U.S. District Court for the Southern District of California. These actions generally allege that the members of the Santarus board of directors breached their fiduciary duties to Santarus s shareholders by failing to maximize the value of Santarus and by making inadequate or misleading disclosures regarding the proposed merger, and that Santarus, we and certain of our subsidiaries aided and abetted those breaches of fiduciary duty. The complaint in the action pending in California federal court also asserts causes of action on behalf of the individual plaintiff for alleged violations of certain sections of the Exchange Act. These actions generally sought, among other things, to enjoin the merger, unspecified damages and fees. On December 9, 2013, Santarus and its directors filed a motion to stay the action pending in California Superior Court. On December 11, 2013, the Delaware Court of Chancery consolidated the nine actions pending in that court, appointed lead counsel for the plaintiffs, and designated the amended complaint filed by plaintiff Imad Ahmad Khalil on December 9, 2013 as the operative complaint in the consolidated Delaware litigation. On December 20, 2013, the parties in the Delaware litigation reached an agreement in principle, subject to full documentation, to resolve the plaintiffs claims in that action in exchange for certain supplemental disclosures that Santarus included in an amended Schedule 14D-9 it filed on that date. The Company completed its merger with Santarus on January 2, 2014. The parties in the Delaware litigation executed a Memorandum of Understanding reflecting the terms of their agreement in principle on January 17, 2014 and are currently drafting full settlement documentation and engaging in confirmatory discovery. The settlement of the Delaware litigation will be subject to approval by the Delaware Court of Chancery. The plaintiffs counsel in the Delaware litigation has also indicated that the plaintiffs intend to request an award of an unspecified amount attorneys fees from the Delaware Court of Chancery. On January 22, 2014, Santarus and its directors filed a renewed motion to stay the action pending in California Superior Court, and we filed a separate motion to stay that action in favor of the Delaware litigation. On January 22, 2014, Santarus and its directors filed a motion to stay the action pending in the California federal court in favor of the Delaware litigation, and we filed a joinder in support of that motion on January 23, 2014. On February 12, 2014, the parties in the action pending in California federal court filed a joint motion to stay that action pending a

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decision by the Delaware Court of Chancery regarding final approval of the proposed settlement of the Delaware litigation, and the California federal court granted that motion on February 13, 2014. The Company is vigorously defending the action pending in California Superior Court and attempting to finalize the settlement of the consolidated Delaware litigation as described above. The Company believes that all of the claims asserted against it by Santarus shareholders lack merit. Currently, the Company cannot predict or determine the timing or outcome of this inquiry or its impact on financial condition or results of operations.

Zegerid Rx and Zegerid OTC Patent Litigation

Zegerid Rx Litigation

In April 2010, the U.S. District Court for the District of Delaware ruled that five patents covering Zegerid capsules and Zegerid powder for oral suspension (U.S. Patent Nos. 6,489,346; 6,645,988; 6,699,885; 6,780,882; and 7,399,772) were invalid due to obviousness. These patents were the subject of lawsuits Santarus filed in 2007 against Par, in response to ANDAs filed by Par with the FDA. The University of Missouri, licensor of the patents, is joined in the litigation as a co-plaintiff. In May 2010, Santarus filed an appeal of the District Court s ruling to the U.S. Court of Appeals for the Federal Circuit. Following the District Court s decision, Par launched its generic version of Zegerid capsules in June 2010.

In September 2012, the U.S. Court of Appeals for the Federal Circuit reversed in part the April 2010 decision of the District Court. The Federal Circuit found that certain claims of U.S. Patent Nos. 6,780,882 and 7,399,772, which Par had been found to infringe, were not invalid due to obviousness. The Federal Circuit affirmed the district court s finding of invalidity for the asserted claims from the remaining three patents. Following the Federal Circuit s decision, Par announced that it had ceased distribution of its generic Zegerid capsules product in September 2012. In December 2012, the Federal Circuit remanded the case to the district court for further proceedings pertaining to damages. In February 2013, Santarus filed an amended complaint with the district court for infringement of U.S. Patent Nos. 6,780,882 and 7,399,772 and requested a jury trial with respect to the issue of damages in connection with Par s launch of its generic version of Zegerid capsules in June 2010. In March 2013, Par filed its amended answer, which alleges, among other things, failure to state a claim upon which relief can be granted and non-infringement based on purported invalidity of the two asserted patents. In addition, Par filed a motion for a judgment on the pleadings, alleging, among other things, that the two asserted patents are invalid because the Federal Circuit purportedly did not expressly address certain prior art references considered by the district court. The trial on Santarus s damages claim against Par is currently scheduled for November 2014. Although the Company does not believe that Par has a meritorious basis upon which to further challenge validity of the asserted patents in this proceeding, currently, the Company cannot predict or determine the timing or outcome of this inquiry or its impact on financial condition or results of operations.

In December 2011, Santarus filed a lawsuit in the U.S. District Court for the District of New Jersey against Zydus Pharmaceuticals USA, Inc., or Zydus, for infringement of the patents listed in the Orange Book for Zegerid capsules. The University of Missouri, licensor of the patents, is joined in the litigation as a co-plaintiff. Zydus had filed an ANDA with the FDA regarding its intent to market a generic version of Zegerid capsules prior to the expiration of the listed patents. In September 2012, Santarus amended its complaint to be limited to U.S. Patent No. 7,399,772, which patent was found not to be invalid in the September 2012 Federal Circuit decision. In October 2012, Zydus filed its

answer, which alleged, among other things, failure to state a claim upon which relief can be granted. The lawsuit was commenced within the requisite 45-day time period, resulting in an FDA stay on the approval of Zydus proposed product for 30 months or until a decision is rendered by the district court, which is adverse to the asserted patent. In December 2013, the district court entered an order staying the case for 60 days, rescheduling the trial for April 2014, and extending the 30-month stay from May 2014 to July 2014. In February 2014, Santarus and MSD agreed to settle this case and the litigation with Zydus related to Zegerid over-the-counter, or OTC, medication which is discussed below. Zydus may begin selling a generic version of prescription Zegerid capsules upon expiration of the applicable patent in mid-2016 (or earlier under certain circumstances). The district court entered an order dismissing the case with prejudice in February 2014.

Zegerid OTC Litigation

In September 2010, MSD filed a lawsuit in the U.S. District Court for the District of New Jersey against Par for infringement of the patents listed in the Orange Book for Zegerid OTC. Santarus and the University of Missouri, licensors of the listed patents, are joined in the lawsuit as co-plaintiffs. Par had filed an ANDA with the FDA regarding its intent to market a generic version of Zegerid OTC prior to the expiration of the listed patents. In October 2012, MSD amended its complaint to be limited to U.S. Patent No. 7,399,772, which patent was found not to be invalid in the Federal Circuit s September 2012 decision. Also in October 2012, Par filed its answer, which alleged, among other things, failure to state a claim upon which relief can be granted, non-infringement and invalidity. Par has received tentative approval of its proposed generic Zegerid OTC product. Although the 30-month stay expired in February 2013, the parties have agreed that Par will not launch its generic Zegerid OTC product unless there is a district court judgment favorable to Par or in certain other specified circumstances. The Markman hearing for this matter took place in July 2013, and the district court issued a Markman order in October 2013 in which the district court adopted MSD s proposed

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Notes to Consolidated Financial Statements Continued

construction of several claim terms that were consistent with those adopted by the U.S. District Court for the District of Delaware in the prescription Zegerid litigation. In February 2014, the case was settled, allowing Par to begin selling a generic version of Zegerid OTC capsules upon expiration of the applicable patent in mid-2016 (or earlier under certain circumstances). The Company expects the district court to enter an order dismissing this case soon.

In December 2011, MSD filed a lawsuit in the U.S. District Court for the District of New Jersey against Zydus for infringement of the patents listed in the Orange Book for Zegerid OTC. Santarus and the University of Missouri, licensors of the listed patents, are joined in the litigation as co-plaintiffs. Zydus had filed an ANDA with the FDA regarding its intent to market a generic version of Zegerid OTC prior to the expiration of the listed patents. In September 2012, MSD amended its complaint to be limited to U.S. Patent No. 7,399,772, which patent was found not to be invalid in the Federal Circuit s September 2012 decision. In October 2012, Zydus filed its answer, which alleges, among other things, failure to state a claim upon which relief can be granted. The lawsuit was commenced within the requisite 45-day time period, resulting in an FDA stay on the approval of Zydus proposed product for 30 months or until a decision is rendered by the District Court, which is adverse to the asserted patent. In December 2013, the District Court entered an order staying the case for 60 days, rescheduling the trial for April 2014, and extending the 30-month stay from May 2014 to July 2014. As discussed in connection with the lawsuit against Zydus for infringement of the patents covering prescription Zegerid, in February 2014, Santarus and MSD agreed to settle this case and the related prescription Zegerid litigation with Zydus. Zydus may begin selling a generic version of Zegerid OTC capsules upon expiration of the applicable patent in mid-2016 (or earlier under certain circumstances). The District Court entered an order dismissing the case with prejudice in February 2014.

Fenoglide Patent Litigation

In January 2013, Santarus filed a lawsuit in the U.S. District Court for the District of Delaware against Mylan Inc. and Mylan Pharmaceuticals Inc., collectively referred to herein as Mylan, for infringement of the patents listed in the Orange Book for Fenoglide 120 mg and 40 mg (U.S. Patent Nos. 7,658,944, and 8,124,125). Veloxis Pharmaceuticals A/S, or Veloxis, is joined in the lawsuit as a co-plaintiff. The lawsuit was filed in response to an ANDA filed with the FDA by Mylan regarding Mylan s intent to market a generic version of Fenoglide 120 mg and 40 mg tablets prior to the expiration of the listed patents. Santarus commenced the lawsuit within the requisite 45-day time period, resulting in an FDA stay on the approval of Mylan s proposed product for 30 months or until a decision is rendered by the district court, which is adverse to the asserted patents, whichever may occur earlier. Absent a court decision, the 30-month stay is expected to expire in June 2015. Mylan has filed an answer in the case that asserts, among other things, non-infringement, invalidity, and failure to state a claim, and it has also filed counterclaims. Currently, the Company cannot predict or determine the timing or outcome of this inquiry or its impact on financial condition or results of operations.

18. Condensed Consolidating Financial Information for Guarantors

Salix Pharmaceuticals, Inc., Oceana and Santarus, collectively referred to as the Guarantors, currently guarantee the 2021 Notes, the Senior Term B Loan Facility and the Revolving Credit Facility. The guarantees are full and unconditional and joint and several, and each of the Guarantors is wholly owned, either directly or indirectly, by the

Company. The Company has no independent assets or operations and all Company subsidiaries other than the Guarantors are minor, as such term is defined in Rule 3-10(h)(6) of Regulation S-X. As a result, the Company is not required to present condensed consolidating financial information for the Guarantors pursuant to Rule 3-10(f) of Regulation S-X.

19. Subsequent Event

On February 22, 2015 the Company announced that it had entered into a definitive agreement with Valeant Pharmaceuticals International, Inc., under which Valeant will acquire all of the outstanding common stock of the Company. The acquisition is structured as an all-cash tender offer at a price of $158.00 per share followed by a merger in which each remaining untendered share of Salix common stock would be converted into the right to receive the same $158.00 cash per share consideration as in the tender offer. The transaction, which is expected to close in the second quarter of 2015, is subject to customary closing conditions and regulatory approval.

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

The following discussion should be read in conjunction with our Consolidated Financial Statements and notes thereto included elsewhere in this report.

RESTATEMENT

As discussed in the Explanatory Note to this Form 10-Q/A and in Note 1A of the Notes to Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q/A, we are restating our unaudited consolidated financial statements and related disclosures for the three months ended March 31, 2014. The following discussion and analysis of our financial condition and results of operations incorporates the restated amounts. For this reason, the data set forth in this Item 2 may not be comparable to the discussion and data in our previously filed quarterly report on Form 10-Q for the quarter ended March 31, 2014.

OVERVIEW

We are a specialty pharmaceutical company dedicated to acquiring, developing and commercializing prescription drugs and medical devices used in the treatment of a variety of gastrointestinal disorders, which are those affecting the digestive tract. Our strategy is to:

- identify and acquire rights to products that we believe have potential for near-term regulatory approval or are already approved;
- apply our regulatory, product development, and sales and marketing expertise to commercialize these products; and
- market our products through our specialty sales and marketing team by primarily focusing on high-prescribing U.S. physicians in the following specialties: gastroenterologists, who are doctors who specialize in gastrointestinal disorders; hepatologists, who are doctors who specialize in liver disease; colorectal surgeons, who are doctors who specialize in disorders of the colon and rectum, endocrinologists, who are doctors who specialize in diagnosing and treating hormone imbalances such as diabetes mellitus; and primary care doctors.

Significant Developments in the Quarter Ended March 31, 2014

- On January 2, 2014, we completed our acquisition of Santarus, a specialty biopharmaceutical company focused on acquiring, developing and commercializing proprietary products that address the needs of patients treated by physician specialists in gastroenterology and endocrinology, for aggregate consideration of approximately $2.7 billion. As a result of the acquisition, Santarus became one of our indirect wholly owned subsidiaries. We financed the acquisition and transaction costs through a combination of (i) the $1.2 billion Term Loan B Facility, (ii) the net proceeds from our issuance of $750.0 million of 2021 Notes, and (iii) cash on hand of approximately $848.1 million.

On January 30, 2014, the FDA accepted for filing an NDA for our Uceris (budesonide) 2 mg rectal form product. The FDA has issued a Prescription Drug User Fee Act, or PDUFA, action date of September 15, 2014.

On February 25, 2014, a New York Supreme Court entered a verdict in favor of Salix in a lawsuit filed by Napo related to the our collaboration agreement with Napo. See Part II. Item 1. Legal Proceedings for additional information.

On February 27, 2014, we and RedHill entered into an exclusive agreement by which we licensed the worldwide exclusive rights to RedHill s RHB-106 encapsulated formulation for bowel preparation and rights to other purgative developments. We also agreed to engage with RedHill on a potential strategic collaboration relating to certain of our products in specified territories. Concurrently, we licensed additional intellectual property from four individuals. We made upfront payments of $11.5 million in connection with the execution of these agreements. See Note 4, Commitments for additional information.

Introduction to Products

In connection with and following the integration of Santarus, we plan to execute our strategy by:

marketing our currently marketed products (including Santarus s product portfolio) through our established channels and Santarus s network of high-volume specialty and primary care physician-focused sales representatives;

utilizing our expertise to progress pipeline products and indications through late-stage development and approval; and

making select acquisitions to further diversify our product portfolio and improve profitability.

As of March 31, 2014, our products were:

XIFAXAN550 (rifaximin) tablets 550 mg, indicated for the reduction in risk of overt HE recurrence in patients 18 years of age and older;

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XIFAXAN (rifaximin) tablets 200 mg, indicated for the treatment of patients 12 years of age and older with TD caused by noninvasive strains of *E. coli*;

APRISO (mesalamine) extended-release capsules, indicated for the maintenance of remission of ulcerative colitis, or UC;

UCERIS (budesonide MMX) extended release tablets, indicated for the induction of remission in patients with active, mild to moderate UC;

MOVIPREP (PEG 3350, sodium sulfate, sodium chloride, potassium chloride, sodium ascorbate and ascorbic acid for oral solution), indicated for cleansing of the colon as a preparation for colonoscopy in adults 18 years of age or older;

ZEGERID (omeprazole/sodium bicarbonate) capsules and powder for oral suspension, indicated for the treatment of certain upper gastrointestinal conditions, including active duodenal ulcer, active benign gastric ulcer and gastroesophageal reflux disease, or GERD;

GLUMETZA (metformin hydrochloride) extended release tablets, indicated as an adjunct to diet and exercise to improve glycemic control in adults with type 2 diabetes mellitus;

RELISTOR (methylnaltrexone bromide) SI indicated for the treatment of OIC in patients with advanced illness who are receiving palliative care, when the response to laxative therapy has not been sufficient;

OSMOPREP (sodium phosphate monobasic monohydrate, USP and sodium phosphate dibasic anhydrous, USP) tablets, indicated for cleansing of the colon as a preparation for colonoscopy in adults 18 years of age or older;

SOLESTA, a biocompatible tissue-bulking agent indicated for the treatment of fecal incontinence in patients 18 years or older who have failed conservative therapy;

DEFLUX, a biocompatible tissue-bulking agent indicated for the treatment of vesicoureteral reflux, grades II-IV;

FULYZAQ (crofelemer) delayed-release tablets, indicated for the symptomatic relief of non-infectious diarrhea in adult patients with HIV/AIDS on anti-retroviral therapy;

GIAZO (balsalazide disodium) tablets, indicated for the treatment of mildly to moderately active UC in male patients 18 years of age and older;

CYCLOSET (bromocriptine mesylate) tablets, indicated as an adjunct to diet and exercise to improve glycemic control in adults with type 2 diabetes mellitus;

FENOGLIDE (fenofibrate) tablets, indicated as an adjunct to diet to reduce elevated low-density lipoprotein-cholesterol, total cholesterol, triglycerides and apolipoprotein B, and to increase high-density lipoprotein-cholesterol in adult patients with primary hyperlipidemia or mixed dyslipidemia. Fenoglide also is indicated as an adjunct to diet for treatment of adult patients with hypertriglyceridemia;

METOZOLV ODT (metoclopramide hydrochloride) 5 mg and 10 mg orally disintegrating tablets, indicated for short-term (4 to 12 weeks) use in adults for treatment of GERD that fails to respond to conventional therapy, and for relief of symptoms of acute and recurrent diabetic gastroparesis;

AZASAN (azathioprine, USP), 75 mg and 100 mg tablets, indicated as an adjunct for the prevention of rejection in renal homotransplantations and to reduce signs and symptoms of severe active rheumatoid arthritis;

ANUSOL-HC (hydrocortisone, USP) 2.5% cream and ANUSOL-HC (hydrocortisone acetate) 25 mg suppositories, indicated for the relief of the inflammatory and pruritic manifestations of corticosteroid-responsive dermatoses;

PROCTOCORT (hydrocortisone, USP) 1% cream and PROCTOCORT (hydrocortisone acetate) 30 mg suppositories, indicated for the relief of the inflammatory and pruritic manifestations of corticosteroid-responsive dermatoses;

PEPCID (famotidine) for oral suspension, indicated for the short-term treatment of GERD, active duodenal ulcer, active benign gastric ulcer, erosive esophagitis due to GERD, and peptic ulcer disease;

DIURIL (chlorothiazide) oral suspension, indicated for the treatment of hypertension and also as adjunctive therapy in edema associated with congestive heart failure, cirrhosis of the liver, corticosteroid and estrogen therapy, and kidney disease; and

COLAZAL (balsalazide disodium) capsules, indicated for the treatment of mildly to moderately active UC in patients five years of age and older.

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Our primary product candidates currently under development and their status are as follows:

Compound	Condition	Status
Rifaximin	IBS	sNDA submitted June 7, 2010; CRL received on March 7, 2011; FDA meeting held on June 20, 2011; Advisory Committee meeting held on November 16, 2011; currently in Phase 3 retreatment study, with top-line data expected in July 2014
Methylnaltrexone bromide SI	OIC in patients with chronic non-malignant pain; subcutaneous injection	sNDA accepted for filing; CRL received July 27, 2012; FDA Advisory Committee proposed to occur June 11-12, 2014
UCERIS (budesonide) rectal foam	Ulcerative proctitis	NDA accepted for filing January 2014; PDUFA action date September 15, 2014
Methylnaltrexone bromide oral	OIC in patients with chronic non-malignant pain; oral	Phase 3
Rifaximin delayed release	Crohn s disease	Phase 3
Rifaximin SSD/next generation	Prevention of complications in compensated liver cirrhosis	Phase 2
Ruconest	HAE	BLA submitted April 2013; PDUFA action date extended to July 16, 2014

APPLICATION OF CRITICAL ACCOUNTING ESTIMATES

Critical Accounting Policies

In our Annual Report on Form 10-K/A for the fiscal year ended December 31, 2013, we identified our most critical accounting policies and estimates upon which our financial status depends as those relating to: revenue recognition, including allowance for product returns and allowance for rebates and coupons; inventories; valuation of intangible assets and contingent consideration liabilities acquired in business combinations; intangible assets and goodwill; research and development; convertible debt transactions; and deferred tax asset valuation. We reviewed our policies and determined that those policies remained our most critical accounting policies for the three-month period ended March 31, 2014. We did not make any changes in those policies during the quarter.

We recognize revenue from sales transactions where the buyer has the right to return the product at the time of sale only if (1) our price to the buyer is substantially fixed or determinable at the date of sale, (2) the buyer has paid us, or the buyer is obligated to pay us and the obligation is not contingent on resale of the product, (3) the buyer s obligation to us would not be changed in the event of theft or physical destruction or damage of the product, (4) the buyer acquiring the product for resale has economic substance apart from any provided by us, (5) we do not have significant obligations for future performance to directly bring about resale of the product by the buyer, and (6) the amount of

future returns can be reasonably estimated. We recognize revenues for product sales at the time title and risk of loss are transferred to the customer, which is generally at the time products are shipped (unless products are shipped under FOB Destination shipping terms, in which case risk of loss is transferred to the customer upon delivery). Our net product revenue represents our total revenues less allowances for customer credits, including wholesaler discounts, estimated rebates, chargebacks, patient-focused promotional programs and product returns.

We establish allowances for estimated rebates, chargebacks and product returns based on numerous quantitative and qualitative factors, including:

- the number of and specific contractual terms of agreements with customers;

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estimated levels of inventory in the distribution channel;

historical rebates, chargebacks and returns of products;

direct communication with customers;

anticipated introduction of competitive products or generics;

anticipated pricing strategy changes by us and/or our competitors;

analysis of prescription data gathered by a third-party prescription data provider;

the impact of changes in state and federal regulations; and

estimated remaining shelf life of products.

In our analyses, we use prescription data purchased from a third-party data provider to develop estimates of historical inventory channel pull-through. We utilize an internal analysis to compare historical net product shipments to estimated historical prescriptions written. Based on that analysis, we develop an estimate of the quantity of product in the channel that might be subject to various rebate, chargeback and product return exposures. At least quarterly for each product line, we prepare an internal estimate of ending inventory units in the distribution channel by adding estimated inventory in the channel at the beginning of the period, plus net product shipments for the period, less estimated prescriptions written for the period. To estimate months of ending inventory in the distribution channel the Company divides estimated ending inventory in the distribution channel by the Company s estimate of the succeeding quarter s demand, not taking into account any future anticipated demand growth beyond the succeeding quarter. Based on that analysis, we develop an estimate of the quantity of product in the channel that might be subject to various rebate, chargeback and product return exposures. This is done for each product line by applying a rate of historical activity for rebates, chargebacks and product returns, adjusted for relevant quantitative and qualitative factors discussed above, to the potential exposed product estimated to be in the distribution channel. Internal forecasts that are utilized to calculate the estimated number of months in the channel are regularly adjusted based on input from members of our sales, marketing and operations groups. The adjusted forecasts take into account numerous factors including, but not limited to, new product introductions, direct communication with customers and potential product expiry issues. Adjustments to estimates are recorded in the period when significant events or changes in trends are identified.

We offer discounts to our wholesalers and other customers. These discounts are calculated as a percentage of the current published list price and are treated as off-invoice allowances. Accordingly, we record the discounts as a reduction of revenue in the period that we offer the discounts. In addition to these discounts, at the time that we implement a price increase, we generally offer our existing customers an opportunity to purchase a limited quantity of product at the previous list price. Shipments resulting from these offers generally are not in excess of ordinary levels, therefore, we recognize the related revenue upon shipment and include the shipments in estimating our various product related allowances. In the event we determine that these shipments represent purchases of inventory in excess

of ordinary levels for a given wholesaler, the potential impact on product returns exposure would be specifically evaluated and reflected as a reduction in revenue at the time of such shipments.

Allowances for estimated rebates, chargebacks and patient-focused promotional programs were $222.7 million and $184.6 million as of March 31, 2014 and December 31, 2013, respectively. These allowances reflect an estimate of our liability for items such as rebates due to various governmental organizations under the Medicare/Medicaid regulations, rebates due to managed care organizations under specific contracts and chargebacks due to various organizations purchasing certain of our products through federal contracts and/or group purchasing agreements. We estimate our liability for rebates, chargebacks and patient-focused promotional programs at each reporting period based on a methodology of applying relevant quantitative and qualitative assumptions. Due to the subjectivity of our accrual estimates for rebates and chargebacks, we prepare various sensitivity analyses to ensure our final estimate is within a reasonable range as well as review prior period activity to ensure that our methodology is still reasonable. Had a change in one or more variables in the analyses (utilization rates, contract modifications, etc.) resulted in an additional percentage point change in the trailing average of estimated chargeback and rebate activity for the year ended December 31, 2013, we would have recorded an adjustment to revenues of approximately $9.3 million, or 1.3%, for the year. There was no material change in the results of this sensitivity analysis during the three-month period ended March 31, 2014.

Allowances for product returns were $85.0 million and $68.2 million as of March 31, 2014 and December 31, 2013, respectively. These allowances reflect an estimate of our liability for product that may be returned by the original purchaser in accordance with our stated return policy. We estimate our liability for product returns at each reporting period based on historical return rates, the estimated inventory in the channel, and the other factors discussed above. Due to the subjectivity of our accrual estimates for product returns, we prepare various sensitivity analyses as well as review prior period activity to ensure that our methodology is still reasonable.

For the three-month periods ended March 31, 2014 and 2013, our provision for rebates, chargebacks, patient-focused promotional programs and product returns (which items do not include wholesale discounts) grew primarily as a result of increased sales of our existing products, the approval of new products and the acquisition of products. Accordingly, reductions to revenue and corresponding increases to allowance accounts have likewise increased. Our provision for rebates, chargebacks, patient-focused promotional programs and product returns as a percentage of gross product revenue in the three-month periods ended March 31, 2014 and 2013 was 16.8%, and 15.3% for rebates, chargebacks and patient-focused promotional programs and was 3.7% and 2.2% for product returns, respectively.

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The enactment of the Patient Protection and Affordable Care Act and The Health Care and Education Reconciliation Act of 2010 in March 2010 brings significant changes to U.S. health care. These changes began to take effect in the first quarter of 2010. Changes to the rebates for prescription drugs sold to Medicaid beneficiaries, which increase the minimum statutory rebate for branded drugs from 15.1% to 23.1%, were generally effective in the first quarter of 2010. This rebate has been expanded to managed Medicaid, a program that provides for the delivery of Medicaid benefits via managed care organizations, under arrangements between those organizations and state Medicaid agencies. Additionally, a prescription drug discount program for outpatient drugs in health care facilities that serve low-income and uninsured patients, known as 340B facilities, has been expanded. The effect of these changes was not material to our financial results for the three-month periods ended March 31, 2014 and 2013. Based on our current product and payor mix, we believe the effect of these changes should not be material to our future financial results.

Also, there are changes to the tax treatment of subsidies paid by the government to employers who provide their retirees with a drug benefit at least equivalent to the Medicare Part D drug benefit. Beginning in 2013, the federal government will tax the subsidy it provides to such employers. We do not provide retirees with any drug benefits, therefore this change should not affect our financial results.

Beginning in 2011, drug manufacturers will provide a discount of 50% of the cost of branded prescription drugs for Medicare Part D participants who are in the doughnut hole coverage gap in Medicare prescription drug coverage. The doughnut hole will be phased out by the federal government between 2011 and 2020. Based on our current product and payor mix, the cost of this discount was approximately 1% of our gross revenue for the year ended December 31, 2013, which cost as a percentage of gross revenue did not materially change during the three-month period ended March 31, 2014. However, the cost of this discount could have a material effect on our results of operations in future periods.

Beginning in 2011, pharmaceutical manufacturers and importers that sell branded prescription drugs to specified government programs had to pay a non-tax deductible annual fee to the federal government. Companies have to pay an amount based on their prior calendar year market share for branded prescription drug sales into these government programs. Based on our current product and payor mix, the effect of this tax was not material to our financial results for the three-month periods ended March 31, 2014 and 2013, and we do not believe the effect of this tax will be material to future periods.

Additionally, the 2010 healthcare reform legislation imposes a 2.3 % excise tax on U.S. sales of Class I, II and III medical devices beginning in 2013. This tax did not have a material effect on our financial statements for the three-month periods ended March 31, 2014 or 2013, and we do not believe the effect of this tax will be material to future periods.

Results of Operations

Three-month Periods Ended March 31, 2014 and 2013

As a result of the acquisition of Santarus completed on January 2, 2014, period over period results are not necessarily comparable, especially for revenues, cost of goods sold, amortization of product rights, and selling, general and administrative expenses.

Revenues

The following table summarizes net product revenues for the three months ended March 31:

	2014 (Restated) Net Product Revenues	2013 Net Product Revenues
Xifaxan	$ 123,335	$ 153,315
% of net product revenues	*31%*	*76%*
Inflammatory Bowel Disease Apriso/Uceris/Giazo/Colazal	76,978	18,460
% of net product revenues	*19%*	*9%*
Diabetes Glumetza and Cycloset	139,883	
% of net product revenues	*35%*	*0%*
Purgatives OsmoPrep/MoviPrep	7,614	14,062
% of net product revenues	*2%*	*7%*
Zegerid	37,506	
% of net product revenues	*9%*	*0%*
Other Fenoglide/Anusol/Azasan/Diuril/Pepcid/Proctocort/ Relistor/ Deflux/ Solesta/Fulyzaq/Metozolv	17,663	16,764
% of net product revenues	*4%*	*8%*
Net product revenues	$ 402,979	$ 202,601

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Net product revenues for the three-month period ended March 31, 2014 were $402.9 million, compared to $202.6 million for the corresponding three-month period in 2013, a 99% increase. The net product revenue increase for the three-month period ended March 31, 2014 compared to the three-month period ended March 31, 2013 was primarily due to:

- unit sales of Glumetza, Uceris, Cycloset, Zegerid, and Fenoglide due to the acquisition of Santarus, Inc. in January 2014, and
- price increases on our products.

These increases were partially offset by reduced unit sales of Xifaxan, Relistor, and MoviPrep.

Total prescriptions of Xifaxan 550mg prescribed for the three-month period ended March 31, 2014 compared to the corresponding three-month period in 2013 increased 19%. Prescriptions for our purgatives decreased 11% for the three-month period ended March 31, 2014 compared to the corresponding three-month period in 2013. Prescriptions for MoviPrep decreased 10% for the three-month period ended March 31, 2014 compared to the corresponding three-month period in 2013. Prescriptions for OsmoPrep for the three-month period ended March 31, 2014 declined 23% compared to the corresponding three-month period in 2013. Prescriptions for Apriso increased 58% for the three-month period ended March 31, 2014 compared to the corresponding three-month period in 2013.

Costs and Expenses

Costs and expenses for the three-month period ended March 31, 2014 were $423.2 million, compared to $153.3 million for the corresponding three-month period in 2013. Higher costs and expenses were due primarily to increased costs due to the acquisition of Santarus, and increased cost of products sold related to increased product sales. The acquisition of Santarus resulted in increased costs primarily due to the expansion of our field sales force from approximately 250 sales representatives to approximately 500 sales representatives, and transaction and integration costs.

Cost of Products Sold

Cost of products sold for the three-month period ended March 31, 2014 was $116.9 million, compared with $33.1 million for the corresponding three-month period in 2013. Gross margin on total product revenue, excluding $53.9 million and $11.2 million in amortization of product rights and intangible assets for the three-month periods ended March 31, 2014 and 2013, respectively, was 71.0% for the three-month period ended March 31, 2014 and 83.7% for the three-month period ended March 31, 2013. Excluding $18.0 million associated with the step-up in the value of the inventory in connection with the fair value accounting related to the Santarus acquisition, the gross margin for the three-month period ended March 31, 2014 was 75.4%. The lower gross margin in the three-month period ended March 31, 2014 compared to the same period in 2013 is due primarily to sales of Glumetza and Cycloset, which have lower gross margins than Xifaxan, which had reduced sales during the quarter, increased Giazo returns, and other changes in the product revenue mix in the respective periods.

Amortization of Product Rights and Intangible Assets

Amortization of product rights and intangible assets for the three-month period ended March 31, 2014 was $53.9 million, compared with $11.2 million for the corresponding three-month period in 2013. The higher amortization of

product rights and intangible assets in the three-month period ended March 31, 2014 compared to the same period in 2013 is due primarily to amortization expense resulting from the fair value adjustment for purchase accounting for the acquisition of Santarus.

Research and Development

Research and development expenses were $41.2 million for the three-month period ended March 31, 2014, compared to $21.6 million for the comparable period in 2013. The increase in research and development expenses for the three-month period ended March 31, 2014 compared to the corresponding period in 2013 was due primarily to:

payments related to license and patent agreements, of $14.5 million, primarily related to the RedHill agreement;

increased expenses of approximately $3.5 million primarily related to our development programs for rifaximin for hepatic encephalopathy, SSD/next generation, and UCERIS (budesonide) rectal foam; and

increased personnel costs of approximately $2.0 million;

partially offset by decreased expenses of approximately $0.4 million related to our development program for rifaximin for irritable bowel syndrome, or IBS.

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Since inception through March 31, 2014, we have incurred research and development expenditures of approximately $41.7 million for balsalazide, $237.2 million for rifaximin, $32.1 million for granulated mesalamine, $36.5 million for crofelemer, $42.0 million for methylnaltrexone bromide and $41.1 million for budesonide foam.

Due to the significant risks and uncertainties inherent in the clinical development and regulatory approval processes, we cannot reasonably estimate the cost to complete projects and development timelines for their completion. Enrollment in clinical trials might be delayed or occur faster than anticipated for reasons beyond our control, requiring additional cost and time or accelerating spending. Results from clinical trials might not be favorable, or might require us to perform additional unplanned clinical trials, accelerating spending, requiring additional cost and time, or resulting in termination of the project. Further, as evidenced by the Complete Response Letter for rifaximin as a treatment for IBS, data from clinical trials is subject to varying interpretation, and might be deemed insufficient by the regulatory bodies reviewing applications for marketing approvals, requiring additional cost and time, or resulting in termination of the project. Regulatory reviews can also be delayed. For example the PDUFA action dates for Relistor and crofelemer were each extended by three months. Process development and manufacturing scale-up for production of clinical and commercial product supplies might take longer and cost more than our forecasts. As a result, clinical development and regulatory programs are subject to risks and changes that might significantly impact cost projections and timelines.

The following table summarizes costs incurred for our significant projects, in thousands. We consider a project significant if expected spend for any year exceeds 10% of our development project budget for that period.

	Three Months Ended March 31,		Cumulative through March 31,2014
Project	**2014 (Restated)**	**2013 (as revised)**	**(Restated)**
Rifaximin for HE	$ 1,610	$ 1,055	$ 51,816
Rifaximin for IBS	8,588	8,983	122,461
Crofelemer for HIV-associated diarrhea	425	89	36,430
Budesonide foam for ulcerative proctitis	2,370	1,230	41,110
Methylnaltrexone for OIC in patients with chronic pain	1,522	1,182	41,917
Next generation rifaximin	2,464	1,110	10,455
Other non-significant rifaximin clinical projects (2 in 2014 and 2 in 2013)	656	352	N/A
All other clinical programs (8 in 2014 and 6 in 2013)	1,789	1,765	N/A

We generally expect research and development costs to increase in absolute terms in future periods as we pursue additional indications and formulations for rifaximin, continue development for Relistor, rifaximin delayed release, and Ruconest, and if and when we acquire new products.

Selling, General and Administrative

Selling, general and administrative expenses were $207.1 million for the three-month period ended March 31, 2014, compared to $85.0 million in the corresponding three-month period in 2013. This increase was primarily due to:

transaction and integration costs related to the Santarus acquisition of approximately $86.4 million;

increased personnel and related costs of $24.1 million primarily as result of the increase in our field sale representatives from approximately 250 personnel to approximately 500 personnel in connection with the Santarus acquisition;

increased marketing expenses of $6.8 million related to Uceris and Glumetza; and

increased legal expenses of approximately $5.7 million related to our Napo lawsuit, our patent infringement complaint against Lupin, and the subpoena from the U.S. Attorney s Office for the Southern District of New York received in February 2013.

These increases were partially offset by reduced marketing expenses related to Solesta of $0.9 million.

We expect selling, general and administrative expenses to increase as we expand our sales and marketing efforts for our current products, including Relistor, Solesta, Deflux, and the products acquired in our Santarus acquisition, and other indications for rifaximin and methylnaltrexone bromide, if approved.

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Interest Expense

Interest expense was $42.7 million for the three-month period ended March 31, 2014, compared to $15.3 million in the corresponding three-month period in 2013. Interest expense for the three-month period ended March 31, 2014 consisted primarily of:

- $7.1 million of interest expense on our 2015 convertible notes issued in June 2010, including $4.4 million of amortization of debt discount;
- $8.4 million of interest expense on our 2019 convertible notes issued in March 2012, including $5.2 million of amortization of debt discount;
- $13.9 million of interest expense on our 2020 Term Loan B credit facility; and
- $12.2 million of interest expense on our 2021 senior notes.

Interest expense for the three-month period ended March 31, 2013 consisted of:

- $6.8 million of interest expense on our 2015 convertible notes issued in June 2010, including $4.0 million of amortization of debt discount;
- $0.4 million of interest expense on our 2028 convertible notes issued in August 2008, including $0.2 million of amortization of debt discount; and
- $8.1 million of interest expense on our 2019 convertible notes issued in March 2012, including $5.0 million of amortization of debt discount.

Interest and Other Income

Interest and other income was $0.3 million for the three-month period ended March 31, 2014 and $0.0 million for the three-month period ended March 31, 2013. Other income for the three-month period ended March 31, 2014 includes interest income of $0.4 million, offset by $0.1 million of the other expenses. Other income for the three-month period ended March 31, 2013 includes $0.4 million of foreign currency exchange losses and $0.1 million of other expenses, offset by interest income of $0.5 million.

Due to the current economic climate, we expect 2014 interest rates paid to us on our cash and cash equivalents will be equal to or lower than we experienced during 2013. We expect cash balances in 2014 to be lower as a result of our acquisition of Santarus.

Provision for Income Tax

Income tax benefit was $28.0 million and income tax expense was $11.5 million for the three-month periods ended March 31, 2014 and 2013, respectively. Our effective tax rates for the three-month periods ended March 31, 2014 and 2013 were 44.8% and 33.9%, respectively. The increase in our effective tax rate during the three-month period ended March 31, 2014, as compared to the same period March 31, 2013, is due primarily to non-deductible acquisition costs that occurred during the first quarter of 2014. Our effective rate for the period ended March 31, 2014 differs from the statutory federal income tax rate of 35% primarily due to state income taxes and expenses and losses which are non-deductible for federal and state income tax purposes. The Company s effective tax rate might fluctuate throughout the year due to various items including, but not limited to, certain transactions the Company enters into, settlement of uncertain tax positions, the implementation of tax planning strategies, and changes in the tax law. As of March 31, 2014, Congress had not extended the federal Research and Development tax credit for tax year 2014. As such, the Company has not included the projected tax benefit of this credit in its effective tax rate for the quarter. During the three-month period ended March 31, 2014, the Internal Revenue Service commenced an audit for the 2011 tax year. At this time we are not aware of any potential audit adjustments that will materially impact the Company s financial statements.

Net Income (Loss)

Net loss was $34.6 million for the three-month period ended March 31, 2014, compared to net income of $22.4 million for the three-month period ended March 31, 2013.

Liquidity and Capital Resources

From inception until first achieving profitability in the third quarter of 2004, we financed product development, operations and capital expenditures primarily from public and private sales of equity securities and from funding arrangements with collaborators. Since launching Colazal in January 2001, net product revenue has been a growing source of cash. In August 2008, we closed an offering of $60.0 million of the 2028 Notes, with net proceeds of $57.3 million. None of the 2028 Notes currently are outstanding. On June 3, 2010, we closed an offering of $345.0 million of the 2015 Notes, with net proceeds of approximately $334.2 million. On March 16, 2012, we closed an offering of $690.0 million of the 2019 Notes, with net proceeds of approximately $668.3 million. On December 27, 2013, we closed an offering of the 2021 Notes.

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On January 2, 2014, we completed our acquisition of Santarus. We financed the acquisition and transaction costs through a combination of (i) $1.2 billion in borrowings under our Term Loan B Facility, (ii) the net proceeds from our issuance of the 2021 Notes and (iii) $848.1 million of cash on hand.

As of March 31, 2014 we had $385.1 million in cash and cash equivalents, compared to $1.2 billion as of December 31, 2013. In addition, on December 31, 2013, $750 million in restricted cash representing the gross proceeds from the sale of our 2021 Notes on December 27, 2013, which were held in escrow to finance a portion of the consideration for our acquisition of Santarus. We expect our future cash balances to be lower due to debt service on the additional debt issued in connection with our acquisition of Santarus.

At March 31, 2014, our cash and cash equivalents consisted primarily of demand deposits, certificates of deposit, overnight investments in Eurodollars and money market funds at reputable financial institutions, and did not include any auction rate securities. We have not realized any material loss in principal or liquidity in any of our investments to date. However, declines in the stock market and deterioration in the overall economy could lead to a decrease in demand for our marketed products, which could have an adverse effect on our business, financial condition and results of operations. Based on our current projections, we believe that our cash flow from operations should be sufficient to satisfy our expected cash requirements, including debt service for our current debt, including the debt issued in connection with our acquisition of Santarus, without requiring additional capital. However, we might seek additional debt or equity financing or both to fund our operations or acquisitions, and our actual cash needs might vary materially from those now planned because of a number of factors including: whether we acquire additional products or companies; risk associated with acquisitions; FDA and foreign regulation and regulatory processes; the status of competitive products, including potential generics in an increasingly global industry; intellectual property and related litigation risks in an increasingly global industry; product liability litigation; our success selling products; the results of research and development activities; establishment of and change in collaborative relationships; general economic conditions; and technological advances by us and other pharmaceutical companies. The Credit Agreement and the 2021 Notes discussed below contain covenants that restrict our ability to issue additional debt or additional capital, and any additional debt we issue might be subject to financial and restrictive covenants. If we issue additional equity, our stockholders could suffer dilution. We might also enter into additional collaborative arrangements that could provide us with additional funding in the form of equity, debt, licensing, milestone and/or royalty payments. We might not be able to enter into such arrangements or raise any additional funds on terms favorable to us or at all.

In connection with the Audit Committee s review, which began in Fall 2014, of Salix s financial statements and related disclosures, our Audit Committee and management determined that wholesaler inventory levels of XIFAXAN® 550, APRISO® and UCERIS® were greater, at approximately 9 months, 9 months and 5 months, respectively, as of September 30, 2014, than our target of approximately 3 months. In order to reduce wholesaler inventory levels to meet this target (established in Fall 2014) by the end of 2015, we intend to sell to our wholesalers amounts of XIFAXAN® 550, APRISO® and UCERIS® that are less than end-user demand until the target levels are reached. As a result, our revenue and cash flow may be decreased in the fourth quarter of 2014 and the full year 2015, compared to prior periods. In addition, wholesalers may demand increased discounts on our products, which could further decrease revenue and cash flow, and it may take longer than planned to reach our target wholesaler inventory levels, which could result in decreased revenue and cash flow for a longer period than anticipated. If our revenue and cash flow from operations are less than expected, we may need to seek additional debt or equity financing to satisfy our expected cash requirements, and such financing may not be available on satisfactory terms or at all.

Cash Flows

Net cash used by operating activities was $217.2 million for the three-month period ended March 31, 2014 and was primarily attributable to our net loss for the period, net of non-cash charges and increased accounts receivable, offset

by, among other things, increased reserves for product returns, rebates and chargebacks due to the timing of quarterly payments, and non-cash depreciation and amortization expense. Net cash provided by operating activities was $211.2 million for the three-month period ended March 31, 2013 and was primarily attributable to collections of accounts receivable for sales made in the fourth quarter of 2012 and our net income for the period, net of non-cash charges.

Net cash used in investing activities was $2.4 billion for the three-month period ended March 31, 2014 and was due to the acquisition of Santarus and the purchase of other property and equipment, partially offset by the sale of short-term investments that we acquired as part of the Santarus acquisition. Net cash used in investing activities was $1.2 million for the three-month period ended March 31, 2013 and was primarily due to purchases of property and equipment.

Net cash provided by financing activities was $1.9 billion for the three-month period ended March 31, 2014 and was primarily due to proceeds from our Term Loan B Facility and senior notes due 2021, offset by debt issuance costs associated with our Term Loan B Facility and 2021 Notes, principal payments on the Term Loan B Facility, and net settlement of stock-based compensation. Net cash provided by financing activities of $0.4 million for the three-month period ended March 31, 2013 consisted primarily of the proceeds from the exercise of stock options.

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Commitments

As of March 31, 2014, we had non-cancelable purchase order commitments for inventory purchases of approximately $222.3 million, which included any minimum purchase commitments under our manufacturing agreements. We anticipate significant expenditures related to our on-going sales, marketing, product launch efforts and our on-going development efforts for rifaximin, our budesonide product candidates, methylnaltrexone bromide and crofelemer. To the extent we acquire rights to additional products, we will incur additional expenditures.

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Our acquisition of Santarus caused material changes in certain of our contractual commitments during the quarter ended March 31, 2014. Our contractual commitments for non-cancelable purchase commitments of inventory, minimum lease obligations for all non-cancelable operating leases, debt and minimum capital lease obligations (including interest) as of March 31, 2014, were as follows (in thousands):

	Total	< 1 year	1-3 years	3-5 years	> 5 years
Operating leases	$ 63,444	$ 7,587	$ 15,376	$ 14,377	$ 26,104
Purchase commitments	222,340	117,840	44,000	44,000	16,500
2015 Notes(1)	355,674	9,488	346,186		
2019 Notes(2)	741,319	10,350	20,700	710,269	
2021 Notes(3)	1,053,750	45,000	90,000	90,000	828,750
Credit Agreement(4)	1,434,263	109,406	211,163	200,963	912,731
Revolving Credit Facility	3,563	750	1,500	1,313	
Long term contractual obligations	242	219	21	2	
Capital lease obligations	40	40			
Total	$ 3,874,635	$ 300,680	$ 728,946	$ 1,060,924	$ 1,784,085

(1) Contractual interest and principal obligations related to our 2015 Notes total $355.7 million at March 31, 2014, including $9.5 million and $346.2 million due in one year or less and one to three years, respectively. If these notes had been converted at March 31, 2014 based on the closing price of our stock of $103.61 per share on that date and we chose to settle them in cash, the settlement amount would have been approximately $770.7 million.

(2) Contractual interest and principal obligations related to our 2019 Notes total $741.3 million at March 31, 2014, including $10.4 million, $20.7 million, and $710.3 million due in one year or less, one to three years, and three to five years, respectively. If these notes had been converted at March 31, 2014 based on the closing price of our stock of $103.61 per share on that date and we chose to settle them in cash, the settlement amount would have been approximately $1.1 billion.

(3) Contractual interest and principal obligations related to our 2021 Notes total $1,053.8 million at March 31, 2014, including $45.0 million, $90.0 million, $90.0 million and $828.8 million due in one year or less, one to three years, and three to five years, and greater than five years, respectively.

(4) Contractual interest and principal obligations related to our Credit Agreement total $1,434.3 million at March 31, 2014, including $109.4 million, $211.2 million, $201.0 million and $912.7 million due in one year or less, one to three years, and three to five years, and greater than five years, respectively. Contractual interest and principal obligations related to our Credit Agreement exclude excess cash flow payment obligations that commence in 2015.

We enter into license agreements with third parties that sometimes require us to make royalty, milestone or other payments contingent upon the occurrence of certain future events linked to the successful development and commercialization of pharmaceutical products. Some of the payments are contingent upon the successful achievement of an important event in the development life cycle of these pharmaceutical products, which might or might not occur. If required by the agreements, we will make royalty payments based upon a percentage of the sales of a pharmaceutical product if regulatory approval to market this product is obtained and the product is commercialized. Because of the contingent nature of these payments, we have not attempted to predict the amount or period in which such payments would possibly be made and thus they are not included in the table of contractual obligations. See Note 4, Commitments, for additional information.

2028 Notes

On August 22, 2008 we closed an offering of $60.0 million in 2028 Notes. Net proceeds from the offering were $57.3 million. In March 2012, we entered into a note repurchase agreement with the holder of a majority in principal amount of the 2028 Notes. We used a portion of the proceeds from our offering of the 2019 Notes discussed below to purchase from this holder and another holder approximately 42.1% of the 2028 Notes for an aggregate purchase price of approximately $137.2 million. In December 2012 one of the holders of the 2028 Notes converted notes with a par value of $22.3 million under the terms of the note indenture, and received cash equal to the par value of the notes and interest on these notes through February 15, 2013, and 1.9 million shares of common stock.

We called the 2028 Notes for redemption in September 2013 but before the redemption date, the holders elected to convert the remaining 2028 Notes with a par value of $12.5 million under the terms of the note indenture, and the holders received cash equal to the par value of the notes and interest on these notes through August 15, 2013, and 1.2 million shares of common stock.

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2015 Notes

On June 3, 2010 we closed an offering of $345.0 million in 2015 Notes. Net proceeds from the offering were $334.2 million. The 2015 Notes are governed by an indenture, dated as of June 3, 2010, between us and U.S. Bank National Association, as trustee. The 2015 Notes bear interest at a rate of 2.75% per year, payable semiannually in arrears on May 15 and November 15 of each year. The 2015 Notes will mature on May 15, 2015, unless previously converted or repurchased in accordance with their terms prior to such date. The 2015 Notes are senior unsecured obligations, and rank (i) equally to any of our existing and future unsecured senior debt, (ii) senior to any of our future indebtedness that is expressly subordinated to these 2015 Notes, and (iii) effectively junior to any secured indebtedness to the extent of the value of the assets securing such indebtedness.

The 2015 Notes are convertible into approximately 7,439,000 shares of our common stock under certain circumstances prior to maturity at a conversion rate of 21.5592 shares per $1,000 principal amount of 2015 Notes, which represents a conversion price of approximately $46.38 per share, subject to adjustment under certain conditions. Holders may submit their 2015 Notes for conversion at their option at specified times prior to the maturity date of May 15, 2015 only if: (1) the last reported sale price of our common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is equal to or more than 130% of the conversion price of the 2015 Notes on the last day of such preceding fiscal quarter; (2) the trading price for the 2015 Notes, per $1,000 principal amount of the 2015 Notes, for each such trading day was less than 98% of the product of the last reported sale price of our common stock and the conversion rate of the 2015 Notes on such date; or (3) we enter into specified corporate transactions. The first of these conditions had been met as of the fiscal quarter ended March 31, 2014. The 2015 Notes will be convertible, at the option of the noteholders, regardless of whether any of the foregoing conditions have been satisfied, on or after January 13, 2015 at any time prior to the close of business on the second scheduled trading day immediately preceding the stated maturity date of May 15, 2015. Upon conversion, we may pay cash, shares of our common stock or a combination of cash and stock, as determined by us at our discretion.

In connection with the issuance of the 2015 Notes, we entered into capped call transactions covering approximately 7,439,000 shares of our common stock. The capped call transactions have a strike price of $46.38 and a cap price of $62.44, and are exercisable when and if the 2015 Notes are converted. If upon conversion of the 2015 Notes, the price of our common stock is above the strike price of the capped calls, the counterparties will deliver shares of our common stock and/or cash with an aggregate value approximately equal to the difference between the price of our common stock at the conversion date (as defined, with a maximum price for purposes of this calculation equal to the cap price) and the strike price, multiplied by the number of shares of our common stock related to the capped call transactions being exercised. We paid $44.3 million for these capped calls, and charged that amount to additional paid-in capital.

2019 Notes

On March 16, 2012 we closed an offering of $690.0 million in 2019 Notes. Net proceeds from the offering were approximately $668.3 million. The 2019 Notes are governed by an indenture, dated as of March 16, 2012 between the Company and U.S. Bank National Association, as trustee. The 2019 Notes bear interest at a rate of 1.50% per year, payable semiannually in arrears on March 15 and September 15 of each year. The 2019 Notes will mature on March 15, 2019, unless earlier converted or repurchased in accordance with their terms prior to such date. The 2019 Notes are senior unsecured obligations, and rank (i) equally to any of our existing and future unsecured senior debt, (ii) senior to any of our future indebtedness that is expressly subordinated to them, and (iii) effectively junior to any secured indebtedness to the extent of the value of the assets securing such indebtedness.

The 2019 Notes are convertible into approximately 10,484,000 shares of our common stock under certain circumstances prior to maturity at a conversion rate of 15.1947 shares per $1,000 principal amount of 2019 Notes, which represents a conversion price of approximately $65.81 per share, subject to adjustment under certain conditions. Holders may submit their 2019 Notes for conversion at their option at specified times prior to the maturity date of March 15, 2019 only if: (1) the last reported sale price of our common stock for at least 20 trading days in the period of 30 consecutive trading days ending on the last trading day of the immediately preceding fiscal quarter is equal to or more than 130% of the conversion price of the 2019 Notes on the last day of such preceding fiscal quarter; (2) the trading price for the 2019 Notes, per $1,000 principal amount of the 2019 Notes, for each such trading day was less than 98% of the product of the last reported sale price of our common stock and the conversion rate of the 2019 Notes on such date; or (3) we enter into specified corporate transactions. The first of these conditions had been met as of the fiscal quarter ended March 31, 2014. The 2019 Notes will be convertible, at the option of the noteholders, regardless of whether any of the foregoing conditions have been satisfied, on or after November 9, 2018 at any time prior to the close of business on the second scheduled trading day immediately preceding the stated maturity date of March 15, 2019. Upon conversion, we may pay cash, shares of our common stock or a combination of cash and stock, as determined by us at our discretion.

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In connection with the issuance of the 2019 Notes, we entered into convertible bond hedge transactions with certain counterparties covering approximately 10,484,000 shares of our common stock. The convertible bond hedge transactions have a strike price of $65.81 and are exercisable when and if the 2019 Notes are converted. If upon conversion of the 2019 Notes, the price of our common stock is above the strike price of the convertible bond hedge transactions, the counterparties will deliver shares of our common stock and/or cash with an aggregate value approximately equal to the difference between the price of our common stock at the conversion date and the strike price, multiplied by the number of shares of our common stock related to the convertible bond hedge transaction being exercised. We paid $167.0 million for these convertible bond hedge transactions and charged this to additional paid-in capital.

Simultaneously with entering into the convertible bond hedge transactions, we entered into privately negotiated warrant transactions whereby we sold the counterparties to these transactions warrants to acquire, subject to customary adjustments, approximately 10,484,000 shares of our common stock at a strike price of $85.31 per share, also subject to adjustment. We received $99.0 million for these warrants and credited this amount to additional paid-in capital.

2021 Notes

On December 27, 2013, we closed an offering of $750.0 million in 2021 Notes. The 2021 Notes were issued pursuant to an indenture, dated as of December 27, 2013, between us and U.S. Bank National Association, as trustee. We used the net proceeds from the sale of the 2021 Notes to finance a portion of the approximately $2.7 billion that was payable as consideration for our acquisition of Santarus, which closed on January 2, 2014, and to pay the related fees and expenses in connection therewith. The 2021 Notes will mature on January 15, 2021 and bear interest at a rate of 6.00% per annum, accruing from December 27, 2013. The 2021 Notes are senior unsecured obligations, and rank (i) equally to any of our existing and future unsecured senior debt, (ii) senior to any of our future indebtedness that is expressly subordinated to them, and (iii) effectively junior to any secured indebtedness to the extent of the value of the assets securing such indebtedness. Following the acquisition of Santarus, Santarus, Salix Pharmaceuticals, Inc. and Oceana became guarantors of the 2021 Notes.

At any time prior to January 15, 2017, we are entitled, at our option, to redeem some or all of the 2021 Notes at a redemption price of 100% of the principal amount thereof, plus a make-whole premium set forth in the indenture and accrued and unpaid interest, if any, to the redemption date. On and after January 15, 2017, we may redeem the 2021 Notes, in whole or in part, at redemption prices (expressed as percentages of principal amount thereof) equal to 104.50% for the 12-month period beginning on January 15, 2017, 103.00% for the 12-month period beginning January 15, 2018, 101.50% for the 12-month period beginning on January 15, 2019 and 100.00% for the period beginning on January 15, 2020 and thereafter, plus accrued and unpaid interest, if any. At any time prior to January 15, 2017, we also may redeem up to 35% of the principal amount of the 2021 Notes at a redemption price equal to 106.00% of the principal amount thereof plus accrued and unpaid interest, if any, with the net cash proceeds of certain equity offerings.

The indenture for the 2021 Notes contains covenants that restrict the ability of us and certain of our subsidiaries to, among other things: (i) borrow money or issue preferred stock; (ii) pay dividends or make other payments or distributions on equity or purchase, redeem or otherwise acquire equity; (iii) make principal payments on, or purchase or redeem subordinated indebtedness prior to any scheduled principal payment or maturity; (iv) make certain investments; (v) create liens on their assets; (vi) sell their assets; (vii) enter into certain transactions with affiliates; (viii) engage in unrelated businesses and (ix) consolidate, merge or sell substantially all of our assets. These covenants are subject to a number of exceptions and qualifications, including the fall away of certain of these covenants if the 2021 Notes receive an investment grade credit rating in the future. The indenture for the 2021 Notes also requires us to make an offer to repurchase the 2021 Notes upon the occurrence of certain events constituting either a change of

control that reduces our credit rating or an asset sale.

Credit Agreement

On January 2, 2014, we entered the Credit Agreement with Jefferies Finance LLC, as collateral agent and administrative agent, and the lenders party thereto, providing for (i) the $1.2 billion Term Loan B Facility, and (ii) the $150 million Revolving Credit Facility. We refer to the Senior Term Loan Facility and the Revolving Credit Facility, collectively, as the Senior Secured Facilities. The proceeds of the Term Loan B Facility were used to fund a portion of the purchase price of the acquisition of Santarus. The proceeds of the Revolving Credit Facility can be used in the future for working capital and general corporate purposes, including permitted investments and acquisitions. Santarus, Salix Pharmaceuticals, Inc. and Oceana, each a guarantor, have guaranteed our obligations under the Credit Agreement and the obligations of each of the other guarantors under the loan documents. Additionally, we and the guarantors have granted to the collateral agent, for the benefit of the lenders under the Credit Agreement, a first priority security interest in substantially all of our and their respective assets.

The term loans under the Term Loan B Facility are subject to quarterly amortization equal to 1.25% of the original aggregate principal amount thereof and the remaining principal balance is due and payable on January 2, 2020, unless earlier prepaid. The Senior Secured Facilities bear interest at an annual rate of, at our option, either (i) Adjusted LIBOR (as defined by the Credit Agreement), with a floor of 1.00%, plus a margin of 3.25% or (ii) the highest of (A) the Wall Street Journal s published U.S. Prime Lending

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Rate, (B) the Federal Funds Effective Rate (as defined by the Credit Agreement) in effect on such day plus 1/2 of 1%, (C) one-month Adjusted LIBOR plus 1.00% per annum and (D) 2.00%, in each case plus a margin of 2.25%. If the ratio of the our consolidated total debt to consolidated EBITDA is less than 3.75 to 1.00, the margins will be reduced by 25 basis points.

We are required to prepay term loans under the Term Loan B Facility with (i) 100% of the proceeds of asset sales not reinvested within generally one year, (ii) 100% of the proceeds from certain debt financings and (iii) 50% of Excess Cash Flow (as defined in the Credit Agreement). The percentage of Excess Cash Flow that must be used to prepay the Term Loan B Facility decreases to 25% if the Total Leverage Ratio is less than 3:50 to 1:00 and to zero if the Total Leverage Ratio is less than 2:50 to 1:00.

The Credit Agreement includes customary affirmative and negative covenants, including restrictions on additional indebtedness, liens, investments, asset sales, stock buybacks and dividends, mergers, consolidations, and transactions with affiliates and capital expenditures. The negative covenants are generally subject to various exceptions. The Credit Agreement does not include any financial maintenance covenants, with the exception that If 25% or more of the Revolving Credit Facility is being utilized, a Total Leverage Ratio requirement (measured as of the last day of each quarter), which decreases over time, must be satisfied.

Item 3. Quantitative and Qualitative Disclosures About Market Risk

Our purchases of raw materials and finished goods are denominated primarily in U.S. dollars and purchases denominated in currencies other than the U.S. dollar are insignificant. Additionally, our net assets denominated in currencies other than the U.S. dollar are insignificant and have not historically exposed us to material risk associated with fluctuations in currency rates. Given these facts, we have not considered it necessary to use foreign currency contracts or other derivative instruments to manage changes in currency rates. However, these circumstances might change.

We have outstanding $345.0 million of 2.75% convertible senior notes due 2015, $690.0 million of 1.5% convertible senior notes due 2019 and $750 million of 6.00% senior notes due 2021. The interest rates on these notes are fixed and therefore they do not expose us to risk related to rising interest rates.

In connection with the June 2010 offering of the 2015 Notes, we paid $44.3 million to purchase capped call options covering approximately 7,439,000 shares of our common stock. If the per share price of our common stock remains below $46.38, these call options will be worthless. If the per share price of our common stock exceeds $62.44, then to the extent of the excess, these call options will not provide us protection against dilution from conversion of the 2015 Notes.

In connection with the March 2012 offering of the 2019 Notes, we paid $167.0 million to purchase convertible bond hedge transactions covering approximately 10,484,000 shares of our common stock. If the per share price of our common stock remains below $65.81, these call options will be worthless. Simultaneously with entering into the convertible bond hedge transactions, we sold warrants to acquire, subject to customary adjustments, approximately 10,484,000 shares of our common stock at a strike price of $85.31 per share, also subject to adjustment. If the per share price of our common stock exceeds $85.31, then to the extent of the excess, these warrants will counter any benefit of the convertible bond hedges we purchased.

The Credit Agreement we entered into in January 2014 in connection with our acquisition of Santarus consists of the $1.2 billion Term Loan B Facility, and the $150 million Revolving Credit Facility. Both of these facilities bear interest

at variable rates based on either LIBOR or the Federal Funds Effective Rate plus a margin, with a minimum rate for each of the indexes.

Item 4. Controls and Procedures

Disclosure controls and procedures (as defined in Exchange Act Rule 13a-15(e)) are designed only to provide reasonable assurance that information to be disclosed in our Exchange Act reports is recorded, processed, summarized and reported within the time periods specified in the SEC s rules and forms and accumulated and communicated to the issuer s management, including its principal financial officer, or persons performing similar functions, as appropriate to allow timely decision regarding required disclosure. As of the end of the period covered by this report, we carried out an evaluation, under the supervision and with the participation of our management, including our President and Chief Executive Officer and Executive Vice President, Finance and Administration and Chief Financial Officer, of the effectiveness of our disclosure controls and procedures pursuant to Exchange Act Rule 13a-15(e). Based upon that evaluation, our President and Chief Executive Officer and Executive Vice President, Finance and Administration and Chief Financial Officer concluded that our disclosure controls and procedures were effective to provide the reasonable assurance discussed above.

Subsequent to that evaluation management, including our Acting Chief Executive Officer and Acting Chief Financial Officer, has determined that deficiencies in internal control over financial reporting exist because we did not (1) establish and maintain adequate procedures and controls for (a) product returns and for the communications between our sales and accounting/finance functions to record agreed upon returns and (b) the recognition of revenue for sales to customers with FOB Destination shipping terms, (2) comply with established policies to properly obtain, evaluate, review and approve agreements with

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customers and (3) periodically review and assess our account classification policies in light of changes in our organization, management and personnel over time, and the effect of non-routine transactions. Management further concluded that these deficiencies are material weaknesses, as defined by Securities and Exchange Commission regulations, and that our disclosure controls and procedures were not effective as of March 31, 2014 as a result of that material weakness in our internal control over financial reporting.

In light of the material weaknesses referred to above, we performed additional analyses and procedures in order to conclude that our consolidated financial statements in this Form 10-Q/A for the quarter ended March 31, 2014 are fairly presented, in all material respects, in accordance with U.S. GAAP.

We are actively engaged in developing and implementing remediation plans designed to address these material weaknesses. The actions that we are taking are subject to ongoing senior management review and Audit Committee oversight. Management believes the foregoing efforts will effectively remediate the material weaknesses in the first quarter of 2015. As we continue to evaluate and work to improve our internal control over financial reporting, management may execute additional measures to address potential control deficiencies or modify its remediation plans and will continue to review and make necessary changes to the overall design of our internal controls.

There was no change in our internal control over financial reporting in the quarter ended March 31, 2014 that materially affected, or is reasonably likely to materially affect, our internal control over financial reporting, except as noted above.

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PART II. OTHER INFORMATION

Item 1. Legal Proceedings

From time to time, we are involved in various litigation matters that are being defended and handled in the ordinary course of business. The assessment of whether a loss is probable or reasonably possible, and whether the loss or a range of loss is estimable, often involves a series of complex judgments about future events. Management maintains accruals for such losses that are probable of being incurred and subject to reasonable estimation. For current matters not specifically reported herein, management does not anticipate that the ultimate liabilities, if any, arising from the resolution of such current matters would have a material effect on our financial condition or results of operations. It is possible, however, that future results of operations for any particular period could be materially affected by changes in our assessment related to any of these matters.

Product Liability Claims

The Company is currently and might continue to be subject to product liability claims that arise through the testing, manufacturing, marketing and sale of its products, including claims related to OsmoPrep and Relistor. The Company is vigorously defending these claims and intends to continue to vigorously defend any future claims. The Company currently has product liability coverage for all of its products other than with regard to claims filed prior to August 31, 2010 relating to OsmoPrep and Visicol, but it is possible that this coverage, and any future coverage, will be insufficient for any liabilities that may arise in the future.

Napo Litigation

On May 5, 2011, Napo filed a lawsuit against us in the Supreme Court of the State of New York, County of New York, alleging that we had engaged in fraudulent conduct, breached our collaboration agreement with Napo dated December 9, 2008, and breached our duty of good faith and fair dealing. Napo also sought a declaratory judgment that it had the right to terminate the collaboration agreement and sought unspecified damages in excess of $150 million. On or about December 28, 2011, Napo filed an amended complaint seeking an unspecified amount of damages for alleged breaches of the collaboration agreement by the Company. Napo s amended complaint no longer sought a declaratory judgment that Napo had the right to terminate the collaboration agreement and rendered moot the need for the court to rule on the Company s motion to dismiss the original complaint. Discovery concluded last year, and, on May 31, 2013 we filed a motion for partial summary judgment. The court heard oral arguments on the motion in August 2013. On December 24, 2013, the court entered a short-form order granting our motion for partial summary judgment, narrowing the issues in the case. Napo timely appealed that decision to the Appellate Division of the Supreme Court of the State of New York. On January 29, 2014 the Court vacated and replaced portions of the short-form order with an order continuing to grant our motion for partial summary judgment, narrowing the issues in the case. Trial on the claims remaining in the case commenced on February 10, 2014 and on February 25, 2014 the jury rendered its verdict, concluding that Salix had complied with its contractual obligations in commercializing Fulyzaq in the United States, and thus did not breach the collaboration agreement between the parties. On May 1, 2014, Napo filed an appeal of the jury verdict. We continue to advance our development and commercialization plans for crofelemer in accordance with the collaboration agreement and continue to believe that Napo s allegations are without merit and its lawsuit baseless.

Lupin Litigation

On September 7, 2012, we and Dr. Falk Pharma filed a patent infringement complaint against Lupin in the U.S. District Court for the District of Delaware. The complaint alleges infringement of the 620 patent, based on Lupin s filing of an ANDA seeking approval to market and sell a generic version of Apriso before the expiration of the 620 patent. The filing of this suit within the 45 day response period provided by the Hatch Waxman Act imposes a 30-month stay of approval of Lupin s ANDA unless the court finds in Lupin s favor prior to that time. On March 4, 2013, we and Dr. Falk Pharma filed an amended complaint to also enforce the issued 886 patent in the pending suit. On July 30, 2013 the USPTO issued the 965 patent, which further protects the Apriso product. On August 19, 2013 we and Dr. Falk Pharma filed a second amended complaint to enforce the 965 patent and the 451 patent against Lupin. The court conducted a pretrial evidentiary hearing, known as a Markman hearing, on November, 21, 2013. The court adopted each of Salix s claim construction positions in its order issued December 17, 2013. The trial is scheduled for September, 2014. We continue to evaluate our intellectual property protecting Apriso, in which we have full confidence. We intend to vigorously enforce our intellectual property rights.

Novel Litigation

On February 18, 2014, we and Dr. Falk Pharma filed a patent infringement complaint against Novel in the U.S. District Court for the District of Delaware. The complaint alleges infringement of the 620 patent, the 886 patent, and the 965 patent based on Novel s filing of an ANDA seeking approval to market and sell a generic version of Apriso before the expiration of these patents. The filing of this suit within the 45-day response period provided by the Hatch-Waxman Act imposes a 30-month stay of approval of Novel s ANDA unless the court finds in Novel s favor prior to that time. We continue to evaluate our intellectual property protecting Apriso, in which we have full confidence. We intend to vigorously enforce our intellectual property rights.

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DOJ Subpoena

On February 1, 2013, our wholly owned subsidiary Salix Pharmaceuticals, Inc. received a subpoena from the U.S. Attorney s Office for the Southern District of New York requesting documents regarding our sales and promotional practices for Xifaxan, Relistor and Apriso. The Company is continuing to respond to the subpoena and intends to cooperate fully with the subpoena and related government investigation. Currently, we cannot predict or determine the timing or outcome of this inquiry or its impact on financial condition or results of operations.

Santarus Shareholder Litigation

Beginning on November 12, 2013, eleven putative class action lawsuits were filed by shareholders of Santarus seeking to challenge our proposed acquisition of Santarus, which was announced on November 7, 2013. Nine of these actions were filed in the Delaware Court of Chancery, one was filed in California Superior Court (San Diego County) and one was filed in the U.S. District Court for the Southern District of California. These actions generally allege that the members of the Santarus board of directors breached their fiduciary duties to Santarus s shareholders by failing to maximize the value of Santarus and by making inadequate or misleading disclosures regarding the proposed merger, and that Santarus, we and certain of our subsidiaries aided and abetted those breaches of fiduciary duty. The complaint in the action pending in California federal court also asserts causes of action on behalf of the individual plaintiff for alleged violations of certain sections of the Exchange Act. These actions generally sought, among other things, to enjoin the merger, unspecified damages and fees. On December 9, 2013, Santarus and its directors filed a motion to stay the action pending in California Superior Court. On December 11, 2013, the Delaware Court of Chancery consolidated the nine actions pending in that court, appointed lead counsel for the plaintiffs, and designated the amended complaint filed by plaintiff Imad Ahmad Khalil on December 9, 2013 as the operative complaint in the consolidated Delaware litigation. On December 20, 2013, the parties in the Delaware litigation reached an agreement in principle, subject to full documentation, to resolve the plaintiffs claims in that action in exchange for certain supplemental disclosures that Santarus included in an amended Schedule 14D-9 it filed on that date. We completed our merger with Santarus on January 2, 2014. The parties in the Delaware litigation executed a Memorandum of Understanding reflecting the terms of their agreement in principle on January 17, 2014 and are currently drafting full settlement documentation and engaging in confirmatory discovery. The settlement of the Delaware litigation will be subject to approval by the Delaware Court of Chancery. The plaintiffs counsel in the Delaware litigation has also indicated that the plaintiffs intend to request an award of an unspecified amount attorneys fees from the Delaware Court of Chancery. On January 22, 2014, Santarus and its directors filed a renewed motion to stay the action pending in California Superior Court, and we filed a separate motion to stay that action in favor of the Delaware litigation. On January 22, 2014, Santarus and its directors filed a motion to stay the action pending in the California federal court in favor of the Delaware litigation, and we filed a joinder in support of that motion on January 23, 2014. On February 12, 2014, the parties in the action pending in California federal court filed a joint motion to stay that action pending a decision by the Delaware Court of Chancery regarding final approval of the proposed settlement of the Delaware litigation, and the California federal court granted that motion on February 13, 2014. We are vigorously defending the action pending in California Superior Court and attempting to finalize the settlement of the consolidated Delaware litigation as described above. We believe that all of the claims asserted against us by Santarus shareholders lack merit.

Zegerid Rx and Zegerid OTC Patent Litigation

Zegerid Rx Litigation

In April 2010, the U.S. District Court for the District of Delaware ruled that five patents covering Zegerid capsules and Zegerid powder for oral suspension (U.S. Patent Nos. 6,489,346; 6,645,988; 6,699,885; 6,780,882; and 7,399,772) were invalid due to obviousness. These patents were the subject of lawsuits Santarus filed in 2007 against Par, in

response to ANDAs filed by Par with the FDA. The University of Missouri, licensor of the patents, is joined in the litigation as a co-plaintiff. In May 2010, Santarus filed an appeal of the District Court s ruling to the U.S. Court of Appeals for the Federal Circuit. Following the District Court s decision, Par launched its generic version of Zegerid capsules in June 2010.

In September 2012, the U.S. Court of Appeals for the Federal Circuit reversed in part the April 2010 decision of the District Court. The Federal Circuit found that certain claims of U.S. Patent Nos. 6,780,882 and 7,399,772, which Par had been found to infringe, were not invalid due to obviousness. The Federal Circuit affirmed the district court s finding of invalidity for the asserted claims from the remaining three patents. Following the Federal Circuit s decision, Par announced that it had ceased distribution of its generic Zegerid capsules product in September 2012. In December 2012, the Federal Circuit remanded the case to the district court for further proceedings pertaining to damages. In February 2013, Santarus filed an amended complaint with the district court for infringement of U.S. Patent Nos. 6,780,882 and 7,399,772 and requested a jury trial with respect to the issue of damages in connection with Par s launch of its generic version of Zegerid capsules in June 2010. In March 2013, Par filed its amended answer, which alleges,

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among other things, failure to state a claim upon which relief can be granted and non-infringement based on purported invalidity of the two asserted patents. In addition, Par filed a motion for a judgment on the pleadings, alleging, among other things, that the two asserted patents are invalid because the Federal Circuit purportedly did not expressly address certain prior art references considered by the district court. The trial on Santarus s damages claim against Par is currently scheduled for November 2014. Although we do not believe that Par has a meritorious basis upon which to further challenge validity of the asserted patents in this proceeding, we cannot be certain of the outcome of this or any other proceedings.

In December 2011, Santarus filed a lawsuit in the U.S. District Court for the District of New Jersey against Zydus Pharmaceuticals USA, Inc., or Zydus, for infringement of the patents listed in the Orange Book for Zegerid capsules. The University of Missouri, licensor of the patents, is joined in the litigation as a co-plaintiff. Zydus had filed an ANDA with the FDA regarding its intent to market a generic version of Zegerid capsules prior to the expiration of the listed patents. In September 2012, Santarus amended its complaint to be limited to U.S. Patent No. 7,399,772, which patent was found not to be invalid in the September 2012 Federal Circuit decision. In October 2012, Zydus filed its answer, which alleged, among other things, failure to state a claim upon which relief can be granted. The lawsuit was commenced within the requisite 45-day time period, resulting in an FDA stay on the approval of Zydus proposed product for 30 months or until a decision is rendered by the district court, which is adverse to the asserted patent. In December 2013, the district court entered an order staying the case for 60 days, rescheduling the trial for April 2014, and extending the 30-month stay from May 2014 to July 2014. In February 2014, Santarus and MSD agreed to settle this case and the related Zegerid OTC litigation, discussed below. Zydus may begin selling a generic version of prescription Zegerid capsules upon expiration of the applicable patent in mid-2016 (or earlier under certain circumstances). The district court entered an order dismissing the case with prejudice in February 2014.

Zegerid OTC Litigation

In September 2010, MSD filed a lawsuit in the U.S. District Court for the District of New Jersey against Par for infringement of the patents listed in the Orange Book for Zegerid OTC. Santarus and the University of Missouri, licensors of the listed patents, are joined in the lawsuit as co-plaintiffs. Par had filed an ANDA with the FDA regarding its intent to market a generic version of Zegerid OTC prior to the expiration of the listed patents. In October 2012, MSD amended its complaint to be limited to U.S. Patent No. 7,399,772, which patent was found not to be invalid in the Federal Circuit s September 2012 decision disclosed above. Also in October 2012, Par filed its answer, which alleged, among other things, failure to state a claim upon which relief can be granted, non-infringement and invalidity. Par has received tentative approval of its proposed generic Zegerid OTC product. Although the 30-month stay expired in February 2013, the parties have agreed that Par will not launch its generic Zegerid OTC product unless there is a district court judgment favorable to Par or in certain other specified circumstances. The Markman hearing for this matter took place in July 2013, and the district court issued a Markman order in October 2013 in which the district court adopted MSD s proposed construction of several claim terms that were consistent with those adopted by the U.S. District Court for the District of Delaware in the prescription Zegerid litigation. In February 2014, the case was settled, allowing Par to begin selling a generic version of Zegerid OTC capsules upon expiration of the applicable patent in mid-2016 (or earlier under certain circumstances). We expect the district court to enter an order dismissing this case soon.

In December 2011, MSD filed a lawsuit in the U.S. District Court for the District of New Jersey against Zydus for infringement of the patents listed in the Orange Book for Zegerid OTC. Santarus and the University of Missouri, licensors of the listed patents, are joined in the litigation as co-plaintiffs. Zydus had filed an ANDA with the FDA regarding its intent to market a generic version of Zegerid OTC prior to the expiration of the listed patents. In September 2012, MSD amended its complaint to be limited to U.S. Patent No. 7,399,772, which patent was found not to be invalid in the Federal Circuit s September 2012 decision. In October 2012, Zydus filed its answer, which alleges,

among other things, failure to state a claim upon which relief can be granted. The lawsuit was commenced within the requisite 45-day time period, resulting in an FDA stay on the approval of Zydus proposed product for 30 months or until a decision is rendered by the district court, which is adverse to the asserted patent. In December 2013, the district court entered an order staying the case for 60 days, rescheduling the trial for April 2014, and extending the 30-month stay from May 2014 to July 2014. As discussed in connection with the lawsuit against Zydus for infringement of the patents covering prescription Zegerid, in February 2014, Santarus and MSD agreed to settle this case and the related prescription Zegerid litigation with Zydus. Zydus may begin selling a generic version of Zegerid OTC capsules upon expiration of the applicable patent in mid-2016 (or earlier under certain circumstances). The district court entered an order dismissing the case with prejudice in February 2014.

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Fenoglide Patent Litigation

In January 2013, Santarus filed a lawsuit in the U.S. District Court for the District of Delaware against Mylan Inc. and Mylan Pharmaceuticals Inc., collectively referred to herein as Mylan, for infringement of the patents listed in the Orange Book for Fenoglide 120 mg and 40 mg (U.S. Patent Nos. 7,658,944, and 8,124,125). Veloxis Pharmaceuticals A/S, or Veloxis, is joined in the lawsuit as a co-plaintiff. The lawsuit was filed in response to an ANDA filed with the FDA by Mylan regarding Mylan s intent to market a generic version of Fenoglide 120 mg and 40 mg tablets prior to the expiration of the listed patents. Santarus commenced the lawsuit within the requisite 45-day time period, resulting in an FDA stay on the approval of Mylan s proposed product for 30 months or until a decision is rendered by the district court, which is adverse to the asserted patents, whichever may occur earlier. Absent a court decision, the 30-month stay is expected to expire in June 2015. Mylan has filed an answer in the case that asserts, among other things, non-infringement, invalidity, and failure to state a claim, and it has also filed counterclaims. We are not able to predict the timing or outcome of this lawsuit.

Item 1A. Risk Factors

This report contains forward-looking statements that involve risks and uncertainties. Our actual results could differ materially from those discussed in this report. Factors that could cause or contribute to these differences include, but are not limited to, those discussed below and elsewhere in this report and in any documents incorporated in this report by reference.

If any of the following risks, or other risks not presently known to us or that we currently believe to not be significant, develop into actual events, then our business, financial condition, results of operations or prospects could be materially adversely affected. If that happens, the market price of our common stock could decline, and stockholders might lose all or part of their investment.

General Risks

Future sales of Xifaxan and our other marketed products might be less than expected.

Following completion of our acquisition of Santarus, we currently actively market and sell more than 20 primary products. We expect Xifaxan, which was launched in mid-2004 for the treatment of TD, and approved and launched in March 2010 for the treatment of HE, to continue to be our most significant source of revenue in the future. If sales of our marketed products decline or if we experience product returns significantly in excess of estimated amounts recorded, particularly with respect to Xifaxan, it would have a material adverse effect on our business, financial condition and results of operations.

The degree of market acceptance of our products among physicians, patients, healthcare payors and the medical community will depend upon a number of factors including:

- the timing of regulatory approvals and product launches by us or competitors, and including any generic or OTC competitors;

perceptions by physicians and other members of the healthcare community regarding the safety and efficacy of our products;

price increases, and the price of our products relative to other drugs or competing treatments;

patient and physician demand;

adverse side effects or unfavorable publicity concerning our products or other drugs in our class;

the results of product development efforts for new indications;

the scope and timing of additional marketing approvals and favorable reimbursement programs for expanded uses;

the availability of sufficient commercial quantities of the products; and

our success in getting other companies to distribute our products outside of the U.S. gastroenterology, hepatology and colorectal surgery markets.

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Regulatory approval of our product candidates is time-consuming, expensive and uncertain, and could result in unexpectedly high expenses.

Development of our products is subject to extensive regulation by governmental authorities in the United States and other countries. To market a new drug in the U.S., we must submit to the FDA and obtain FDA approval of an NDA or a BLA. An NDA or BLA must be supported by extensive clinical and preclinical data, as well as extensive information regarding chemistry, manufacturing and controls, or CMC, to demonstrate the safety and effectiveness of the applicable product candidate. The FDA s regulatory review of NDAs and BLAs is becoming increasingly focused on product safety attributes, and even if approved, our product candidates may not be approved for all indications requested and such approval may be subject to limitations on the indicated uses for which the product candidate may be marketed, restricted distribution methods or other limitations. In addition, the FDA s large workload has led to delays in its review of NDA submissions, which could require us to incur significant unexpected expenses or delay or limit our ability to sell product candidates for which we have not yet received regulatory approval.

Failure can occur at any stage of clinical testing. The clinical study process may fail to demonstrate that our product candidates are safe for humans or effective for their intended uses. Our clinical tests must comply with FDA and other applicable U.S. and foreign regulations, including a requirement that they be conducted in accordance with good clinical practices. We may encounter delays based on our inability to timely enroll enough patients to complete our clinical studies. We may suffer significant setbacks in advanced clinical studies, even after showing promising results in earlier studies. Based on results at any stage of clinical studies, we may decide to discontinue development of a product candidate. In addition, we or the FDA may suspend clinical studies at any time if the patients participating in the studies are exposed to unacceptable health risks or if the FDA finds deficiencies in our applications to conduct the clinical studies or in the conduct of our studies.

Regulatory approval of an NDA or a BLA is difficult, time-consuming and expensive to obtain. The number and types of preclinical studies and clinical trials that will be required for NDA or BLA approval varies depending on the drug, the disease or the condition that the drug is designed to target and the regulations applicable to any particular drug. We could encounter problems that cause us to repeat or perform additional preclinical studies, CMC studies or clinical studies. Our clinical studies might be delayed or halted, or additional studies might be required, for various reasons, including:

- the drug is not effective;
- patients experience severe side effects during treatment;
- patients do not enroll in the studies at the rate expected;
- drug supplies are not sufficient to treat the patients in the studies; or
- we decide to modify the drug during testing.

If regulatory approval of any product is granted, it will be limited to those indications for which the product has been shown to be safe and effective, as demonstrated to the FDA s satisfaction through clinical studies. In addition, before

the FDA approves one of our investigational drugs, the FDA may choose to conduct an inspection of one or more clinical or manufacturing sites. These inspections may be conducted by the FDA both at U.S. sites as well as overseas. Any restrictions on the ability of FDA investigators to travel overseas to conduct such inspections, either because of financial or other reasons including political unrest, disease outbreaks or terrorism, could delay the inspection of overseas sites and consequently delay FDA approval of our investigational drugs.

To market drugs outside the U.S., we and current or future collaborators must comply with numerous and varying regulatory requirements of other countries. Regulatory approval procedures vary among countries and can involve additional product testing and additional administrative review periods, including obtaining reimbursement approval in select markets. Regulatory approval in one country does not ensure regulatory approval in another, but a failure or delay in obtaining regulatory approval in one country may negatively impact the regulatory process in others.

The FDA may require significant additional clinical testing for our product candidates, and we may not receive regulatory approval for some or all of these product candidates.

In addition to the general development and regulatory risks described above, each of our investigational drugs is subject to additional risks that may cause us to incur significant additional costs and the FDA, or applicable foreign regulator, may ultimately refuse to approve of one or more of our product candidates. If we experience delays or setbacks for any reason, our product development costs will increase and we may decide to abandon a product candidate entirely. If any of our product candidates fail to receive regulatory approval, we will have incurred significant expenses without the possibility of generating revenues, which could have a material adverse effect on our business.

In August 2010, the FDA accepted our NDA for rifaximin for IBS, and gave us an action date of December 7, 2010. In October 2010, the FDA informed us it was extending the action date by three months to provide for a full review and extended our action date to March 7, 2011. We received a CRL on March 7, 2011. The FDA deemed that the Xifaxan 550 mg sNDA was not ready for approval, primarily due to a newly expressed need for retreatment information. We initiated enrollment in a retreatment trial in the first quarter of 2012, but there is no assurance that the FDA will approve rifaximin for IBS in a timely manner, or at all.

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On July 27, 2012, the FDA issued a CRL following the FDA s review of an sNDA for Relistor SI for the treatment of OIC in adult patients with chronic, non-cancer pain. The CRL requested additional clinical data. In October 2012, Salix and Progenics held an End-of-Review meeting with the FDA s Division of Gastroenterology and Inborn Errors Products to better understand the contents of the CRL. The Division expressed a concern that there might be a risk associated with the chronic use of mu-opioid antagonists in patients that are taking opioids for chronic pain. In order to understand this potential risk, the Division has communicated that a very large, well-controlled, chronic administration trial will have to be conducted to assess the safety of any mu-opioid antagonist prior to market approval for the treatment of patients with OIC who are taking opioids for chronic, non-cancer pain. We have since had additional discussions with the Division and expressed the view that the post-marketing, clinical and preclinical data currently available adequately demonstrate an appropriate and expected safety profile sufficient to permit the approval of the sNDA and have filed a formal appeal to that effect. The FDA initially planned to convene an Advisory Committee on March 10-11, 2014 regarding this sNDA, but postponed the date of the meeting due to scheduling conflicts. The Advisory Committee meeting has been rescheduled for June 11-12, 2014. The FDA intends to seek input from this Advisory Committee prior to answering our formal appeal to the CRL and has stated that it will take action under the appeal within 30 days after receiving input from the Advisory Committee. Based on the results of this meeting, we believe we might terminate our development program for Relistor SI for the treatment of OIC in chronic non-cancer pain. We remain hopeful that a path forward can lead to the expansion of the use of this new and alternative therapy to treat OIC in patients suffering from chronic pain; however, depending on the results of our discussions with the Division, we believe we might terminate our development program for Relistor SI for the treatment of OIC in chronic non-cancer pain. We are currently evaluating the Relistor Oral program and currently believe we will continue this program. However, additional information and additional guidance from the FDA could result in the termination of the Relistor Oral program. There is no assurance the FDA will approve Relistor SI or Relistor Oral for the treatment of OIC in adult patients with chronic, non-cancer pain in a timely manner, or at all.

Regulatory approvals, even if granted, might entail ongoing requirements or restrictions on marketing. These requirements or restrictions, or inquiries into our marketing practices, could increase our expenses and limit revenue.

Regulatory approvals might entail ongoing requirements for post-marketing studies or limit how or to whom we can sell our products. Even if we obtain regulatory approvals, labeling and promotional activities are subject to continual scrutiny by the FDA and other federal and state authorities. For example, in 2008, the FDA required us to put a black box warning on the OsmoPrep and Visicol labels regarding potential kidney damage that could result from their use, and a black box warning for Metozolv regarding tardive dyskensia which could result from its use. We believe these warnings contributed to reduced sales of those products, and they could limit future sales of those products. With regard to OsmoPrep and Visicol, following consultation with the FDA, we also developed a risk evaluation and mitigation strategy, or REMS, including a medication guide. We have conducted post-marketing clinical trials as part of this strategy. In December 2011, the FDA agreed that a REMS was no longer required for OsmoPrep and Visicol.

In addition, we periodically receive inquiries from authorities, including specifically the Office of Prescription Drug Promotion of the FDA, or OPDP, formerly known as the Division of Drug Marketing, Advertising, and Communications, regarding compliance with marketing and other regulations. Responding to inquiries from authorities can be costly and divert the time and attention of our senior management from our business operations and result in increased legal expenses. The laws and regulations regarding off-label promotion and the authorities interpretation of them might increase our expenses, impair our ability to effectively market our products, and limit our revenue.

On February 1, 2013, our wholly owned subsidiary Salix Pharmaceuticals, Inc. received a subpoena from the U.S. Attorney s Office for the Southern District of New York requesting documents regarding our sales and promotional

practices for Xifaxan, Relistor and Apriso. The Company is in the process of responding to the subpoena and intends to cooperate fully with the subpoena and related government investigation, which has and will continue to increase our legal expenses, and might require management time and attention. Currently, we cannot predict or determine the timing or outcome of this inquiry or its impact on our financial condition or results of operations.

Our intellectual property rights might not afford us with meaningful protection, which could result in substantial costs to us and negatively affect our revenues by impacting our pricing and sales volume as well as royalties and other payments owed to us by third parties.

The intellectual property rights protecting our products might not afford us with meaningful protection from generic and other competition. In addition, because our strategy is to in-license or acquire pharmaceutical products which typically have been discovered and initially researched by others, future products might have limited or no remaining patent protection due to the time elapsed since their discovery. Competitors could also design around any of our intellectual property or otherwise design competitive products that do not infringe our intellectual property.

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Any litigation in which we become involved to enforce intellectual property rights could result in substantial cost to us. In addition, claims by others that we infringe their intellectual property could be costly. Our patent or other proprietary rights related to our products might conflict with the current or future intellectual property rights of others. Litigation or patent interference proceedings, either of which could result in substantial cost to us, might be necessary to defend any patents to which we have rights and our other proprietary rights or to determine the scope and validity of other parties proprietary rights. The defense of patent and intellectual property claims is both costly and time-consuming, even if the outcome is favorable. Any adverse outcome could subject us to significant liabilities to third parties, require disputed rights to be licensed from third parties, or require us to cease selling one or more of our products. We might not be able to obtain a license to any third-party technology that we require to conduct our business, or, if obtainable, that technology might not be available at a reasonable cost.

Upon patent expiration, our drugs could be subject to generic competition, which could negatively affect our pricing and sales volume. As previously disclosed, this has already happened to Colazal, which had been our largest selling drug prior to 2008. See Part I. Item 1. Business Patents and Proprietary Rights in our Annual Report on Form 10-K for the year ended December 31, 2013 for additional information about the existing patent protection for our products.

We also rely on trade secrets, proprietary know-how and technological advances, which we seek to protect, in part, through confidentiality agreements with collaborative partners, employees and consultants. These agreements might be breached and we might not have adequate remedies for any such breach. In addition, our trade secrets and proprietary know-how might otherwise become known or be independently developed by others.

Intense competition might render our products noncompetitive or obsolete.

Competition in our business is intense and characterized by extensive research efforts and rapid technological progress. Technological developments by competitors, regulatory approval for marketing competitive products, including potential generic or over-the-counter products, or superior marketing resources possessed by competitors could adversely affect the commercial potential of our products and could have a material adverse effect on our revenue and results of operations. Generic competition is an increasing risk, as we have experienced with Colazal and Pepcid, and with challenges to our bowel-cleansing products intellectual property noted in Part I. Item 1. Business Patents and Proprietary Rights in our Annual Report on Form 10-K for the year ended December 31, 2013. We believe that there are numerous pharmaceutical and biotechnology companies, including large well-known pharmaceutical companies, as well as academic research groups throughout the world, engaged in research and development efforts with respect to pharmaceutical products targeted at gastrointestinal diseases and conditions addressed by our current and potential products. In particular, we are aware of products in research or development by competitors that address the diseases being targeted by our products. Developments by others might render our current and potential products obsolete or noncompetitive. Competitors might be able to complete the development and regulatory approval process sooner and, therefore, market their products earlier than we can.

Many of our competitors have greater financial, marketing and personnel resources and development capabilities than we do. For example, many large, well-capitalized companies already offer products in the United States and Europe that target the indications for:

Xifaxan for HE, including lactulose (various manufacturers);

Xifaxan for TD, including ciprofloxacin, commonly known as Cipro (Bayer AG);

Apriso, including Asacol and Delzicol (Warner Chilcott plc, or Warner Chilcott), sulfasalazine (Pfizer Pharmaceuticals, or Pfizer), Dipentum (Alaven Pharmaceutical LLC), Pentasa and once-a-day Lialda (Shire Pharmaceuticals Group, or Shire) and three generic balsalazide disodium capsule products;

OsmoPrep and MoviPrep, including Colyte (Meda Pharmaceuticals Inc.), Golytely (Braintree Laboratories, Inc., or Braintree), Halflytely (Braintree), SuPrep (Braintree), and Nulytely (Braintree), Trilyte (Alaven) and Prepopik (Ferring Pharmaceuticals, Inc.), as well as potential generics from Novel or others;

Relistor for OIC, including OTC laxatives (various manufacturers), Amitiza (Sucampo AG), Kristalose (Cumberland Pharmaceuticals, Inc.), and Entereg (Cubist Pharmaceuticals, Inc.);

Solesta, including various OTC antidiarrheals, fiber, stool softeners and laxatives (various manufacturers), biofeedback, the medical device Inter Stim (Medtronic, Inc.) and sphincteroplasty surgery;

Metozolv ODT, including Reglan (Ani Pharmaceuticals, Inc.), and various generics;

Uceris, including Asacol and Delzicol (Warner Chilcott), Lialda and Pentasa (Shire), Remicade (Janssen Biotech, Inc.) and Humira (AbbVie Inc., or AbbVie);

Zegerid, including Nexium (AstraZeneca plc), Aciphex (Eisai Inc.) and Dexilant (Takeda Pharmaceuticals, Inc., or Takeda) and various generics and OTC proton pump inhibitor products;

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Glumetza, including Fortamet (Andrx Laboratories LLC), Glucophage and Glucophage XR (Bristol Myers Squibb, or BMS), various generics and other prescription diabetes treatments;

Cycloset, including Januvia (Merck), Onglyza (BMS), Byetta (Amylin Pharmaceuticals, Inc., or Amylin), Victoza (Novo Nordisk Inc.), Bydureon (Amylin), Avandia (SB PharmCo Puerto Rico, Inc.), Actos (Takeda), Amaryl (Sanofi Aventis), Glynase (Pfizer) and various branded and generic metformin products; and

Fenoglide, including Trico (AbbVie), Antara (Lupin Atlantis Holdings, S.A.), Lipofen (Cipher Pharmaceuticals, Inc.), Lopid (Pfizer), Trilipix (AbbVie) and other prescription treatments for primary hyperlipidemia, mixed dyslipidemia and hypertriglyceridemia (such as statins and niacin).

In addition, other products are in research or development by competitors that address the diseases and diagnostic procedures being targeted by these and our other products.

Failure to integrate Santarus or other acquired businesses into our operations successfully could adversely affect our business.

Our strategy is to identify and acquire rights to products that we believe have potential for near-term regulatory approval or are already approved, through the purchase or license of products and the purchase of companies. Our integration of the operations of acquired products and businesses, including Santarus, which we acquired on January 2, 2014, and Oceana, which we acquired in December 2011 and which includes foreign employees and operations, requires significant efforts, including the coordination of information technologies, research and development, sales and marketing, operations, manufacturing and finance. These efforts result in additional expenses and involve significant amounts of management s time. In addition, acquisitions may result in our assumption of unknown and/or unexpected, and perhaps material, liabilities. Factors that will affect the success of our acquisitions, including the acquisition of Santarus, include the strength of the acquired companies or products underlying technology, our ability to execute our business strategy, results of clinical trials, regulatory approvals and reimbursement levels of the acquired products and related procedures, our ability to adequately fund acquired in-process research and development projects and retain key employees, and our ability to achieve financial and operational synergies with our acquired companies and products, such as by increasing sales of our products, achieving cost savings and effectively combining technologies to develop new products. Our failure to manage successfully and coordinate the growth of these acquisitions could have a material adverse impact on our business. In addition, we cannot be certain that the businesses or products we acquire will become profitable or remain so or that we will realize that operational cost savings or other expected synergies of an acquisition. If an acquisition is not successful, we may record related asset impairment charges in the future.

We have incurred, and will continue to incur, significant costs in connection with our acquisition of Santarus.

We have incurred and expect to continue to incur a number of non-recurring costs associated with combining our operations with Santarus s operations. These costs and expenses include the incurrence of $1.95 billion of new indebtedness, financial advisory, legal, accounting, consulting and other advisory fees and expenses, reorganization and restructuring costs, severance/employee benefit-related expenses, filing fees, printing expenses and other related charges. There are also a large number of processes, policies, procedures, operations, technologies and systems that must be integrated in connection with the acquisition. While both we and Santarus have assumed that a certain level of expenses would be incurred in connection with our acquisition of Santarus, there are many factors beyond our control that could affect the total amount or the timing of the integration and implementation expenses.

We also may incur additional unanticipated costs in connection with the acquisition of Santarus that we may not recoup. These costs and expenses could, particularly in the near term, exceed the cost savings that we expect to achieve from the elimination of duplicative expenses and the realization of economies of scale, other efficiencies and cost savings. Although we expect that these savings will offset these integration and implementation costs over time, this net benefit may not be achieved in the near term or at all.

Uncertainties associated with our acquisition of Santarus may cause a loss of employees and may otherwise affect our future operations.

Our success will depend in part upon our ability to retain our key employees. Key employees may depart because of issues relating to the uncertainty and difficulty of integration or a desire not to remain us. As a result, we may not retain key employees to the same extent that we and Santarus have been able to retain their own employees in the past, which could have a negative impact on the our business. If key employees depart, the integration of Santarus may be more difficult and our business and results of operations could be harmed.

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We could be exposed to significant product liability claims that could prevent or interfere with our product commercialization efforts.

We have been in the past and might continue to be subjected to product liability claims that arise through the testing, manufacturing, marketing and sale of our products. We currently have liability coverage for both clinical trials and the commercialization of our products other than claims with regard to Osmoprep and Visicol filed prior to August 31, 2010, but it is possible that this coverage and any future coverage will be insufficient to satisfy any liabilities that arise. We would have to assume defense of the lawsuits and be responsible for damages, fees and expenses, if any, that are awarded against us or for amounts in excess of our product liability coverage. These claims could expose us to significant liabilities that could prevent or interfere with our product commercialization efforts. Product liability claims could require us to spend significant time and money in litigation or to pay significant damages. In the future, we might not be able to obtain adequate coverage at an acceptable cost or might be unable to obtain adequate coverage at all.

If government and other third-party payors do not provide coverage or reimburse patients for our products, our ability to derive revenues might suffer.

Our success will depend in part on the extent to which government and health administration authorities, private health insurers and other third-party payors will pay for our products. Reimbursement for newly approved healthcare products is uncertain. We acquired our first medical devices in December 2011, one of which was launched in 2011, and we are navigating the complex medical device reimbursement system.

In the United States and elsewhere, third-party payors, such as Medicaid, are increasingly challenging the prices charged for medical products and services. Government and other third-party payors are increasingly attempting to contain healthcare costs by limiting both coverage and the level of reimbursement for new therapeutic products. In the United States, a number of legislative and regulatory proposals aimed at changing the healthcare system have been passed in recent years, including the Affordable Care Act. Many significant changes in this legislation do not take effect until 2014. These changes to the healthcare system could increase our costs and reduce the amount we can charge for our products. In addition, an increasing emphasis on managed care in the United States has and will continue to increase pressure on pharmaceutical and medical device pricing. While we cannot predict whether legislative or regulatory proposals will be adopted or what effect those proposals or managed care efforts, including those relating to Medicaid payments, might have on our business, the announcement and/or adoption of such proposals or efforts could increase costs and reduce or eliminate profit margins, which could have a material adverse effect on our business, financial condition and results of operations. Third-party insurance coverage might not be available to patients for our products. If government and other third-party payors do not provide adequate coverage and reimbursement levels for our products, the market acceptance of these products might be reduced.

Our ability to increase revenue in the future will depend in part on our success in in-licensing or acquiring additional pharmaceutical products or medical devices.

We currently intend to in-license or acquire additional pharmaceutical products or medical devices, as we did with crofelemer and budesonide, that have been developed beyond the initial discovery phase and for which late-stage human clinical data is already available, or as we did with Relistor, Deflux and Solesta, that have already received regulatory approval. As we have grown, there are fewer of these opportunities that are large enough to have a material impact on our revenues, and we might encounter more competition from larger companies for these opportunities. In addition, these kinds of pharmaceutical products and medical devices might not be available to us on attractive terms or at all. To the extent we acquire rights to additional products, we might incur significant additional expense in connection with the development and, if approved by the FDA, marketing of these products.

We are dependent on third parties to supply us with products.

We rely entirely on third parties to supply us with our commercially marketed products and our products under development, and it may be difficult or impossible to obtain these products or the raw materials used to produce them. The raw material used in production of the crofelemer drug substance, our anti-secretory agent that is approved for marketing in the United States under the trade name Fulyzaq for the treatment of HIV-associated diarrhea, grows in select countries in South America. In addition, a key raw material for Relistor grows in Tasmania. Our ability to successfully obtain raw materials is not within our control. Failure to obtain these raw materials, whether due to international, political or economic conditions or otherwise, could delay development, increase expenses, delay regulatory approval, or eventually prevent us from generating revenue from additional indications for crofelemer or Relistor, if approved, which could have a material adverse effect on our business. Likewise, interruption of supply of any of our other products, whether for clinical use or commercial use, could have a material adverse effect on our business.

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We do not have any manufacturing facilities and are dependent on third parties to manufacture our products.

We own no manufacturing facilities, and we have limited capabilities in manufacturing pharmaceutical products. We do not generally expect to engage directly in the manufacturing of products, but instead contract with and rely on third-party vendors for these services. A limited number of contract manufacturers exist which are capable of manufacturing our marketed products and our product candidates. Our manufacturers must comply with U.S. regulations, including current Good Manufacturing Practices, or cGMP, regulations relating to manufacturing, packaging, documentation, quality control and quality assurance, and their facilities must be inspected and approved by the FDA and other regulatory agencies on an ongoing basis. We may be subject to serious consequences if our manufacturers are found to have deficiencies in their manufacturing processes, including potential delays in the regulatory approval process for our drug candidates and recalls of our commercialized products. For example, in April 2010 we received a CRL from the FDA related to our NDA for balsalazide disodium tablets. The sole issue raised in this letter concerned a deficiency of the manufacturing facility for this application, which delayed FDA approval almost two years. Given our ongoing dependence on third-party vendors for supply of material for use in clinical trials and for commercial product, our manufacturing strategy presents the following risks:

- the manufacture of products might be difficult to scale up when required and result in delays, inefficiencies and poor or low yields of quality products;
- some of our contracts contain purchase commitments that require us to make minimum purchases that might exceed our needs or limit our ability to negotiate with other manufacturers, which might increase costs;
- the cost of manufacturing certain products might make them prohibitively expensive;
- delays in scale-up to commercial quantities and any change in manufacturers could delay clinical studies, regulatory submissions and commercialization of our products;
- manufacturers are subject to the FDA s cGMP regulations and similar foreign standards, and we do not have control over compliance with these regulations by the third-party manufacturers;
- if we need to change manufacturers, transfers of technical expertise would be required which would include educating the new manufacturer in the processes necessary for the production of our products, which might not be successful; and
- if we need to change manufacturers, FDA and comparable foreign regulators might require additional testing and compliance inspections prior to the new manufacturer being qualified for the production of our products.

Any manufacturing defect or error discovered after products have been produced and distributed could result in even more significant consequences, including:

delays, warning letters and fines;

product recalls or seizures and injunctions on sales;

refusal of the FDA to review pending applications;

total or partial suspension of production;

withdrawals of previously approved marketing applications;

damage to our reputation; and

product liability claims, civil penalties and criminal prosecutions.

In addition, the occurrence of manufacturing-related compliance issues could require subsequent withdrawal of the drug approval, reformulation of the drug product, additional testing or changes in labeling of the finished product. Any delay, interruption or cessation of production by our third-party manufacturers or strategic partners of our commercial products or product candidates, or their respective materials and components, as a result of any of the above factors or otherwise, may limit our ability to meet demand for commercial products and/or delay ongoing clinical trials, either of which could have a material adverse effect on our business, results of operations and financial condition.

Because our business and industry are highly regulated and scrutinized, any failure to follow such regulations could result in litigation or government enforcement actions that could have a material adverse effect on our business and results of operations.

Our business and industry are highly regulated and scrutinized, and subject to litigation risks, including product liability risks described above and the risk of government enforcement actions. We are subject to extensive and complex laws and regulations, including but not limited to, health care fraud and abuse laws, such as the federal False Claims Act, the federal Anti-Kickback Statute, other state and federal laws and regulations, and, with respect to our international operations, U.S. laws such as the Foreign Corrupt Practices Act, or FCPA, local laws such as the UK Bribery Act 2010, and various foreign laws and regulations. While we have developed and implemented a corporate compliance program designed to promote compliance with applicable laws and

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regulations, we cannot guarantee that this program will protect us from governmental investigations or other actions or lawsuits stemming from a failure or alleged failure to be in compliance with such laws or regulations. In recent years, there has been a heightened risk of governmental investigations into pharmaceutical companies sales and promotional practices for their products, including off-label uses, as evidenced by recent enforcement activity and/or pronouncements by the Office of Inspector General of the Department of Health and Human Services, the Department of Justice and state attorneys general. Matters underlying governmental investigations may also be the subject of private litigation. See the risk factor entitled Regulatory approvals, even if granted, might entail ongoing requirements or restrictions on marketing. These requirements or restrictions, or inquiries into our marketing practices, could increase our expenses and limit revenue above, and Part II. Item 1. Legal Proceedings for information about a pending federal government investigation concerning our sales and promotional practices for Xifaxan, Relistor and Apriso. If we are not successful in defending ourselves or asserting our rights in this investigation, or any other investigation or litigation, we could incur significant damages, fines or other penalties, which could have a material adverse effect on our business and results of operations.

We are subject to numerous environmental laws and regulations and any failure to comply with such laws and regulations could have a material adverse effect on our business and results of operations.

Our research, development and manufacturing efforts, and those of third parties that research, develop and manufacture our products and product candidates on our behalf or in collaboration with us, involve the controlled use of hazardous materials, including chemicals, viruses, bacteria and various radioactive compounds, and are therefore subject to numerous U.S. and international environmental and safety laws and regulations and to periodic inspections for possible violations of these laws and regulations. In addition, we, and our collaborators and third-party manufacturers may also become subject to laws and regulations related to climate change, including the impact of global warming. The costs of compliance with environmental and safety laws and regulations are significant, and the costs of complying with climate change laws could also be significant. Any violations, even if inadvertent or accidental, of current or future environmental, safety or climate change laws or regulations could subject us to substantial fines, penalties or environmental remediation costs, or cause us to lose permits or other authorizations to operate affected facilities, any of which could adversely affect our operations.

We are subject to complex laws and regulations governing our employees and contractors and any failure to comply with such laws and regulations could have a material adverse effect on our business and results of operations.

The laws and regulations applicable to our relationships with our employees and contractors are complex, extensive and fluid, and are subject to evolving interpretations by regulatory and judicial authorities. Failure to comply with these laws and regulations could result in significant damages, orders and/or fines and therefore could adversely affect our operations.

Our results of operations might fluctuate from period to period, and a failure to meet the expectations of investors or the financial community at large could result in a decline in our stock price.

As they have in the past, our results of operations might fluctuate significantly on a quarterly and annual basis due to, among other factors:

- the timing of regulatory approvals and product launches by us or competitors, including potential generic or over-the-counter competitors;

the level of revenue generated by commercialized products, including potential (1) increased purchases of inventory by wholesalers in anticipation of potential price increases or introductions of new dosages or bottle sizes, and subsequent lower than expected revenue as the inventory is used, or (2) decreased purchases of inventory by wholesalers (or wholesaler demands for increased product discounts) as a result of wholesalers holding a significant number of months of inventory of our key products;

the timing of any up-front payments that might be required in connection with any future acquisition of product rights;

the timing of milestone payments that might be required to our current or future licensors;

fluctuations in our development and other costs in connection with ongoing product development programs;

the level of marketing and other expenses required in connection with product launches and ongoing product growth;

the timing of the acquisition and integration of businesses, assets, products and technologies; and

general and industry-specific business and economic conditions.

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We may not be able to generate sufficient cash to service all of our indebtedness and may be forced to take other actions to satisfy our obligations under our indebtedness, which may not be successful.

Our ability to make scheduled payments on or to refinance our debt obligations depends on our financial condition and operating performance, which is subject to prevailing economic and competitive conditions and to certain financial, business and other factors beyond our control. We may be unable able to maintain a level of cash flows from operating activities sufficient to permit us to pay the principal, premium, if any, and interest on our indebtedness, including the notes.

If our cash flows and capital resources are insufficient to fund our debt service obligations, we may be forced to reduce or delay investments and capital expenditures, or to sell assets, seek additional capital or restructure or refinance our indebtedness. Our ability to restructure or refinance our debt will depend on the condition of the capital markets and our financial condition at such time. Any refinancing of our debt could be at higher interest rates and may require us to comply with more onerous covenants, which could further restrict our business operations. The terms of our credit agreement, other existing or future debt instruments and the indenture governing the 2021 Notes may restrict us from adopting some of these alternatives. In the absence of such operating results and resources, we could face substantial liquidity problems and might be required to dispose of material assets or operations to meet our debt service and other obligations. The credit agreement and the indenture governing the 2021 Notes restrict our ability to dispose of assets and use the proceeds from the disposition. We may not be able to consummate those dispositions or to obtain the proceeds that we could realize from them, and these proceeds may not be adequate to meet any debt service obligations then due. These alternative measures may not be successful and may not permit us to meet our scheduled debt service obligations.

We are a holding company that depends on cash flows from our wholly owned subsidiaries to meet our obligations.

We are a holding company conducting substantially all of our operations through our subsidiaries, and all of our consolidated operating assets are held by our subsidiaries. Accordingly, we rely on the operations of our subsidiaries to fund payments on our indebtedness. Our subsidiaries are legally distinct from us and, under certain circumstances, legal and contractual restrictions may limit our ability to obtain cash from them. We and certain of our subsidiaries have entered into agreements limiting the ability of these subsidiaries to incur consensual encumbrances or restrictions on their ability to pay dividends or make other intercompany payments to us, but these limitations are subject to certain qualifications and exceptions. In the event that we do not receive distributions from our subsidiaries, we may be unable to make required principal and interest payments on our indebtedness.

Our stock price is volatile.

Our stock price has been extremely volatile and might continue to be, making owning our stock risky. Between January 1, 2011 and February 24, 2014, the price of a share of our common stock varied from a low of $25.64 to a high of $108.87. Our stock price increased or decreased by 5% or more on 15 days in 2011, 4 days in 2012 and 5 days in 2013.

The securities markets have experienced significant price and volume fluctuations unrelated to the performance of particular companies, including as a result of the recent credit and economic crisis. In addition, the market prices of the common stock of many publicly traded pharmaceutical and biotechnology companies have in the past been and can in the future be expected to be especially volatile. Announcements of strategic transactions, prescription trends, technological innovations or new products by us or our competitors, generic approvals, developments or disputes concerning proprietary rights, publicity regarding actual or potential medical results relating to products under

development by us or our competitors, regulatory developments in both the United States and other countries, public concern as to the safety of pharmaceutical products, economic and other external factors, period-to-period fluctuations in financial results, and stock market speculation regarding any of these factors, might have a significant impact on the market price of our common stock.

Provisions in our charter documents and under Delaware law could discourage a takeover or changes in our current directors or management that stockholders consider favorable.

Provisions in our certificate of incorporation and amended and restated bylaws could have the effect of discouraging, delaying or preventing a takeover or other change of control of us or the removal of our current directors and management, even if these events could be beneficial to stockholders. These provisions, which could also limit the price that investors might be willing to pay for our common stock, include the following:

Our stockholders may not act by written consent. As a result, a stockholder, or stockholders, controlling a majority of our common stock would not be able to take certain actions without holding a stockholders meeting.

Our board of directors may issue, without stockholder approval, up to 5,000,000 shares of undesignated preferred stock. The ability to issue undesignated preferred stock makes it possible for our board of directors to issue preferred stock with voting or other rights or preferences that could impede the success of any attempt to acquire us.

Only our board of directors has the right to elect directors to fill vacancies created by the expansion of the board of directors or the resignation, death, or removal of directors, which prevents stockholders from being able to fill vacancies on our board of directors.

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Stockholders must provide advance notice to nominate individuals for election to our board of directors or to propose matters that can be acted upon at a stockholders meeting. These provisions might discourage or deter a potential acquirer from conducting a solicitation of proxies to elect the acquirer s own slate of directors or otherwise attempting to obtain control of our company.

As a Delaware corporation, we are also subject to certain Delaware anti-takeover provisions. Under Delaware law, a corporation may not engage in a business combination with any holder of 15% or more of its capital stock unless the holder has held the stock for three years or, among other things, the board of directors has approved the transaction. Our board of directors could rely on Delaware law to prevent or delay an acquisition of us.

Risks Relating to the Restatement

Implementing our plan to decrease wholesaler inventory levels will adversely affect our revenues.

In connection with the Audit Committee s review, which began in Fall 2014, of Salix s financial statements and related disclosures, our Audit Committee and management determined that wholesaler inventory levels of XIFAXAN® 550, APRISO® and UCERIS® were greater, at approximately 9 months, 9 months and 5 months, respectively, as of September 30, 2014, than our target (established in Fall 2014) of approximately 3 months. In order to reduce wholesaler inventory levels to meet this target by the end of 2015, we intend to sell to our wholesalers amounts of XIFAXAN® 550, APRISO® and UCERIS® that are less than end-user demand until the target levels are reached. As a result, our revenue and cash flows may be decreased in the fourth quarter of 2014 and the full year 2015, compared to prior periods. In addition, wholesalers may demand increased discounts on our products, which could further decrease revenue and cash flows, and it may take longer than anticipated to reach our target wholesaler inventory levels, which could result in decreased revenues and cash flows for a longer period than anticipated.

We are restating certain prior consolidated financial statements, which may lead to additional risks and uncertainties, including shareholder litigation and governmental investigations, loss of investor confidence, and negative impacts on our stock price.

As discussed in the Explanatory Note to this Form 10-Q/A and in Note 1A to the Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q/A, we are restating our unaudited consolidated financial statements for the three months ended March 31, 2014. The determination to restate these financial statements was made by our Audit Committee, after discussion with management and EY, following the identification of certain errors in its accounting, which are primarily associated with the timing of recognition of certain revenue, revenue-reducing returns and discounts, and expenses. As a result of these events, we have become subject to a number of additional risks and uncertainties, including substantial unanticipated costs for accounting and legal fees in connection with or related to the restatement and potential shareholder litigation and governmental investigations. We will incur additional substantial defense and investigation costs regardless of the outcome of any such litigation or governmental investigation. Likewise, such events may cause a diversion of our management s time and attention. If we do not prevail in any such litigation or governmental investigation, we could be required to pay substantial damages or settlement costs. In addition, the fact that we have completed a restatement may lead to a loss of investor confidence and have negative impacts on the trading price of our common stock.

If we are unable to maintain effective internal control over financial reporting in the future, the accuracy and timeliness of our financial reporting may be adversely affected.

Maintaining effective internal control over financial reporting is necessary for us to produce reliable financial statements. In connection with the restatement of our unaudited interim consolidated financial statements in this Form 10-Q/A, management, including our Acting Chief Executive Officer and Acting Chief Financial Officer, reassessed

the effectiveness of our internal control over financial reporting as of March 31, 2014. Based on this reassessment using the criteria set forth by the Committee of Sponsoring Organizations of the Treadway Commission (COSO) in Internal Control Integrated Framework (2013 framework), management has concluded that we did not maintain effective internal control over financial reporting as of March 31, 2014 because we did not (1) establish and maintain adequate procedures and controls for (a) product returns and for the communications between our sales and accounting/finance functions to record agreed upon returns and (b) the recognition of sales to customers with FOB Destination shipping terms, (2) comply with established policies to properly obtain, evaluate, review and approve agreements with customers and (3) periodically review and assess our account classification policies in light of changes in our organization, management and personnel over time, and the effect of non-routine transactions. These control deficiencies resulted in the restatement of our unaudited consolidated financial statements as of December 31, 2013, as discussed in further detail in the Explanatory Note to this Form 10-Q/A and Note 1A to the Consolidated Financial Statements included in Part I, Item 1 of this Form 10-Q/A. We are actively engaged in developing and implementing remediation plans designed to address this material weakness. If we are unable to effectively remediate these material weaknesses or we are otherwise unable to maintain effective internal control over financial reporting, , it could result in another material misstatement of our financial statements that would require a restatement, investor confidence in the accuracy and timeliness of our financial reports may be impacted, and the market price of our common stock could be negatively impacted.

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Item 6. Exhibits

Exhibit Number	Description of Document	Registrant s Form	Dated	Exhibit Number	Filed Herewith
31.1	Certification by the Acting Chief Executive Officer pursuant to Section 240.13a-14 or Section 240.15d-14 of the Securities and Exchange Act of 1934, as amended.				X
31.2	Certification by the Acting Chief Financial Officer pursuant to Section 240.13a-14 or Section 240.15d-14 of the Securities and Exchange Act of 1934, as amended.				X
32.1	Certification by the Acting Chief Executive Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				X
32.2	Certification by the Acting Chief Financial Officer pursuant to 18 U.S.C. 1350 as adopted pursuant to Section 906 of the Sarbanes-Oxley Act of 2002.				X
101	Financials in XBRL format				X

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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.

SALIX PHARMACEUTICALS, LTD.

Date: March 2, 2015

By: /s/ THOMAS W. D ALONZO
Thomas W. D Alonzo
Acting Chief Executive Officer

Date: March 2, 2015

By: /s/ TIMOTHY J. CREECH
Timothy J. Creech
Senior Vice President, Finance & Administration, and

Acting Chief Financial Officer

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