

IRONWOOD PHARMACEUTICALS INC
Form 10-Q
May 02, 2019
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2019

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: 001-34620

IRONWOOD PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

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Delaware
(State or other jurisdiction of
incorporation or organization)

04-3404176
(I.R.S. Employer
Identification Number)

301 Binney Street
Cambridge, Massachusetts
(Address of Principal Executive Offices)

02142
(Zip Code)

(617) 621-7722

(Registrant's telephone number, including area code)

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

Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit such files): Yes No

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

Large accelerated filer Accelerated filer

Non-accelerated filer Smaller reporting company

Emerging growth company

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

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

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

Title of each class	Trading Symbol(s)	Name of each exchange on which registered
Class A common stock, \$0.001 par value	IRWD	Nasdaq Global Select Market

As of April 30, 2019, there were 155,621,305 shares of Class A common stock outstanding.

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NOTE REGARDING FORWARD-LOOKING STATEMENTS

This Quarterly Report on Form 10-Q, including the sections titled “Management’s Discussion and Analysis of Financial Condition and Results of Operations” and “Risk Factors”, contains forward-looking statements. All statements contained in this Quarterly Report on Form 10-Q other than statements of historical fact are forward-looking statements. Forward-looking statements include statements regarding our future financial position, business strategy, budgets, projected costs, plans and objectives of management for future operations. The words “may,” “continue,” “estimate,” “intend,” “plan,” “will,” “believe,” “project,” “expect,” “seek,” “anticipate” and similar expressions may identify forward-looking statements but the absence of these words does not necessarily mean that a statement is not forward-looking. These forward-looking statements include, among other things, statements about:

- the demand and market potential for our products in the countries where they are approved for marketing, as well as the revenues therefrom;
- the timing, investment and associated activities involved in commercializing LINZESS® by us and Allergan plc in the U.S.;
- the timing and execution of the launches and commercialization of CONSTELLA® in Europe and LINZESS in Japan and China;
- the timing, investment and associated activities involved in developing, obtaining regulatory approval for, launching, and commercializing our products and product candidates by us and our partners worldwide;
- our ability and the ability of our partners to secure and maintain adequate reimbursement for our products;
- our ability and the ability of our partners and third parties to manufacture and distribute sufficient amounts of linaclotide active pharmaceutical ingredient, drug product and finished goods, as applicable, on a commercial scale;
- our expectations regarding U.S. and foreign regulatory requirements for our products and our product candidates, including our post-approval development and regulatory requirements;
- the ability of our product candidates to meet existing or future regulatory standards;
- the safety profile and related adverse events of our products and our product candidates;
- the therapeutic benefits and effectiveness of our products and our product candidates and the potential indications and market opportunities therefor;

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- our and our partners' ability to obtain and maintain intellectual property protection for our products and our product candidates and the strength thereof, as well as Abbreviated New Drug Applications filed by generic drug manufacturers and potential U.S. Food and Drug Administration approval thereof, and associated patent infringement suits that we have filed or may file, or other action that we may take against such companies, and the timing and resolution thereof;
- our and our partners' ability to perform our respective obligations under our collaboration, license and other agreements, and our ability to achieve milestone and other payments under such agreements;
- our plans with respect to the development, manufacture or sale of our product candidates and the associated timing thereof, including the design and results of pre-clinical and clinical studies;
- the in-licensing or acquisition of externally discovered businesses, products or technologies, as well as partnering arrangements, including expectations relating to the completion of, or the realization of the expected benefits from, such transactions;

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- our expectations as to future financial performance, revenues, expense levels, payments, cash flows, profitability, tax obligations, capital raising and liquidity sources, real estate needs and concentration of voting control, as well as the timing and drivers thereof, and internal control over financial reporting;
- our ability to repay our outstanding indebtedness when due, or redeem or repurchase all or a portion of such debt, as well as the potential benefits of the note hedge transactions described herein;
- inventory levels and write downs, or asset impairments, and the drivers thereof, and inventory purchase commitments;
- our ability to compete with other companies that are or may be developing or selling products that are competitive with our products and product candidates;
- the status of government regulation in the life sciences industry, particularly with respect to healthcare reform;
- trends and challenges in our potential markets;
- our ability to attract and motivate key personnel;
- any benefits or costs of the separation of the Company's operations into two independent, publicly traded companies, including the tax treatment; and
- other factors discussed elsewhere in this Quarterly Report on Form 10-Q.

Any or all of our forward-looking statements in this Quarterly Report on Form 10-Q may turn out to be inaccurate. These forward-looking statements may be affected by inaccurate assumptions or by known or unknown risks and uncertainties, including the risks, uncertainties and assumptions identified under the heading "Risk Factors" in this Quarterly Report on Form 10-Q. In light of these risks, uncertainties and assumptions, the forward-looking events and circumstances discussed in this Quarterly Report on Form 10-Q may not occur as contemplated, and actual results could differ materially from those anticipated or implied by the forward-looking statements.

You should not unduly rely on these forward-looking statements, which speak only as of the date of this Quarterly Report on Form 10-Q. Unless required by law, we undertake no obligation to publicly update or revise any forward-looking statements to reflect new information or future events or otherwise. You should, however, review the factors and risks we describe in the reports we will file from time to time with the U.S. Securities and Exchange Commission, or the SEC, after the date of this Quarterly Report on Form 10-Q.

NOTE REGARDING TRADEMARKS

LINZESS® and CONSTELLA® are trademarks of Ironwood Pharmaceuticals, Inc. ZURAMPIC® and DUZALLO® are trademarks of AstraZeneca AB. Any other trademarks referred to in this Quarterly Report on Form 10-Q are the property of their respective owners. All rights reserved.

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IRONWOOD PHARMACEUTICALS, INC.

QUARTERLY REPORT ON FORM 10-Q

FOR THE QUARTER ENDED MARCH 31, 2019

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PART I — FINANCIAL INFORMATION

Item 1. Financial Statements

Ironwood Pharmaceuticals, Inc.

Condensed Consolidated Balance Sheets

(In thousands, except share and per share amounts)

(unaudited)

	March 31, 2019	December 31, 2018
ASSETS		
Current assets:		
Cash and cash equivalents	\$ 119,045	\$ 173,172
Accounts receivable, net	3,291	20,991
Related party accounts receivable, net	69,326	59,959
Inventory, net	593	—
Prepaid expenses and other current assets	8,327	11,063
Restricted cash	1,250	1,250
Total current assets	201,832	266,435
Restricted cash, net of current portion	6,426	6,426
Property and equipment, net	19,017	17,270
Operating lease right-of-use assets	84,833	—
Convertible note hedges	50,589	41,020
Goodwill	785	785
Other assets	56	114
Total assets	\$ 363,538	\$ 332,050
LIABILITIES AND STOCKHOLDERS' DEFICIT		
Current liabilities:		
Accounts payable	\$ 11,203	\$ 18,123
Accrued research and development costs	9,734	8,219
Accrued expenses and other current liabilities	39,591	45,252
Capital lease obligations	—	73
Current portion of deferred rent	—	252
Current portion of 2026 Notes	45,961	47,554
Current portion of operating lease liabilities	12,080	—
Current portion of contingent consideration	—	51
Total current liabilities	118,569	119,524
Capital lease obligations, net of current portion	—	158
Deferred rent, net of current portion	—	6,308
Note hedge warrants	39,388	33,763
Convertible senior notes	269,947	265,601
Operating lease liabilities, net of current portion	79,950	—
2026 Notes, net of current portion	90,140	100,537
Other liabilities	2,723	2,530

Commitments and contingencies

Stockholders' deficit:

Preferred stock, \$0.001 par value, 75,000,000 shares authorized, no shares issued and outstanding	—	—
Class A common stock, \$0.001 par value, 500,000,000 shares authorized and 155,625,549 issued and outstanding at March 31, 2019 and 500,000,000 shares authorized and 154,414,691 shares issued and outstanding at December 31, 2018	156	154
Additional paid-in capital	1,413,077	1,394,603
Accumulated deficit	(1,650,412)	(1,591,128)
Total stockholders' deficit	(237,179)	(196,371)
Total liabilities and stockholders' deficit	\$ 363,538	\$ 332,050

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

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Ironwood Pharmaceuticals, Inc.

Condensed Consolidated Statements of Operations

(In thousands, except per share amounts)

(unaudited)

	Three Months Ended	
	March 31,	
	2019	2018
Revenues:		
Collaborative arrangements revenue	\$ 66,152	\$ 63,086
Product revenue, net	—	635
Sale of active pharmaceutical ingredient	2,578	5,434
Total revenues	68,730	69,155
Cost and expenses:		
Cost of revenues, excluding amortization of acquired intangible assets	1,043	2,607
Research and development	53,990	36,505
Selling, general and administrative	64,741	59,501
Amortization of acquired intangible assets	—	3,476
Loss on fair value remeasurement of contingent consideration	—	512
Restructuring expenses	3,328	2,422
Total cost and expenses	123,102	105,023
Loss from operations	(54,372)	(35,868)
Other (expense) income:		
Interest expense	(9,592)	(9,273)
Interest and investment income	736	681
Gain on derivatives	3,944	1,316
Other expense, net	(4,912)	(7,276)
Net loss	\$ (59,284)	\$ (43,144)
Net loss per share—basic and diluted	\$ (0.38)	\$ (0.29)
Weighted average number of common shares used in net loss per share—basic and diluted:	154,956	151,013

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

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Ironwood Pharmaceuticals, Inc.

Condensed Consolidated Statements of Comprehensive Loss

(In thousands)

(unaudited)

	Three Months Ended	
	March 31,	
	2019	2018
Net loss	\$ (59,284)	\$ (43,144)
Other comprehensive loss:		
Unrealized losses on available-for-sale securities	—	(12)
Total other comprehensive loss	—	(12)
Comprehensive loss	\$ (59,284)	\$ (43,156)

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

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Ironwood Pharmaceuticals, Inc.

Condensed Consolidated Statements of Stockholders' Deficit

(In thousands, except share amounts)

(unaudited)

	Class A common stock Shares	Amount	Additional paid-in capital	Accumulated deficit	Total Stockholders' deficit
Balance at December 31, 2018	154,414,691	154	1,394,603	(1,591,128)	\$ (196,371)
Issuance of common stock upon exercise of stock options and employee stock purchase plan	1,210,858	2	3,486	—	3,488
Share-based compensation expense related to share-based awards to employees and employee stock purchase plan	—	—	14,988	—	14,988
Net loss	—	—	—	(59,284)	(59,284)
Balance at March 31, 2019	155,625,549	\$ 156	\$ 1,413,077	\$ (1,650,412)	\$ (237,179)

	Class A common stock Shares	Amount	Class B common stock Shares	Amount	Additional paid-in capital	Accumulated deficit	Accumulated other comprehensive loss	Total Stockholders' deficit
Balance at December 31, 2017	136,465,526	137	13,983,762	14	1,318,536	(1,308,760)	(79)	9,844
Issuance of common stock upon exercise of stock options and employee stock purchase plan	882,448	1	272,146	—	6,193	—	—	6,194
Issuance of common stock awards	162	—	—	—	—	—	—	—
Conversion of Class B common	258,551	—	(258,551)	—	—	—	—	—

stock to Class A common stock								
Share-based compensation expense related to share-based awards to employees and employee stock purchase plan	—	—	—	—	9,062	—	—	9,062
Unrealized losses on available-for-sale securities	—	—	—	—	—	—	(12)	(12)
Net loss	—	—	—	—	—	(43,144)	—	(43,144)
Balance at March 31, 2018	137,606,687	\$ 138	13,997,357	\$ 14	\$ 1,333,791	\$ (1,351,904)	\$ (91)	\$ (91)

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

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Ironwood Pharmaceuticals, Inc.

Condensed Consolidated Statements of Cash Flows

(In thousands)

(unaudited)

	Three Months Ended March 31,	
	2019	2018
Cash flows from operating activities:		
Net loss	\$ (59,284)	\$ (43,144)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	1,242	1,790
Amortization of acquired intangible assets	—	3,476
Loss (gain) on disposal of property and equipment	586	(34)
Share-based compensation expense	14,988	9,043
Change in fair value of note hedge warrants	5,625	3,941
Change in fair value of convertible note hedges	(9,569)	(5,257)
Accretion of discount/premium on investment securities	—	(118)
Non-cash interest expense	4,609	4,239
Non-cash change in fair value of contingent consideration	—	512
Changes in assets and liabilities:		
Accounts receivable and related party accounts receivable, net	8,333	11,506
Prepaid expenses and other current assets	2,481	(1,647)
Inventory, net	(152)	(768)
Other assets	58	62
Accounts payable, related party accounts payable and accrued expenses	(13,454)	(12,300)
Accrued research and development costs	1,515	(2,640)
Operating lease right-of-use assets	3,466	—
Operating lease liabilities	(2,829)	—
Deferred rent	—	453
Net cash used in operating activities	(42,385)	(30,886)
Cash flows from investing activities:		
Purchases of available-for-sale securities	—	(2,491)
Sales and maturities of available-for-sale securities	—	48,620
Purchases of property and equipment	(3,235)	(1,509)
Proceeds from sale of property and equipment	258	33
Net cash (used in) provided by investing activities	(2,977)	44,653
Cash flows from financing activities:		
Proceeds from exercise of stock options and employee stock purchase plan	3,487	6,203
Payments on capital lease obligations	—	(827)
Principal payments on 2026 notes	(12,252)	—
Payments on contingent purchase price consideration	—	(91)
Net cash (used in) provided by financing activities	(8,765)	5,285

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Net (decrease) increase in cash, cash equivalents and restricted cash	(54,127)	19,052
Cash, cash equivalents and restricted cash, beginning of period	180,848	132,792
Cash, cash equivalents and restricted cash, end of period	\$ 126,721	\$ 151,844
Reconciliation of cash, cash equivalents, and restricted cash to the condensed consolidated balance sheets		
Cash and cash equivalents	\$ 119,045	\$ 144,788
Restricted cash	7,676	7,056
Total cash, cash equivalents, and restricted cash	\$ 126,721	\$ 151,844

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

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Ironwood Pharmaceuticals, Inc.

Notes to Condensed Consolidated Financial Statements

(unaudited)

1. Nature of Business

Overview

Ironwood Pharmaceuticals, Inc. (“Ironwood” or the “Company”) is a gastrointestinal (“GI”) healthcare company focused on creating medicines that make a difference for people living with GI diseases. The Company is advancing innovative product opportunities in areas of large unmet need, capitalizing on its proven development and commercial capabilities and its deep expertise in GI diseases. On April 1, 2019, the Company completed its tax-free spin-off of its soluble guanylate cyclase (“sGC”) business into a separate, publicly traded company called Cyclerion Therapeutics, Inc. (“Cyclerion”).

The Company’s commercial product, linaclotide, is available to adult men and women suffering from irritable bowel syndrome with constipation (“IBS-C”), or chronic idiopathic constipation (“CIC”), in certain countries around the world. Linaclotide is available under the trademarked name LINZESS® to adult men and women suffering from IBS-C or CIC in the United States (the “U.S.”) and Mexico and to adult men and women suffering from IBS-C in Japan. Linaclotide is available under the trademarked name CONSTELLA® to adult men and women suffering from IBS-C or CIC in Canada, and to adult men and women suffering from IBS-C in certain European countries.

The Company has formed strategic partnerships with leading pharmaceutical companies to support the development and commercialization of linaclotide throughout the world. The Company and its partner, Allergan plc (together with its affiliates, “Allergan”), began commercializing LINZESS in the U.S. in December 2012. Under the Company’s collaboration with Allergan for North America, total net sales of LINZESS in the U.S., as recorded by Allergan, are reduced by commercial costs incurred by each party, and the resulting amount is shared equally between the Company and Allergan. Allergan also has an exclusive license from the Company to develop and commercialize linaclotide in all countries other than China, Hong Kong, Macau, Japan and the countries and territories of North America (the “Allergan License Territory”). On a country-by-country and product-by-product basis in the Allergan License Territory, Allergan pays the Company a royalty as a percentage of net sales of products containing linaclotide as an active ingredient. In addition, Allergan has exclusive rights to commercialize linaclotide in Canada as CONSTELLA and in Mexico as LINZESS.

Astellas Pharma Inc. (“Astellas”), the Company’s partner in Japan, has an exclusive license to develop and commercialize linaclotide in Japan. In March 2017, Astellas began commercializing LINZESS for the treatment of adults with IBS-C in Japan, and in September 2018, Astellas began commercializing LINZESS for the treatment of adults with chronic constipation in Japan. The Company has a collaboration agreement with AstraZeneca AB (together with its affiliates, “AstraZeneca”), to co-develop and co-commercialize linaclotide in China, Hong Kong and Macau, with AstraZeneca having primary responsibility for the local operational execution. In January 2019, the National Medical Products Administration approved the marketing application for LINZESS for adults with IBS-C in China.

The Company and Allergan are exploring ways to enhance the clinical profile of LINZESS by studying linaclotide in additional indications, populations and formulations to assess its potential to treat various conditions. In July 2018, the Company announced the initiation of a Phase IIIb trial evaluating the efficacy and safety of linaclotide 290 mcg on multiple abdominal symptoms in addition to pain, including bloating and discomfort, in adult patients with IBS-C.

The Company and Allergan are also advancing MD-7246, a delayed release form of linaclotide, as an oral, intestinal, non-opioid pain relieving agent for patients suffering from abdominal pain associated with IBS with diarrhea (“IBS-D”).

The Company is advancing another GI development program, IW-3718, a gastric retentive formulation of a bile acid sequestrant, for the potential treatment of persistent gastroesophageal reflux disease (“GERD”). In June 2018, the Company initiated two Phase III clinical trials evaluating the safety and efficacy of IW-3718 in patients with persistent GERD.

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On April 1, 2019, Ironwood completed the previously announced separation of its sGC business, and certain other assets and liabilities, into a separate, independent publicly traded company (the “Separation”). The Separation was effected by means of a distribution of all of the outstanding shares of common stock, with no par value, of Cyclorion through a dividend of Cyclorion’s common stock, to Ironwood’s stockholders of record as of the close of business on March 19, 2019. Cyclorion is a clinical-stage biopharmaceutical company harnessing the power of sGC pharmacology to discover, develop, and commercialize breakthrough treatments for serious and orphan diseases. Cyclorion’s portfolio is comprised of several sGC stimulators, including olinciguat a vascular sGC stimulator in Phase II development, praliciguat a systemic sGC stimulator in Phase II development, and IW-6463, a central nervous system-penetrant sGC stimulator in Phase I development. The accompanying condensed consolidated financial statements and related disclosure are as of March 31, 2019 and do not reflect the effects of the Separation on the Company’s assets, liabilities, and stockholders’ deficit.

Additionally, the Company has periodically entered into co-promotion agreements to maximize its salesforce productivity. In December 2018 and in March 2019, the Company extended the VIBERZI Amendment, and in April 2019, the Company entered into a new agreement with Allergan, to continue sales detailing activities for VIBERZI, for treatment for adults suffering from IBS-D through December 2019.

These agreements are more fully described in Note 3, Collaboration, License, Co-Promotion and Other Commercial Agreements, to these condensed consolidated financial statements.

Basis of Presentation

The accompanying condensed consolidated financial statements and the related disclosures are unaudited and have been prepared in accordance with accounting principles generally accepted in the U.S. Additionally, certain information and footnote disclosures normally included in the Company’s annual financial statements have been condensed or omitted. Accordingly, these interim condensed consolidated financial statements should be read in conjunction with the consolidated financial statements and notes thereto contained in the Company’s Annual Report on Form 10-K for the year ended December 31, 2018, which was filed with the Securities and Exchange Commission on February 25, 2019 (the “2018 Annual Report on Form 10-K”).

The unaudited interim condensed consolidated financial statements have been prepared on the same basis as the audited consolidated financial statements and, in the opinion of management, reflect all normal recurring adjustments considered necessary for a fair presentation of the Company’s financial position as of March 31, 2019, and the results of its operations for the three months ended March 31, 2019 and 2018, its statements of stockholders’ deficit for the three months ended March 31, 2019 and 2018, and its cash flows for the three months ended March 31, 2019 and 2018. The results of operations for the three months ended March 31, 2019 and 2018 are not necessarily indicative of the results that may be expected for the full year or any other subsequent interim period.

Principles of Consolidation

The accompanying condensed consolidated financial statements include the accounts of Ironwood and its wholly owned subsidiaries as of March 31, 2019, including Cycleron, which on April 1, 2019 became an independent, publicly-traded company, Ironwood Pharmaceuticals Securities Corporation and Ironwood Pharmaceuticals GmbH. All intercompany transactions and balances are eliminated in consolidation.

Use of Estimates

The preparation of condensed consolidated financial statements in accordance with U.S. generally accepted accounting principles requires the Company's management to make estimates and judgments that may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, and the amounts of revenues and expenses during the reported periods. On an on-going basis, the Company's management evaluates its estimates, judgments and methodologies. Significant estimates and assumptions in the condensed consolidated financial statements include those related to revenue recognition; available-for-sale securities; accounts receivable; inventory valuation, and related reserves; impairment of long-lived assets, including goodwill; initial valuation procedures for right-of-use assets and operating lease liabilities; initial valuation procedures for the issuance of convertible notes; fair value of derivatives; balance sheet classification of notes payable and convertible notes; income taxes, including the valuation allowance for deferred tax assets; research and

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development expenses; contingencies and share-based compensation. The Company bases its estimates on historical experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ materially from these estimates under different assumptions or conditions. Changes in estimates are reflected in reported results in the period in which they become known.

Reclassifications of Prior Period Financial Statements

Certain prior period financial statement items, such as restructuring expenses, have been reclassified to conform to current period presentation.

Summary of Significant Accounting Policies

The Company's significant accounting policies are described in Note 2, Summary of Significant Accounting Policies, in the 2018 Annual Report on Form 10-K. During the three months ended March 31, 2019, the Company adopted the following additional significant accounting policies:

Leases

Effective January 1, 2019, the Company adopted Accounting Standards Codification ("ASC") Topic 842, Leases ("ASC 842") using the optional transition method. The adoption of ASC 842 represents a change in accounting principle that aims to increase transparency and comparability among organizations by requiring the recognition of right-of-use assets and lease liabilities on the balance sheet for both operating and finance leases. In addition, the standard requires enhanced disclosures that meet the objective of enabling financial statement users to assess the amount, timing, and uncertainty of cash flows arising from leases. The reported results for the three months ended March 31, 2019 reflect the application of ASC 842 guidance, while the reported results for prior periods were prepared in conjunction with ASC 840, Leases ("ASC 840"). Because there were no material changes to the values of capital leases as a result of adoption of ASC 842, the Company concluded that no cumulative-effect adjustment to the accumulated deficit as of January 1, 2019 was necessary.

The recognition of right-of-use assets and lease liabilities related to our operating leases under ASC 842 has had a material impact on the Company's condensed consolidated financial statements.

As part of the ASC 842 adoption, the Company has utilized certain practical expedients outlined in the guidance. These practical expedients include:

- Accounting policy election to use the short-term lease exception by asset class;
- Election of the practical expedient package during transition, which includes:
 - o An entity need not reassess whether any expired or existing contracts are or contain leases.
 - o An entity need not reassess the classification for any expired or existing leases. As a result, all leases that were classified as operating leases in accordance with ASC 840 are classified as operating leases under ASC 842, and all leases that were classified as capital leases in accordance with ASC 840 are classified as finance leases under ASC 842.
 - o An entity need not reassess initial direct costs for any existing leases.

The Company's lease portfolio as of the adoption date includes: a property lease for its headquarters location, a data center colocation lease, vehicle leases for its salesforce representatives, and leases for computer and office equipment. The Company determines if an arrangement is a lease at the inception of the contract. The asset component of the Company's operating leases are recorded as operating lease right-of-use assets, and the liability component is recorded as current portion of operating lease liabilities and operating lease liabilities, net of current portion in the Company's condensed consolidated balance sheets. As of March 31, 2019, the Company did not have any finance leases.

Right-of-use assets and operating lease liabilities are recognized based on the present value of lease payments over the lease term at the commencement date. Existing leases in the Company's lease portfolio as of the adoption date were valued as of January 1, 2019. The Company uses an incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments, if an implicit rate of return is not provided with the lease contract. Operating lease right-of-use assets are adjusted for incentives received.

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Lease cost is recognized on a straight-line basis over the lease term, and includes amounts related to short-term leases.

New Accounting Pronouncements

From time to time, new accounting pronouncements are issued by the Financial Accounting Standards Board (the “FASB”) or other standard setting bodies that are adopted by the Company as of the specified effective date. Except as set forth below, the Company did not adopt any new accounting pronouncements during the three months ended March 31, 2019 that had a material effect on its condensed consolidated financial statements.

In February 2016, the FASB issued ASU No. 2016-02, Leases (“ASU 2016-02”), which supersedes the lease accounting requirements in ASC Topic 840, Leases, and most industry-specific guidance with ASC Topic 842, Leases. ASU 2016-02 requires the identification of arrangements that should be accounted for as leases by lessees. In general, for lease arrangements exceeding a 12-month term, these arrangements must now be recognized as assets and liabilities on the balance sheet of the lessee. Under ASU 2016-02, a right-of-use asset and lease obligation will be recorded for all leases, whether operating or financing, while the income statement will reflect lease expense for operating leases and amortization and interest expense for financing leases. The balance sheet amount recorded for existing leases at the date of adoption of ASU 2016-02 must be calculated using the applicable incremental borrowing rate at the date of adoption. ASU 2016-02 is effective for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. Early adoption is permitted. In July 2018, the FASB issued ASU No. 2018-10, Leases (Topic 842), Codification Improvements (“ASU 2018-10”), ASU No. 2018-11, Leases (Topic 842), Targeted Improvements (“ASU 2018-11”), and ASU No. 2019-01 Leases (Topic 842), Codification Improvements (“ASU 2019-01”) to provide additional guidance for the adoption of Topic 842. ASU 2018-10 clarifies certain provisions and corrects unintended applications of the guidance, such as the rate implicit in a lease, impairment of the net investment in a lease, lessee reassessment of lease classifications, lessor reassessment of lease term and purchase options, variable payments that depend on an index or rate and certain transition adjustments. The amendments in ASU 2018-11 allow for an additional transition method, whereby at the adoption date the entity recognizes a cumulative-effect adjustment to the opening balance of retained earnings in the period of adoption, while the comparative period disclosures continue recognition under ASC Topic 840. Additionally, ASU 2018-11 includes a practical expedient for separating contract components for lessors. The Company adopted ASC Topic 842 using the optional transition method outlined in ASU 2018-11 as of January 1, 2019. The adoption of ASC Topic 842 resulted in the recognition of operating lease right-of-use assets of approximately \$88.3 million and corresponding lease liabilities of approximately \$94.9 million. The adoption of these ASUs did not have a material impact on the Company’s results of operations, however, the adoption resulted in significant changes to the Company’s financial statement disclosures.

In June 2016, the FASB issued ASU No. 2016-13, Measurement of Credit Losses on Financial Instruments (“ASU 2016-13”). ASU 2016-13 will change how companies account for credit losses for most financial assets and certain other instruments. For trade receivables, loans and held-to-maturity debt securities, companies will be required to recognize an allowance for credit losses rather than reducing the carrying value of the asset. ASU 2016-13 is effective for fiscal years beginning after December 15, 2019, including interim periods within those fiscal years. Early adoption is permitted. The Company is currently evaluating the potential impact that the adoption of ASU 2016-13 will have on the Company’s financial position and results of operations.

In October 2016, the FASB issued ASU No. 2016-16, Accounting for Income Taxes: Intra-Entity Asset Transfers of Assets Other than Inventory (“ASU 2016-16”). ASU 2016-16 eliminates the ability to defer the tax expense related to intra-entity asset transfers other than Inventory. Under the new standard, entities should recognize the income tax consequences on an intra-entity transfer of an asset other than inventory when the transfer occurs. ASU 2016-16 is effective for fiscal periods beginning after December 15, 2018. Early adoption is permitted. The Company adopted this standard during the three months ended March 31, 2019. The adoption of this standard did not have a material impact on the Company’s financial position and results of operations.

In January 2017, the FASB issued ASU No. 2017-04, Intangibles—Goodwill and Other (Topic 350) (“ASU 2017-04”) to simplify the accounting for goodwill impairment by removing Step 2 of the goodwill impairment test. ASU 2017-04 is effective for fiscal years beginning after December 15, 2019. Early adoption is permitted. The Company is evaluating the potential impact that the adoption of ASU 2017-04 may have on the Company’s financial position and results of operations.

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In June 2018, the FASB issued ASU No. 2018-07, Compensation—Stock Compensation (Topic 718) (“Topic 718”): Improvements to Nonemployee Share-Based Payment Accounting (“ASU 2018-07”). ASU 2018-07 expands the scope of Topic 718 to include share-based payment transactions for acquiring goods and services from non-employees, and as a result, the accounting for share-based payments to non-employees will be substantially aligned. ASU 2018-07 is effective for fiscal years beginning after December 15, 2018, including interim periods within that fiscal year. Early adoption is permitted but not earlier than an entity’s adoption date of Topic 606. The Company adopted this standard during the three months ended March 31, 2019. The adoption of ASU 2018-07 did not have a material impact on the Company’s financial position and results of operations.

In July 2018, the FASB issued ASU 2018-09, Codification Improvements (“ASU 2018-09”). The amendments in ASU 2018-09 affect a wide variety of Topics in the FASB codification and apply to all reporting entities within the scope of the affected accounting guidance. The Company has evaluated ASU 2018-09 in its entirety and determined that the amendments related to Topic 718-740, Compensation—Stock Compensation—Income Taxes, are the only provisions that currently apply to the Company. The amendments in ASU 2018-09 related to Topic 718-740, Compensation—Stock Compensation—Income Taxes, clarify that an entity should recognize excess tax benefits related to stock compensation transactions in the period in which the amount of the deduction is determined. The amendments in ASU 2018-09 related to Topic 718-740 are effective for fiscal years beginning after December 15, 2018, with early adoption permitted. The Company adopted this standard during the three months ended March 31, 2019. The adoption of this standard did not have a material impact on the Company’s financial position and results of operations.

In August 2018, the FASB issued ASU No. 2018-13, Fair Value Measurement (Topic 820): Disclosure Framework—Changes to the Disclosure Requirement for Fair Value Measurement (“ASU 2018-13”) which amends the disclosure requirements for fair value measurements. The amendments in ASU 2018-13 are effective for fiscal years beginning after December 15, 2019, with early adoption permitted. The Company is currently evaluating the potential impact that the adoption of ASU 2018-13 may have on the Company’s financial position and results of operations.

In August 2018, the FASB issued ASU No. 2018-15, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement that is a Service Contract (a consensus of the FASB Emerging Issues Task Force) (“ASU 2018-15”) which provides additional guidance on the accounting for costs of implementation activities performed in a cloud computing arrangement that is a service contract. The amendments in ASU 2018-15 are effective for fiscal years beginning after December 15, 2019, with early adoption permitted. The Company is currently evaluating the potential impact that the adoption of ASU 2018-15 may have on the Company’s financial position and results of operations.

In October 2018, the FASB issued ASU No. 2018-17, Consolidation (Topic 810): Targeted Improvements to Related Party Guidance for Variable Interest Entities (“ASU 2018-17”). The update is intended to improve general purpose financial reporting by considering indirect interests held through related parties in common control arrangements on a proportional basis for determining whether fees paid to decision makers and service providers are variable interests. The amendments in ASU 2018-17 will be effective for fiscal years beginning after December 15, 2019, with early adoption permitted. The Company is currently evaluating the potential impact that the adoption of ASU 2018-17 may have on the Company’s financial position and results of operations.

No other accounting standards known by the Company to be applicable to it that have been issued by the FASB or other standard-setting bodies and that do not require adoption until a future date are expected to have a material impact on the Company's consolidated financial statements upon adoption.

2. Net Loss Per Share

Basic and diluted net loss per common share is computed by dividing net loss by the weighted average number of common shares outstanding during the period.

In June 2015, in connection with the issuance of approximately \$335.7 million in aggregate principal amount of the 2022 Notes, the Company entered into convertible note hedge transactions (the "Convertible Note Hedges"). The Convertible Note Hedges are generally expected to reduce the potential dilution to the Company's Class A common stockholders upon a conversion of the 2022 Notes and/or offset any cash payments the Company is required to make in excess of the principal amount of converted 2022 Notes in the event that the market price per share of the Company's Class A common stock, as measured under the terms of the Convertible Note Hedges, is greater than the conversion

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price of the 2022 Notes (Note 8). The Convertible Note Hedges are not considered for purposes of calculating the number of diluted weighted average shares outstanding, as their effect would be antidilutive.

Concurrently with entering into the Convertible Note Hedges, the Company also entered into certain warrant transactions in which it sold note hedge warrants (the “Note Hedge Warrants”) to the Convertible Note Hedge counterparties to acquire 20,249,665 shares of the Company’s Class A common stock, subject to customary anti-dilution adjustments. The Note Hedge Warrants could have a dilutive effect on the Company’s Class A common stock to the extent that the market price per share of the Class A common stock exceeds the applicable strike price of such warrants (Note 8). The Note Hedge Warrants are not considered for purposes of calculating the number of diluted weighted averages shares outstanding, as their effect would be antidilutive. As a result of the Separation, effective April 15, 2019, the conversion rate under the indenture was adjusted from 60.3209 to 68.9172 shares of Ironwood common stock per \$1,000 principal amount of the 2022 Notes (Note 13).

The following potentially dilutive securities have been excluded from the computation of diluted weighted average shares outstanding as their effect would be anti-dilutive (in thousands):

	Three Months Ended March 31,	
	2019	2018
Options to purchase common stock	24,080	22,973
Shares subject to repurchase	32	31
Restricted stock units	3,641	3,230
Shares subject to issuance under Employee Stock Purchase Plan	125	138
Note hedge warrants	20,250	20,250
2022 Notes	20,250	20,250
	68,378	66,872

3. Collaboration, License, Co-Promotion and Other Commercial Agreements

For the three months ended March 31, 2019, the Company had linaclotide collaboration agreements with Allergan for North America and AstraZeneca for China, Hong Kong and Macau, as well as linaclotide license agreements with Astellas for Japan and with Allergan for the Allergan License Territory. The Company also had agreements with Allergan to co-promote VIBERZI in the U.S. The following table provides amounts included in the Company’s condensed consolidated statements of operations as collaborative arrangements revenue and sale of active

pharmaceutical ingredient (“API”) attributable to transactions from these arrangements (in thousands):

	Three Months Ended	
	March 31,	
Collaborative Arrangements Revenue	2019	2018
Linaclotide Agreements:		
Allergan (North America)	\$ 64,785	\$ 61,599
Allergan (Europe and other)	420	272
Co-Promotion and Other Agreements:		
Allergan (VIBERZI)	—	750
Other	947	465
Total collaborative arrangements revenue	\$ 66,152	\$ 63,086
Sale of API (1)		
Linaclotide Agreements:		
Astellas (Japan)	\$ 2,575	\$ 5,434
Other (1)	3	—
Total sale of API	\$ 2,578	\$ 5,434

(1) Sale of API includes an insignificant amount of revenue from the sale of drug product to AstraZeneca in China during the three months ended March 31, 2019.

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Accounts receivable, net and related party accounts receivable, net totaled approximately \$72.6 million related to collaborative arrangements revenue and sale of API as of March 31, 2019, net of approximately \$2.7 million related to related party accounts payable.

As of March 31, 2019, there were no impairment indicators for the accounts receivable recorded. During the three months ended March 31, 2019, there was no significant unusual activity in accounts receivable.

Linaclotide Agreements

Collaboration Agreement for North America with Allergan

In September 2007, the Company entered into a collaboration agreement with Allergan to develop and commercialize linaclotide for the treatment of IBS-C, CIC and other GI conditions in North America. Under the terms of this collaboration agreement, the Company received a non-refundable, upfront licensing fee and shares equally with Allergan all development costs as well as net profits or losses from the development and sale of linaclotide in the U.S. The Company receives royalties in the mid-teens percent based on net sales in Canada and Mexico. Allergan is solely responsible for the further development, regulatory approval and commercialization of linaclotide in those countries and funding any costs. The collaboration agreement for North America also includes contingent milestone payments, as well as a contingent equity investment, based on the achievement of specific development and commercial milestones. At March 31, 2019, \$205.0 million in license fees and all six development milestone payments had been received by the Company, as well as a \$25.0 million equity investment in the Company's capital stock (Note 11). The Company can also achieve up to \$100.0 million in a sales-related milestone if certain conditions are met, which will be recognized as collaborative arrangements revenue when it is probable that a significant reversal of revenue would not occur and the associated constraints have been lifted.

As a result of the research and development cost-sharing provisions of the linaclotide collaboration for North America, the Company offset approximately \$3.2 million in incremental research and development costs during the three months ended March 31, 2019 and recognized approximately \$1.4 million in incremental research and development costs during the three months ended March 31, 2018, to reflect the obligations of each party under the collaboration to bear half of the development costs incurred.

The Company and Allergan began commercializing LINZESS in the U.S. in December 2012. The Company receives 50% of the net profits and bears 50% of the net losses from the commercial sale of LINZESS in the U.S. Net profits or net losses consist of net sales of LINZESS to third-party customers and sublicense income in the U.S. less the cost of goods sold as well as selling, general and administrative expenses. LINZESS net sales are calculated and recorded by Allergan and may include gross sales net of discounts, rebates, allowances, sales taxes, freight and insurance charges, and other applicable deductions. If either party provided fewer calls on physicians in a particular year than it was

contractually required to provide, such party's share of the net profits would be adjusted as set forth in the collaboration agreement for North America. The Company has completed its obligations under the terms of the commercial agreement with Allergan, pursuant to which it promoted CANASA, and these adjustments to the share of the net profits have been eliminated, in full, in 2018 and all subsequent years. In May 2014, CONSTELLA became commercially available in Canada and in June 2014, LINZESS became commercially available in Mexico.

The Company evaluated this collaboration arrangement under ASC Topic 606, Revenue from Contracts with Customers ("ASC 606") and concluded that all development-period performance obligations had been satisfied as of September 2012. However, the Company has determined that there are three remaining commercial-period performance obligations, which include the sales detailing of LINZESS, participation in the joint commercialization committee, and approved additional trials. The consideration remaining includes cost reimbursements in the U.S., as well as commercial sales-based milestones and net profit and loss sharing payments based on net sales in the U.S. Additionally, the Company receives royalties in the mid-teens percent based on net sales in Canada and Mexico. Royalties, commercial sales-based milestones, and net profit and loss sharing payments will be recorded as collaborative arrangements revenue or expense in the period earned, in accordance with the sales-based royalty exception, as these payments relate predominately to the license granted to Allergan. The Company records royalty revenue in the period earned based on royalty reports from its partner, if available, or based on the projected sales and historical trends. The cost reimbursements received from Allergan during the commercialization period will be recognized as billed in accordance with the right-to-invoice exemption, as the Company's right to consideration corresponds directly with the value of the services transferred during the commercialization period.

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Under the Company's collaboration with Allergan for North America, LINZESS net sales are calculated and recorded by Allergan and include gross sales net of discounts, rebates, allowances, sales taxes, freight and insurance charges, and other applicable deductions, as noted above. These amounts include the use of estimates and judgments, which could be adjusted based on actual results in the future. The Company records its share of the net profits or net losses from the sales of LINZESS in the U.S. on a net basis less commercial expenses, and presents the settlement payments to and from Allergan as collaboration expense or collaborative arrangements revenue, as applicable. This treatment is in accordance with the Company's revenue recognition policy, given that the Company is not the primary obligor and does not have the inventory risks in the collaboration agreement with Allergan for North America. The Company relies on Allergan to provide accurate and complete information related to net sales of LINZESS in accordance with U.S. generally accepted accounting principles in order to calculate its settlement payments to and from Allergan and record collaboration expense or collaborative arrangements revenue, as applicable.

The Company recognized collaborative arrangements revenue from the Allergan collaboration agreement for North America during the three months ended March 31, 2019 and 2018 as follows (in thousands):

	Three Months Ended March 31,	
	2019	2018
Collaborative arrangements revenue related to sales of LINZESS in the U.S.	\$ 64,293	\$ 61,150
Royalty revenue	492	449
Total collaborative arrangements revenue	\$ 64,785	\$ 61,599

The collaborative arrangements revenue recognized in the three months ended March 31, 2019 and 2018 primarily represents the Company's share of the net profits and net losses on the sale of LINZESS in the U.S.

The following table presents the amounts recorded by the Company for commercial efforts related to LINZESS in the U.S. in the three months ended March 31, 2019 and 2018 (in thousands):

	Three Months Ended March 31,	
	2019	2018
Collaborative arrangements revenue related to sales of LINZESS in the U.S.(1)(2)	\$ 64,293	\$ 61,150
Selling, general and administrative costs incurred by the Company(1)	(10,277)	(10,928)
The Company's share of net profit	\$ 54,016	\$ 50,222

(1) Includes only collaborative arrangement revenue or selling, general and administrative costs attributable to the cost-sharing arrangement with Allergan for the three months ended March 31, 2019 and 2018.

In May 2014, CONSTELLA became commercially available in Canada and in June 2014, LINZESS became commercially available in Mexico. The Company records royalties on sales of CONSTELLA in Canada and LINZESS in Mexico in the period earned. The Company recognized approximately \$0.5 million and approximately \$0.4 million of combined royalty revenues from Canada and Mexico during the three months ended March 31, 2019 and 2018, respectively.

License Agreement with Allergan (All countries other than the countries and territories of North America, China, Hong Kong, Macau, and Japan)

In April 2009, the Company entered into a license agreement with Almirall (the “European License Agreement”) to develop and commercialize linaclotide in Europe (including the Commonwealth of Independent States and Turkey) for the treatment of IBS-C, CIC and other GI conditions. In accordance with the European License Agreement, the Company granted Almirall a right to access its U.S. Phase III clinical trial data for the purposes of supporting European regulatory approval. Additionally, the Company was required to participate on a joint development committee during linaclotide’s development period and is required to participate in a joint commercialization committee while linaclotide is commercially available. In October 2015, Almirall transferred its exclusive license to develop and commercialize linaclotide in Europe to Allergan.

Additionally, in October 2015, the Company and Allergan separately entered into an amendment to the European License Agreement relating to the development and commercialization of linaclotide in Europe. Pursuant to

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the terms of the amendment, (i) certain sales-based milestones payable to the Company under the European License Agreement were modified to increase the total milestone payments such that, when aggregated with certain commercial launch milestones, they could total up to \$42.5 million, (ii) the royalties payable to the Company during the term of the European License Agreement were modified such that the royalties based on sales volume in Europe begin in the mid-single digit percent and escalate to the upper-teens percent by calendar year 2019, and (iii) Allergan assumed responsibility for the manufacturing of linaclotide API for Europe from the Company, as well as the associated costs. The Company concluded that the 2015 amendment to the European License Agreement was not a modification to the linaclotide collaboration agreement with Allergan for North America.

In January 2017, concurrently with entering into the commercial agreement as described below in Commercial Agreement with Allergan, the Company and Allergan entered into an amendment to the European License Agreement (the "2017 Amendment"). The European License Agreement, as amended (the "Allergan License Agreement"), extended the license to develop and commercialize linaclotide in all countries other than China, Hong Kong, Macau, Japan, and the countries and territories of North America. On a country-by-country and product-by-product basis in such additional territory, Allergan is obligated to pay the Company a royalty as a percentage of net sales of products containing linaclotide as an active ingredient in the upper-single digits for five years following the first commercial sale of a linaclotide product in a country, and in the low-double digits thereafter. The royalty rate for products in the expanded territory will decrease, on a country-by-country basis, to the lower-single digits, or cease entirely, following the occurrence of certain events. Allergan is also obligated to assume certain purchase commitments for quantities of linaclotide API under the Company's agreements with third-party API suppliers. The amendment to the European License Agreement did not modify any of the milestones or royalty terms related to Europe.

The Company concluded that the 2017 Amendment was a material modification to the European License Agreement; however, this modification did not have a material impact on the Company's condensed consolidated financial statements as there was no deferred revenue associated with the European License Agreement. The Company also concluded that the 2017 Amendment was not a material modification to the linaclotide collaboration agreement with Allergan for North America. The Company's conclusions on deliverables under ASC Topic 605-25, Revenue Recognition—Multiple-Element Arrangements ("ASC 605-25") are described below in Commercial Agreement with Allergan.

The Company evaluated the European License Agreement under ASC 606. In evaluating the terms of the 2009 European License Agreement under ASC 606, the Company determined that there are no remaining performance obligations as of September 2012. However, the Company continues to be eligible to receive consideration in the form of commercial launch milestones, sales-based milestones, and royalties.

The commercial launch milestones, sales-based milestones and royalties under the European License Agreement have historically been recognized as revenue as earned. Under ASC 606, the Company applied the sales-based royalty exception to royalties and sales-based milestones, as these payments relate predominantly to the license granted to Allergan (formerly Almirall). Accordingly, the royalties and sales-based milestones are recorded as revenue in the period earned. The Company records royalties on sales of CONSTELLA in Europe in the period earned based on royalty reports from its partner, if available, or the projected sales and historical trends. The commercial launch milestones are recognized as revenue when it is probable that a significant reversal of revenue would not occur and the associated constraint has been lifted.

Additionally, the Company evaluated the terms of the 2017 Amendment under ASC 606 and determined that it would be treated as a separate contract given that it adds a distinct good or service at an amount that reflects standalone selling price. The Company determined that all performance obligations in the 2017 Amendment were satisfied in

January 2017 when the license for the additional territory was transferred. The Company continues to receive royalties under this agreement, which are recorded in the period earned pursuant to the sales-based royalty exception, as they related predominantly to the license granted to Allergan.

The Company recognized approximately \$0.4 million and \$0.3 million of royalty revenue from the European License Agreement during the three months ended March 31, 2019 and 2018, respectively.

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License Agreement for Japan with Astellas

In November 2009, the Company entered into a license agreement with Astellas, as amended, to develop and commercialize linaclotide for the treatment of IBS C, CIC and other GI conditions in Japan. Astellas is responsible for all activities relating to development, regulatory approval and commercialization in Japan as well as funding the associated costs and the Company is required to participate on a joint development committee over linaclotide's development period. During the year ended December 31, 2017, the Company and Astellas entered into a commercial API supply agreement (the "Astellas Commercial Supply Agreement"). Pursuant to the Astellas Commercial Supply Agreement, the Company sells linaclotide API supply to Astellas at a contractually defined rate and recognizes related revenue as sale of API. Under the license agreement, the Company receives royalties which escalate based on sales volume, beginning in the low-twenties percent, less the transfer price paid for the API included in the product actually sold and other contractual deductions.

In 2009, Astellas paid the Company a non refundable, up front licensing fee of \$30.0 million, which was recognized as collaborative arrangements revenue on a straight line basis over the Company's estimate of the period over which linaclotide was developed under the license agreement in accordance with ASC 605, Revenue Recognition ("ASC 605"). The development period was completed in December 2016 upon approval of LINZESS by the Japanese Ministry of Health, Labor and Welfare, at which point all previously deferred revenue under the agreement was recognized.

The agreement also includes three development milestone payments that totaled up to \$45.0 million, all of which were achieved and recognized as revenue through December 31, 2016 in accordance with ASC 605.

The Company has evaluated the terms of the 2009 License Agreement with Astellas under ASC 606 and has determined that there are no remaining performance obligations as of December 2016. However, there continues to be consideration in the form of royalties on sales of LINZESS in Japan under the 2009 License Agreement. Upon adoption of ASC 606, the Company concluded that the royalties on sales of LINZESS in Japan relate predominantly to the license granted to Astellas. Accordingly, the Company applies the sales-based royalty exception and records royalties on sales of LINZESS in Japan in the period earned based on royalty reports from its partner, if available, or the projected sales and historical trends.

Additionally, under the terms of the Astellas Commercial Supply Agreement, the Company continues to have an ongoing performance obligation to supply API. Upon adoption of ASC 606, product revenue is recognized when the customer obtains control of the Company's product, which occurs at a point in time, typically upon shipment of the product to the customer. This results in earlier revenue recognition than the Company's historical accounting.

During the three months ended March 31, 2019 and 2018, the Company recognized approximately \$2.6 million and approximately \$5.4 million from the sale of API to Astellas under the license agreement and the Astellas Commercial Supply Agreement. The royalties on sales of LINZESS in Japan did not exceed the transfer price of API sold and other contractual deductions during each of the periods presented.

Collaboration Agreement for China, Hong Kong and Macau with AstraZeneca

In October 2012, the Company entered into a collaboration agreement with AstraZeneca (the “AstraZeneca Collaboration Agreement”) to co-develop and co-commercialize linaclotide in China, Hong Kong and Macau (the “License Territory”). The collaboration provides AstraZeneca with an exclusive nontransferable license to exploit the underlying technology in the License Territory. The parties share responsibility for continued development and commercialization of linaclotide under a joint development plan and a joint commercialization plan, respectively, with AstraZeneca having primary responsibility for the local operational execution.

The parties agreed to an Initial Development Plan (“IDP”) which includes the planned development of linaclotide in China, including the lead responsibility for each activity and the related internal and external costs. The IDP indicates that AstraZeneca is responsible for a multinational Phase III clinical trial (the “Phase III Trial”), the Company is responsible for nonclinical development and supplying clinical trial material and both parties are responsible for the regulatory submission process. The IDP indicates that the party specifically designated as being responsible for a particular development activity under the IDP shall implement and conduct such activities. The activities are governed by a Joint Development Committee (“JDC”), with equal representation from each party. The JDC is responsible for

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approving, by unanimous consent, the joint development plan and development budget, as well as approving protocols for clinical studies, reviewing and commenting on regulatory submissions, and providing an exchange of data and information.

The AstraZeneca Collaboration Agreement will continue until there is no longer a development plan or commercialization plan in place, however, it can be terminated by AstraZeneca at any time upon 180 days' prior written notice. Under certain circumstances, either party may terminate the AstraZeneca Collaboration Agreement in the event of bankruptcy or an uncured material breach of the other party. Upon certain change in control scenarios of AstraZeneca, the Company may elect to terminate the AstraZeneca Collaboration Agreement and may re-acquire its product rights in a lump sum payment equal to the fair market value of such product rights.

In connection with the AstraZeneca Collaboration Agreement, the Company and AstraZeneca also executed a co-promotion agreement (the "Co-Promotion Agreement"), pursuant to which the Company utilized its existing sales force to co-promote NEXIUM® (esomeprazole magnesium), one of AstraZeneca's products, in the U.S. The Co-Promotion Agreement expired in May 2014.

There are no refund provisions in the AstraZeneca Collaboration Agreement and the Co-Promotion Agreement (together, the "AstraZeneca Agreements").

Under the terms of the AstraZeneca Collaboration Agreement, the Company received a \$25.0 million non-refundable up-front payment upon execution. The Company is also eligible for \$125.0 million in additional commercial milestone payments contingent on the achievement of certain sales targets. The parties will also share in the net profits and losses associated with the development and commercialization of linaclotide in the License Territory, with AstraZeneca receiving 55% of the net profits or incurring 55% of the net losses until a certain specified commercial milestone is achieved, at which time profits and losses will be shared equally thereafter.

Activities under the AstraZeneca Agreements were evaluated in accordance with ASC 605-25, to determine if they represented a multiple element revenue arrangement. The Company identified the following deliverables in the AstraZeneca Agreements:

- an exclusive license to develop and commercialize linaclotide in the License Territory (the "License Deliverable") (the deliverable was completed upon execution and all associated revenue was recognized as of December 31, 2016),
- research, development and regulatory services pursuant to the IDP, as modified from time to time (the "R&D Services"),
- JDC services,
- obligation to supply clinical trial material, and
- co-promotion services for AstraZeneca's product (the "Co-Promotion Deliverable") (the Co-Promotion Deliverable was completed and all associated revenue was recognized as of December 31, 2013).

Under ASC 605, the License Deliverable is nontransferable and has certain sublicense restrictions. The Company determined that the License Deliverable had standalone value as a result of AstraZeneca's internal product development and commercialization capabilities, which would enable it to use the License Deliverable for its intended purposes without the involvement of the Company. The remaining deliverables were deemed to have standalone value based on their nature and all deliverables met the criteria to be accounted for as separate units of accounting under ASC 605-25. Factors considered in this determination included, among other things, whether any other vendors sell the items separately and if the customer could use the delivered item for its intended purpose without the receipt of the

remaining deliverables.

The Company performs R&D Services and JDC services, and supplies clinical trial materials during the estimated development period. All consideration allocated to such services was being recognized as a reduction of research and development costs, using the proportional performance method, by which the amounts are recognized in proportion to the costs incurred in accordance with ASC 605. At the inception of the arrangement, the Company

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identified the supply of linaclotide drug product for commercial requirements and commercialization services as contingent deliverables under ASC 605 because these services are contingent upon the receipt of regulatory approval to commercialize linaclotide in the License Territory, and there were no binding commitments or firm purchase orders pending for commercial supply at the inception of the AstraZeneca Collaboration Agreement.

In August 2014, the Company and AstraZeneca, through the JDC, modified the IDP and development budget to include approximately \$14.0 million in additional activities over the remaining development period, to be shared by the Company and AstraZeneca under the terms of the AstraZeneca Collaboration Agreement. These additional activities serve to support the continued development of linaclotide in the License Territory, including the Phase III Trial. Pursuant to the terms of the modified IDP and development budget, certain of the Company's deliverables were modified, specifically the R&D Services and the obligation to supply clinical trial material. The modification did not, however, have a material impact on the Company's condensed consolidated financial statements.

The total amount of the non-contingent consideration allocable to the AstraZeneca Agreements was approximately \$34.0 million ("Arrangement Consideration") which includes the \$25.0 million non-refundable up-front payment and approximately \$9.0 million representing 55% of the costs for clinical trial material supply services and research, development and regulatory activities allocated to the Company in the IDP or as approved by the JDC in subsequent periods.

The Company allocated the Arrangement Consideration to the non-contingent deliverables based on management's best estimated selling price ("BESP") of each deliverable using the relative selling price method, as the Company did not have vendor-specific objective evidence or third-party evidence of selling price for such deliverables. Of the total Arrangement Consideration, approximately \$29.7 million was allocated to the License Deliverable, approximately \$1.8 million to the R&D Services, approximately \$0.1 million to the JDC services, approximately \$0.3 million to the clinical trial material supply services, and approximately \$2.1 million to the Co-Promotion Deliverable in the relative selling price model.

Because the Company shares development costs with AstraZeneca, payments from AstraZeneca with respect to both research and development and selling, general and administrative costs incurred by the Company prior to the commercialization of linaclotide in the License Territory are recorded as a reduction in expense, in accordance with the Company's policy, which is consistent with the nature of the cost reimbursement. Development costs incurred by the Company that pertain to the joint development plan and subsequent amendments to the joint development plan, as approved by the JDC, are recorded as research and development expense as incurred. Payments to AstraZeneca are recorded as incremental research and development expense.

Upon the adoption of ASC 606, the Company reevaluated the AstraZeneca Agreements and, consistent with its conclusions under ASC 605, identified six performance obligations including the license, R&D services, JDC services, supply of clinical trial material, co-promotion services for NEXIUM, and Joint Commercialization Committee ("JCC") services. The Company determined that the supply of linaclotide drug product for commercial requirements was an optional service at inception of the arrangement and did not provide a material right to AstraZeneca.

At the adoption date, the Company had fully satisfied its obligation to transfer the license and NEXIUM co-promotion services to AstraZeneca. The following remaining performance obligations are ongoing as of March 31, 2019:

- R&D Services,
- JDC services,
- obligation to supply clinical trial material, and
- JCC services.

Under ASC 606, the Company applied the contract modification practical expedient to the August 2014 amendment, which expanded the scope of the Company's activities under the IDP and increased the development budget. This practical expedient allows an entity to reflect the aggregate effect of all modifications that occur before the beginning of the earliest period presented. The application of this practical expedient resulted in a total transaction price

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of approximately \$34.0 million, which was allocable to the Company's performance obligations on a relative standalone selling price ("SSP") basis.

Under ASC 606, amounts of consideration allocated to the license and NEXIUM co-promotion services would have been recognized in full prior to adoption as these performance obligations were satisfied in October 2012 and December 2013, respectively. Consideration allocated to the R&D Services will be recognized as such services are provided over the performance period using an output method based on full-time employee hours incurred. Consideration allocated to the JDC services are recognized ratably over the development period using a time-based, straight-line attribution model. Revenue from the supply of clinical trial material is recognized as the clinical trial material is delivered to the customer.

Upon commercialization, the Company's only remaining performance obligation will be JCC services. During commercialization, the Company will be entitled to receive sales-based milestone payments from AstraZeneca. Additionally, the parties will share in the net profits and losses associated with the development and commercialization of linaclotide in the License Territory, with AstraZeneca receiving 55% of the net profits or incurring 55% of the net losses until a certain specified commercial milestone is achieved; from that point, profits and losses will be shared equally thereafter. Commercial sales-based milestones and net profit and loss sharing payments will be recorded as collaborative arrangements revenue or expense in the period earned, in accordance with the sales-based royalty exception, as these payments related predominately to the license granted to AstraZeneca. Any cost reimbursements received from AstraZeneca during the commercialization period will be recognized as billed in accordance with the right-to-invoice exemption, as the Company's right to consideration corresponds directly with the value of the services transferred during the commercialization period.

During each of the three months ended March 31, 2019 and 2018, the Company offset an insignificant amount related to R&D Services and JDC services. During the three months ended March 31, 2019 and 2018, the Company recognized an insignificant amount and no revenue, respectively, related to linaclotide drug product as sale of API. Additionally, the Company incurred approximately \$0.2 million related to pre-launch commercial services and supply chain services during the three months ended March 31, 2019.

Co-Promotion and Other Agreements

Agreement with Allergan for VIBERZI

In August 2015, the Company and Allergan entered into an agreement for the co-promotion of VIBERZI in the U.S., Allergan's treatment for adults suffering from IBS-D (the "VIBERZI Co-Promotion Agreement"). The VIBERZI Co-Promotion Agreement was effective through December 31, 2017.

Under the terms of the VIBERZI Co Promotion Agreement, the Company's promotional efforts were compensated based on the volume of calls delivered by the Company's sales force, with the terms of the agreement reducing or eliminating certain of the unfavorable adjustments to the Company's share of net profits stipulated by the linaclotide collaboration agreement with Allergan for North America, provided that the Company provided a minimum number of VIBERZI calls on physicians. The Company provided the minimum number of VIBERZI calls on physicians pursuant to the VIBERZI Co-Promotion Agreement, and was compensated with the elimination of certain of the unfavorable adjustments to the Company's share of net profits stipulated by the linaclotide collaboration agreement with Allergan for North America for the years ending December 31, 2016, 2017 and 2018.

In December 2017, the Company and Allergan entered into an amendment to the commercial agreement with Allergan (the "VIBERZI Amendment"), as described below, to include the VIBERZI promotional activities through December 31, 2018. Under the terms of the VIBERZI Amendment, the Company's clinical sales specialists continued detailing VIBERZI in the second position to the same health care practitioners to whom they detailed LINZESS in the first position and provided certain medical education services. The Company had the potential to achieve a milestone payment of up to \$7.5 million based on the net sales of VIBERZI during 2018, and was compensated approximately \$3.0 million over the term of the agreement for its medical education initiatives. The Company evaluated the VIBERZI Amendment in accordance with ASC 606 and determined that it would be treated as a separate contract because it adds a distinct good or service at an amount that reflects standalone selling price. The following performance obligations under the VIBERZI Amendment were identified:

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- sales detailing of VIBERZI in either first or second position, and
- medical education services.

The sales-based milestone payment was recognized as collaborative arrangements revenue when it was probable that a significant reversal of revenue would not occur and the associated constraint had been lifted. During the three months ended December 31, 2018, the Company determined the sales-based milestone payment was no longer constrained and recognized approximately \$1.3 million in collaborative arrangements revenue. The consideration related to medical education events of approximately \$3.0 million was recognized over the period of performance that medical education services are provided. During the three months ended March 31, 2018, the Company recognized approximately \$0.8 million of collaborative arrangements revenue related to VIBERZI. In December 2018 and in March 2019, the Company extended the VIBERZI Amendment, and in April 2019, the Company entered into a new agreement with Allergan, to continue sales detailing activities for VIBERZI. The terms of the new agreement with Allergan include a new compensation structure that took effect on April 1, 2019 and will continue through December 31, 2019. The Company recognized no revenue under the extensions of the existing agreement related to VIBERZI during the three months ended March 31, 2019.

Commercial Agreement with Allergan

In January 2017, concurrently with entering into the amendment to the European License Agreement, the Company and Allergan entered into an agreement under which the adjustments to the Company's or Allergan's share of the net profits under the share adjustment provision of the collaboration agreement for linaclotide in North America relating to the contractually required calls on physicians in each year were eliminated, in full, in 2018 and all subsequent years (the "Commercial Agreement"). Pursuant to the Commercial Agreement, Allergan appointed the Company, on a non-exclusive basis, to promote CANASA, approved for the treatment of ulcerative proctitis in the U.S. for approximately two years through February 2019. Under the terms of the Commercial Agreement, the Company is obligated to perform third position sales details and offer samples of such products to gastroenterology prescribers who are on the then-current call panel for LINZESS to which the Company provides first or second position details. On a product-by-product basis, Allergan pays the Company a royalty in the mid-teens on incremental sales of CANASA above a mutually agreed upon sales baseline. Additionally, the Company may incur a detailing shortfall penalty if it fails to meet the annual target product detail amount in any calendar year.

In December 2017, the Company and Allergan entered into the VIBERZI Amendment to the Commercial Agreement, as described above, to include and extend the VIBERZI promotional activities through December 31, 2018. The share adjustment relief would have, in the case of Allergan's termination for convenience and certain other specified circumstances, survived termination of the commercial agreement. The Company has completed its obligation under the terms of the Commercial Agreement with Allergan pursuant to which it promoted CANASA. Under ASC 605, the Company concluded that the commercial agreement with Allergan, as amended, was not a material modification to the linaclotide collaboration agreement with Allergan for North America.

Activities under the Commercial Agreement with Allergan and the Allergan License Agreement were evaluated in accordance with ASC 605-25 upon execution, as the agreements were entered into concurrently, to determine if they represented a multiple element revenue arrangement.

The Company identified the following deliverables:

- an exclusive license to develop and commercialize linaclotide in the Allergan License Territory, and
- sales detailing services for CANASA.

The exclusive license for the Allergan License Territory is nontransferable and has certain sublicense restrictions. The Company determined that Allergan had the internal product development and commercialization capabilities that would enable Allergan to use the license for its intended purposes without the involvement of the Company and, therefore, the license had standalone value. The deliverable for the sales detailing services for CANASA was deemed to have standalone value based on the nature of the services, and all deliverables met the criteria to be accounted for as separate units of accounting under ASC 605-25. There was no allocable arrangement consideration at the inception of the arrangement, as the consideration is in the form of royalties and the elimination of a contingent liability.

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Upon adoption of ASC 606, the Company evaluated the commercial agreement and the amendment to the European License Agreement under the contract combination and contract modification guidance in ASC 606. The Company determined that the agreements should be accounted for as separate contracts because each agreement adds distinct goods or services at an amount that reflects standalone selling price. The Company concluded that the CANASA sales detailing deliverable under ASC 605 was also considered a performance obligation in accordance with ASC 606. Accordingly, the Company records royalties on sales of CANASA and any estimated detailing shortfall penalty over the period of performance for the sales details; collaborative arrangements revenue is recognized when it is probable that a significant reversal of revenue would not occur and the associated constraint has been lifted. The Company estimates sales detailing royalties based on royalty reports from its partner, if available, or the projected sales and historical trends. At the inception of the arrangement, the consideration associated with the agreement comprised of royalties and a sales detailing shortfall penalty are fully constrained. During each of the three months ended March 31, 2019 and 2018, the Company did not recognize royalty revenue related to the Commercial Agreement with Allergan for sales of CANASA.

The VIBERZI Amendment was effective as of January 1, 2018 and evaluated in accordance with ASC 606 as described above.

Other Collaboration and License Agreements

The Company has other collaboration and license agreements that are not individually significant to its business. Pursuant to the terms of one agreement, the Company was required to pay \$7.5 million for development milestones, all of which had been paid as of March 31, 2019. The Company may also be required to pay up to \$18.0 million for regulatory milestones, none of which had been paid as of March 31, 2019. Pursuant to the terms of another license agreement, the Company recognized approximately \$0.5 million collaborative arrangements revenue during the three months ended March 31, 2019 related to a nonrefundable upfront payment. The Company is eligible to receive up to \$63.5 million in development and sales-based milestones, as well as a royalty as a percentage of net sales of a product, under the terms of this agreement. The Company did not record any research and development expense associated with the Company's other collaboration and license agreements during the three months ended March 31, 2019 and 2018.

4. Fair Value of Financial Instruments

The tables below present information about the Company's assets that are measured at fair value on a recurring basis as of March 31, 2019 and December 31, 2018 and indicate the fair value hierarchy of the valuation techniques the Company utilized to determine such fair value. In general, fair values determined by Level 1 inputs utilize observable inputs such as quoted prices in active markets for identical assets or liabilities. Fair values determined by Level 2 inputs utilize data points that are either directly or indirectly observable, such as quoted prices for similar instruments

in active markets, interest rates and yield curves. Fair values determined by Level 3 inputs utilize unobservable data points in which there is little or no market data, which require the Company to develop its own assumptions for the asset or liability.

The Company's investment portfolio includes fixed income securities that do not always trade on a daily basis. As a result, the pricing services used by the Company apply other available information as applicable through processes such as benchmark yields, benchmarking of like securities, sector groupings and matrix pricing to prepare valuations. In addition, model processes are used to assess interest rate impact and develop prepayment scenarios. These models take into consideration relevant credit information, perceived market movements, sector news and economic events. The inputs into these models may include benchmark yields, reported trades, broker-dealer quotes, issuer spreads and other relevant data. The Company validates the prices provided by its third-party pricing services by obtaining market values from other pricing sources and analyzing pricing data in certain instances. The Company also invests in certain reverse repurchase agreements which are collateralized by deposits in the form of Government Securities and Obligations for an amount not less than 102% of their principal amount. The Company does not record an asset or liability for the collateral as the Company is not permitted to sell or re-pledge the collateral. The collateral has at least the prevailing credit rating of U.S. Government Treasuries and Agencies. The Company utilizes a third-party custodian to manage the exchange of funds and ensure the collateral received is maintained at 102% of the reverse repurchase agreements principal amount on a daily basis.

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The following tables present the assets and liabilities the Company has measured at fair value on a recurring basis (in thousands):

	March 31, 2019	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents:				
Money market funds	\$ 102,847	\$ 102,847	\$ —	\$ —
Repurchase agreements	15,875	15,875	—	—
Convertible Note Hedges	50,589	—	—	50,589
Total assets measured at fair value	\$ 169,311	\$ 118,722	\$ —	\$ 50,589
Liabilities:				
Note Hedge Warrants	\$ 39,388	\$ —	\$ —	\$ 39,388
Total liabilities measured at fair value	\$ 39,388	\$ —	\$ —	\$ 39,388

	December 31, 2018	Fair Value Measurements at Reporting Date Using		
		Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents:				
Money market funds	\$ 142,218	\$ 142,218	\$ —	\$ —
Repurchase agreements	30,875	30,875	—	—
Convertible Note Hedges	41,020	—	—	41,020
Total assets measured at fair value	\$ 214,113	\$ 173,093	\$ —	\$ 41,020
Liabilities:				
Note Hedge Warrants	\$ 33,763	\$ —	\$ —	\$ 33,763
Contingent Consideration	51	—	—	51
Total liabilities measured at fair value	\$ 33,814	\$ —	\$ —	\$ 33,814

There were no transfers between fair value measurement levels during the three months ended March 31, 2019 or 2018.

Cash equivalents, accounts receivable, related party accounts receivable, prepaid expenses and other current assets, accounts payable, related party accounts payable, accrued expenses and the current portion of capital lease obligations and operating lease obligations at March 31, 2019 and December 31, 2018 are carried at amounts that approximate fair value due to their short-term maturities.

Convertible Note Hedges and Note Hedge Warrants

The Company's Convertible Note Hedges and the Note Hedge Warrants are recorded as derivative assets and liabilities, and are classified as Level 3 under the fair value hierarchy. These derivatives are not actively traded and are valued using the Black-Scholes option-pricing model which requires the use of subjective assumptions. Significant inputs used to determine the fair value as of March 31, 2019 included the price per share of the Company's Class A common stock, time to maturity of the derivative instruments, the strike prices of the derivative instruments, the risk-free interest rate, and the volatility of the Company's Class A common stock. The Company has not paid and does not anticipate paying cash dividends on its shares of common stock in the foreseeable future; therefore, the expected dividend yield is assumed to be zero. Changes to these inputs could materially affect the valuation of the Convertible Note Hedges and Note Hedge Warrants.

In April 2019, the Company announced an adjustment to the conversion rate applicable to the 2022 Notes, effective April 15, 2019 (Note 13).

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The following inputs were used in the fair market valuation of the Convertible Note Hedges and Note Hedge Warrants as of March 31, 2019 and December 31, 2018:

	Three Months Ended March 31, 2019		Year Ended December 31, 2018	
	Convertible Note Hedges	Note Hedge Warrants	Convertible Note Hedges	Note Hedge Warrants
Risk-free interest rate (1)	2.3 %	2.3 %	2.5 %	2.5 %
Time to maturity	3.2	3.8	3.5	4.1
Stock price (2)	\$ 11.33	\$ 11.33	\$ 10.36	\$ 10.36
Strike price (3)	\$ 16.58	\$ 21.50	\$ 16.58	\$ 21.50
Common stock volatility (4)	45.8 %	44.5 %	43.8 %	43.6 %
Dividend yield	— %	— %	— %	— %

- (1) Based on U.S. Treasury yield curve, with terms commensurate with the terms of the Convertible Note Hedges and the Note Hedge Warrants.
- (2) The closing price of the Company's Class A common stock on the last trading day of the quarter ended March 31, 2019 and December 31, 2018, respectively.
- (3) As per the respective agreements for the Convertible Note Hedges and Note Hedge Warrants.
- (4) Selected volatility based on historical volatility of the Company's Class A common stock.

The Convertible Note Hedges and the Note Hedge Warrants are recorded at fair value at each reporting period and changes in fair value are recorded in other expense, net within the Company's condensed consolidated statements of operations. Gains and losses for these derivative financial instruments are presented separately in the Company's condensed consolidated statements of cash flows.

The following table reflects the change in the Company's Level 3 convertible note derivatives from December 31, 2018 through March 31, 2019 (in thousands):

	Convertible Note Hedges	Note Hedge Warrants
Balance at December 31, 2018	\$ 41,020	\$ (33,763)
Change in fair value, recorded as a component of gain (loss) on derivatives	9,569	(5,625)
Balance at March 31, 2019	\$ 50,589	\$ (39,388)

In June 2015, the Company issued approximately \$335.7 million of its 2022 Notes. The Company separately accounted for the liability and equity components of the 2022 Notes by allocating the proceeds between the liability component and equity component (Note 8). The fair value of the 2022 Notes, which differs from their carrying value, is influenced by interest rates, the price of the Company's Class A common stock and the volatility thereof, and the prices for the 2022 Notes observed in market trading, which are Level 2 inputs. The estimated fair value of the 2022 Notes was approximately \$370.1 million and approximately \$315.0 million as of March 31, 2019 and December 31, 2018, respectively.

8.375% Notes Due 2026

In September 2016, the Company closed a direct private placement pursuant to which the Company issued \$150.0 million in aggregate principal amount of the 2026 Notes in January 2017. The estimated fair value of the 2026 Notes was approximately \$144.5 million and approximately \$148.2 million as of March 31, 2019 and December 31, 2018. This valuation was calculated using a discounted cash flow estimate of expected interest and principal payments and was determined using Level 3 inputs, including significant estimates related to expected LINZESS sales and a discount rate equivalent to market participant interest rates.

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5. Inventory

Inventory consisted of the following (in thousands):

	March 31, 2019	December 31, 2018
Raw Materials	\$ 593	\$ —
	\$ 593	\$ —

The Company's inventory represents linaclotide API and drug product. The Company evaluates inventory levels quarterly and any inventory that has a cost basis in excess of its expected net realizable value, inventory that becomes obsolete, inventory in excess of expected sales requirements, inventory that fails to meet commercial sale specifications or is otherwise impaired is written down with a corresponding charge to the statement of operations in the period that the impairment is first identified.

No impairment of inventory was recorded during the three months ended March 31, 2019 or 2018.

6. Accrued Expenses and Other Current Liabilities

Accrued expenses and other current liabilities consisted of the following (in thousands):

	March 31, 2019	December 31, 2018
Salaries	\$ 1,506	\$ 3,627
Accrued vacation	4,379	4,100
Accrued incentive compensation	5,110	16,013
Other employee benefits	1,302	2,154
Professional fees	4,805	2,770
Accrued interest	2,716	873
Restructuring accruals	2,956	3,303
Other	16,817	12,412
	\$ 39,591	\$ 45,252

As of March 31, 2019, other accrued expenses of approximately \$16.8 million includes approximately \$2.5 million related to linaclotide excess purchase commitments, approximately \$8.7 million related to a portion of the activities associated with the Company's separation into two independent publicly traded companies, and approximately \$1.4 million related to excess non-cancelable ZURAMPIC and DUZALLO (the "Lesinurad Products") commercial supply and sample purchase commitments.

As of December 31, 2018, other accrued expenses of approximately \$12.4 million included approximately \$2.5 million related to linaclotide excess purchase commitments, approximately \$2.4 million related to a portion of the activities associated with the Company's separation into two independent publicly traded companies, and approximately \$1.4 million related to excess non-cancelable Lesinurad Products commercial supply and sample purchase commitments.

7. Leases

On January 1, 2019, the Company adopted ASC 842 using the optional transition method. The Company's lease portfolio includes: a property lease for its headquarters location, a data center colocation lease, vehicle leases for its salesforce representatives, and leases for computer and office equipment.

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Lease cost is recognized on a straight-line basis over the lease term. The components of lease cost for the three months ended March 31, 2019 are as follows (in thousands):

	Three Months Ended March 31, 2019
Operating lease cost during period	\$ 4,525
Short-term lease cost	389
Total lease cost	\$ 4,914

Supplemental cash flow information related to leases for the periods reported is as follows (in thousands):

	Three Months Ended March 31, 2019
Right-of-use assets obtained in exchange for new operating lease upon adoption of ASC 842 (in thousands)	\$ 88,299
Cash paid for amounts included in the measurement of lease liabilities (in thousands)	4,412
Weighted-average remaining lease term of operating leases (in years)	5.7
Weighted-average discount rate of operating leases	6.7 %

Future minimum lease payments under non-cancelable operating leases under ASC 842 as of March 31, 2019 are as follows (in thousands):

	Operating Lease Payments
2019(1)	\$ 13,365
2020	18,312
2021	18,863
2022	19,365
2023	19,818
2024 and thereafter	22,118
Total future minimum lease payments	111,841

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Less: present value adjustment	19,811
Operating lease liabilities at March 31, 2019	92,030
Less: current portion of operating lease liabilities	12,080
Operating lease liabilities, net of current portion	\$ 79,950

(1) Amounts are for the nine months ending December 31, 2019

At December 31, 2018, future minimum lease payments under non-cancelable leases under ASC 840 were as follows (in thousands):

	Operating Lease Payments
2019	\$ 18,736
2020	18,312
2021	18,863
2022	19,365
2023	19,818
2024 and thereafter	22,118
Total future minimum lease payments	\$ 117,212

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Headquarters Lease

The Company rents office and laboratory space at its corporate headquarters at 301 Binney Street, Cambridge, Massachusetts (the “Facility”) under a non-cancelable operating lease, entered into in January 2007, as amended in 2017 (“2017 Lease Amendment”).

The 2017 Lease Amendment extends the term of the original Facility lease agreement through January 31, 2025 for the approximately 223,000 square feet of the Facility that the Company currently occupies. The 2017 Lease Amendment includes an option to extend the term of the lease for an additional five years at a market base rental rate, a 3% annual rent escalation, and free rent periods. The rent expense, inclusive of the escalating rent payments, lease incentives and free rent periods, is recognized on a straight-line basis over the lease term through January 2025. Additionally, the 2017 Lease Amendment requires a letter of credit to secure the Company’s obligations under the lease agreement of approximately \$6.4 million, which is recorded as restricted cash.

As of January 1, 2019, in conjunction with the adoption of ASC 842, the Company recorded a right-of-use asset of approximately \$87.7 million, and a lease liability of approximately \$94.3 million associated with its headquarters lease. At March 31, 2019, the balances of the right-of-use asset and lease liability for the headquarters lease were approximately \$84.8 million and approximately \$91.5 million, respectively. The incremental borrowing rate for the outstanding headquarters lease obligation is approximately 6.7%.

Lease cost related to 2017 Lease Amendment recorded during the three months ended March 31, 2019 was approximately \$4.5 million. Under ASC 840, rent expenses related to the 2017 Lease Amendment recorded during the three months ended March 31, 2018 was approximately \$4.5 million.

Data center colocation lease

The Company rents space for its data center at a colocation in Boston, Massachusetts under a non-cancelable operating lease (the “Data Center Lease”). The Data Center Lease contains various provisions including a 4% annual rent escalation. The rent expense, inclusive of the escalating rent payments, is recognized on a straight-line basis over the lease term through August 2022. The Company recorded a right-of-use asset of approximately \$0.6 million, and a lease liability of approximately \$0.6 million associated with the Data Center Lease upon adoption of ASC 842. During the three months ended March 31, 2019, the Company migrated its data management process to a cloud-based services system, rendering its current data center technology and assets obsolete. As a result, the Company considered the right-of-use asset associated with the Data Center Lease to be impaired. The Company recorded a charge of approximately \$0.5 million to selling, general, and administrative expenses on its condensed consolidated statement of operations as a result of the impairment. At March 31, 2019, the lease liability associated with the Data Center Lease was approximately \$0.5 million, and the right-of-use asset was fully impaired. The incremental borrowing rate for the

outstanding Data Center Lease obligation at adoption of ASC 842 was approximately 6.0%.

Lease cost related to the Data Center Lease recorded during the three months ended March 31, 2019 was insignificant. Under ASC 840, rent expenses related to the Data Center Lease were insignificant for the three months ended March 31, 2018.

Vehicle fleet leases

During April 2018, the Company entered into a master services agreement containing 12-month leases (the “2018 Vehicle Leases”) for certain vehicles within its fleet for its field-based sales force and medical science liaisons. These leases are classified in accordance with the practical expedient in ASC 842 as short-term. The 2018 Vehicle Leases expire at varying times beginning in June 2019, with a one-month renewal provision. In accordance with the terms of the 2018 Vehicle Leases, the Company maintains a letter of credit securing its obligation under the lease agreements of \$1.3 million, which is recorded as restricted cash.

Lease cost related to the 2018 Vehicle Leases was approximately \$0.4 million for the three months ended March 31, 2019.

Prior to the adoption of ASC 842, during 2018, the Company had certain ongoing vehicle leases for its field-based sales force and medical science liaisons (the “2015 Vehicle Leases”). These leases were classified as capital leases

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under ASC 840. The 2015 Vehicle Leases expired at varying times through December 2018. In connection with entering into the 2018 Vehicle Leases, all of the 2015 Vehicle Leases were terminated through December 31, 2018. At December 31, 2018, the Company had no remaining capital lease obligations related to the 2015 Vehicle Leases.

Other leases

Prior to the adoption of ASC 842, the Company entered into leases for certain computer and office equipment that expired in 2018. These leases were classified as capital leases under ASC 840. At December 31, 2018, the weighted average interest rate on the outstanding capital lease obligations was approximately 3.4%. At December 31, 2018, the Company had approximately \$0.2 million in capital lease obligations.

8. Notes Payable

8.375% Notes due 2026

On September 23, 2016, the Company closed a direct private placement, pursuant to which the Company issued \$150.0 million in aggregate principal amount of 8.375% notes due 2026 on the Funding Date, January 5, 2017.

The Company capitalized approximately \$0.5 million of debt issuance costs, which were netted against the carrying value of the 2026 Notes.

The 2026 Notes bear an annual interest rate of 8.375%, with interest payable March 15, June 15, September 15 and December 15 of each year (each an "8.375% Payment Date") which began on June 15, 2017. Principal of the 2026 Notes will be payable on the 8.375% Payment Dates beginning March 15, 2019. From March 15, 2019, the Company will make quarterly payments on the 2026 Notes equal to the greater of (i) 7.5% of net sales of linaclotide in the U.S. for the preceding quarter (the "8.375% Synthetic Royalty Amount") and (ii) accrued and unpaid interest on the 2026 Notes (the "8.375% Required Interest Amount"). Principal on the 2026 Notes will be repaid in an amount equal to the

8.375% Synthetic Royalty Amount minus the 8.375% Required Interest Amount, when this is a positive number, until the principal has been paid in full. Given the principal payments on the 2026 Notes are based on the 8.375% Synthetic Royalty Amount, which will vary from quarter to quarter, the 2026 Notes may be repaid prior to September 15, 2026, the final legal maturity date. The Company made principal payments of approximately \$12.3 million through March 31, 2019, and expects to pay approximately \$46.0 million of the principal within twelve months following March 31, 2019.

The 2026 Notes are secured by a security interest in a segregated bank account established to receive the required quarterly payments as well as certain limited accounts receivables, payment intangibles or other rights to payment or proceeds, in each case, up to the 8.375% Synthetic Royalty Amount or estimated equivalent thereto, as applicable. Up to the amount of the required quarterly payments under the 2026 Notes, Allergan deposits its quarterly profit (loss) sharing payments due to the Company related to net sales of linaclotide in the U.S. pursuant to the collaboration agreement for North America, if any, into the segregated bank account. If the funds deposited by Allergan into the segregated bank account are insufficient to make a required payment of interest or principal on a particular 8.375% Payment Date, the Company is obligated to deposit such shortfall out of the Company's general funds into the segregated bank account.

The 2026 Notes may be redeemed at any time prior to maturity, in whole or in part, at the option of the Company. If applicable, the Company will pay a redemption price equal to the percentage of outstanding principal balance of the 2026 Notes being redeemed specified below for the period in which the redemption occurs (plus the accrued and unpaid interest to the redemption date on the 2026 Notes being redeemed):

Payment Dates	Redemption Percentage
From and including March 15, 2019 to and including March 14, 2020	105.50 %
From and including March 15, 2020 to and including March 14, 2021	102.75 %
From and including March 15, 2021 and thereafter	100.00 %

The 2026 Notes contain certain covenants related to the Company's obligations with respect to the commercialization of linaclotide and the related collaboration agreement with Allergan for North America, as well as certain customary covenants, including covenants that limit or restrict the Company's ability to incur certain liens, merge or consolidate or make dispositions of assets. The 2026 Notes also specify a number of events of default (some of which

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are subject to applicable cure periods), including, among other things, covenant defaults, other non-payment defaults, and bankruptcy and insolvency defaults. Upon the occurrence of an event of default, subject to cure periods in certain circumstances, all amounts outstanding may become immediately due and payable.

The accounting for the 2026 Notes requires the Company to make certain estimates and assumptions about the future net sales of linaclotide in the U.S. Linaclotide has been marketed as LINZESS in the U.S. since December 2012 and the estimates of the magnitude and timing of linaclotide net sales are subject to significant variability and uncertainty. These estimates and assumptions are likely to change, which may result in future adjustments to the portion of the 2026 Notes that is classified as a current liability, the amortization of debt issuance costs, the accretion of discounts and recognition of interest expense. Any such adjustments could be material to the Company's condensed consolidated financial statements.

2.25% Convertible Senior Notes due 2022

In June 2015, the Company issued approximately \$335.7 million aggregate principal amount of the 2022 Notes. The Company received net proceeds of approximately \$324.0 million from the sale of the 2022 Notes, after deducting fees and expenses of approximately \$11.7 million. The Company used approximately \$21.1 million of the net proceeds from the sale of the 2022 Notes to pay the net cost of the Convertible Note Hedges (after such cost was partially offset by the proceeds to the Company from the sale of the Note Hedge Warrants), as described below.

The 2022 Notes are governed by an indenture (the "Indenture") between the Company and U.S. Bank National Association, as the trustee. The 2022 Notes are senior unsecured obligations and bear cash interest at the annual rate of 2.25%, payable on June 15 and December 15 of each year, which began on December 15, 2015. The 2022 Notes will mature on June 15, 2022, unless earlier converted or repurchased. The Company may settle conversions of the 2022 Notes through payment or delivery, as the case may be, of cash, shares of Class A common stock of the Company or a combination of cash and shares of Class A common stock, at the Company's option (subject to, and in accordance with, the settlement provisions of the Indenture). The initial conversion rate for the 2022 Notes was 60.3209 shares of Class A common stock (subject to adjustment as provided for in the Indenture) per \$1,000 principal amount of the 2022 Notes, which was equal to an initial conversion price of approximately \$16.58 per share and 20,249,665 shares.

In connection with the Separation, on April 1, 2019, Ironwood distributed to its stockholders one share of Cycleron common stock for every 10 shares of Ironwood common stock held as of the close of business on March 19, 2019, the record date for the distribution. As a result of the Separation, the conversion rate under the indenture was adjusted to equal 68.9172 shares of Ironwood common stock per \$1,000 principal amount of the 2022 Notes, which is equal to an adjusted conversion price of approximately \$14.51 per share and 23,135,435 shares. In connection with the adjustment to the conversion rate of the indenture, the exercise price of the Convertible Note Hedges and the Note Hedge Warrants were adjusted to \$14.51 per share and \$18.82 per share, respectively (Note 13).

Holders of the 2022 Notes may convert their 2022 Notes at their option at any time prior to the close of business on the business day immediately preceding December 15, 2021 in multiples of \$1,000 principal amount, only under the following circumstances:

- during any calendar quarter commencing after the calendar quarter ending on September 30, 2015 (and only during such calendar quarter), if the last reported sale price of the Company's Class A common stock for at least 20 trading days (whether or not consecutive) during a period of 30 consecutive trading days ending on the last trading day of the immediately preceding calendar quarter is greater than or equal to 130% of the conversion price for the 2022 Notes on each applicable trading day;
- during the five business day period after any five consecutive trading day period (the "measurement period") in which the "trading price" (as defined in the Indenture) per \$1,000 principal amount of the 2022 Notes for each trading day of the measurement period was less than 98% of the product of the last reported sale price of the Company's Class A common stock and the conversion rate for the 2022 Notes on each such trading day; or
- upon the occurrence of specified corporate events described in the Indenture.

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On or after December 15, 2021, until the close of business on the second scheduled trading day immediately preceding June 15, 2022, holders may convert their 2022 Notes, in multiples of \$1,000 principal amount, at the option of the holder regardless of the foregoing circumstances.

If a make-whole fundamental change, as described in the Indenture, occurs and a holder elects to convert its 2022 Notes in connection with such make-whole fundamental change, such holder may be entitled to an increase in the conversion rate as described in the Indenture. The Company may not redeem the 2022 Notes prior to the maturity date and no “sinking fund” is provided for by the 2022 Notes, which means that the Company is not required to periodically redeem or retire the 2022 Notes. Upon the occurrence of certain fundamental changes involving the Company, holders of the 2022 Notes may require the Company to repurchase for cash all or part of their 2022 Notes at a repurchase price equal to 100% of the principal amount of the 2022 Notes to be repurchased, plus accrued and unpaid interest.

The Indenture does not contain any financial covenants or restrict the Company’s ability to repurchase the Company’s securities, pay dividends or make restricted payments in the event of a transaction that substantially increases the Company’s level of indebtedness. The Indenture provides for customary events of default. In the case of an event of default with respect to the 2022 Notes arising from specified events of bankruptcy or insolvency, all outstanding 2022 Notes will become due and payable immediately without further action or notice. If any other event of default with respect to the 2022 Notes under the Indenture occurs or is continuing, the trustee or holders of at least 25% in aggregate principal amount of the then outstanding 2022 Notes may declare the principal amount of the 2022 Notes to be immediately due and payable. Notwithstanding the foregoing, the Indenture provides that, upon the Company’s election, and for up to 180 days, the sole remedy for an event of default relating to certain failures by the Company to comply with certain reporting covenants in the Indenture consists exclusively of the right to receive additional interest on the 2022 Notes.

In accordance with accounting guidance for debt with conversion and other options, the Company separately accounted for the liability and equity components of the 2022 Notes by allocating the proceeds between the liability component and the embedded conversion option, or equity component, due to the Company’s ability to settle the 2022 Notes in cash, its Class A common stock, or a combination of cash and Class A common stock at the option of the Company. The carrying amount of the liability component was calculated by measuring the fair value of a similar liability that does not have an associated convertible feature. The allocation was performed in a manner that reflected the Company’s non-convertible debt borrowing rate for similar debt. The equity component of the 2022 Notes was recognized as a debt discount and represents the difference between the gross proceeds from the issuance of the 2022 Notes and the fair value of the liability of the 2022 Notes on their respective dates of issuance. The excess of the principal amount of the liability component over its carrying amount, or debt discount, is amortized to interest expense using the effective interest method over seven years, or the life of the 2022 Notes. The equity component is not remeasured as long as it continues to meet the conditions for equity classification.

The Company’s outstanding Convertible Note balances as of March 31, 2019 and December 31, 2018 consisted of the following (in thousands):

	March 31, 2019	December 31, 2018
Liability component:		
Principal	\$ 335,699	\$ 335,699
Less: unamortized debt discount	(61,019)	(65,094)
Less: unamortized debt issuance costs	(4,733)	(5,004)
Net carrying amount	\$ 269,947	\$ 265,601
Equity component	\$ 114,199	\$ 114,199

In connection with the issuance of the 2022 Notes, the Company incurred approximately \$11.7 million of debt issuance costs, which primarily consisted of initial purchasers' discounts and legal and other professional fees. The Company allocated these costs to the liability and equity components based on the allocation of the proceeds. The portion of these costs allocated to the equity components totaling approximately \$4.0 million were recorded as a reduction to additional paid-in capital. The portion of these costs allocated to the liability components totaling approximately \$7.7 million were recorded as a reduction in the carrying value of the debt on the balance sheet and are amortized to interest expense using the effective interest method over the expected life of the 2022 Notes.

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The Company determined the expected life of the 2022 Notes was equal to their seven-year term. The effective interest rate on the liability components of the 2022 Notes for the period from the date of issuance through March 31, 2019 was 9.34%. The following table sets forth total interest expense recognized related to the 2022 Notes during the three months ended March 31, 2019 and 2018 (in thousands):

	Three Months Ended	
	March 31,	
	2019	2018
Contractual interest expense	\$ 1,888	\$ 1,888
Amortization of debt issuance costs	272	226
Amortization of debt discount	4,075	3,734
Total interest expense	\$ 6,235	\$ 5,848

Convertible Note Hedge and Warrant Transactions with Respect to 2022 Notes

To minimize the impact of potential dilution to the Company's Class A common stockholders upon conversion of the 2022 Notes, the Company entered into the Convertible Note Hedges covering 20,249,665 shares of the Company's Class A common stock in connection with the issuance of the 2022 Notes. The Convertible Note Hedges have an exercise price of approximately \$16.58 per share and are exercisable when and if the 2022 Notes are converted. If upon conversion of the 2022 Notes, the price of the Company's Class A common stock is above the exercise price of the Convertible Note Hedges, the counterparties are obligated to deliver shares of the Company's Class A common stock and/or cash with an aggregate value approximately equal to the difference between the price of the Company's Class A common stock at the conversion date and the exercise price, multiplied by the number of shares of the Company's Class A common stock related to the Convertible Note Hedge being exercised.

Concurrently with entering into the Convertible Note Hedges, the Company also sold Note Hedge Warrants to the Convertible Note Hedge counterparties to acquire 20,249,665 shares of the Company's Class A common stock, subject to customary anti-dilution adjustments. The strike price of the Note Hedge Warrants is initially \$21.50 per share, subject to adjustment, and such warrants are exercisable over the 150 trading day period beginning on September 15, 2022. The Note Hedge Warrants could have a dilutive effect on the Class A common stock to the extent that the market price per share of the Company's Class A common stock exceeds the applicable strike price of such warrants.

The Convertible Note Hedges and the Note Hedge Warrants are separate transactions entered into by the Company and are not part of the terms of the 2022 Notes. Holders of the 2022 Notes and the Note Hedge Warrants do not have any rights with respect to the Convertible Note Hedges. The Company paid approximately \$91.9 million for the Convertible Note Hedges and recorded this amount as a long-term asset on the condensed consolidated balance sheet. The Company received approximately \$70.8 million for the Note Hedge Warrants and recorded this amount as a long-term liability, resulting in a net cost to the Company of approximately \$21.1 million. The Convertible Note Hedges and Note Hedge Warrants are accounted for as derivative assets and liabilities, respectively, in accordance

with ASC Topic 815, Derivatives and Hedging (Note 4).

9. Employee Stock Benefit Plans

The Company has several share-based compensation plans under which stock options, restricted stock awards, restricted stock units (“RSUs”), and other share-based awards are available for grant to employees, directors and consultants of the Company.

The following table summarizes share-based compensation expense reflected in the condensed consolidated statements of operations for the three months ended March 31, 2019 and 2018 (in thousands):

	Three Months Ended	
	March 31,	
	2019	2018
Research and development	\$ 3,972	\$ 3,322
Selling, general and administrative	10,499	5,526
Restructuring expenses	517	195
	\$ 14,988	\$ 9,043

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During the three months ended March 31, 2018, the Company reduced its field-based workforce by approximately 60 employees, primarily consisting of field-based sales representatives that promoted DUZALLO or ZURAMPIC in the first position, resulting in a modification to certain share-based payment awards. As a result of the modification, the Company recorded stock-based compensation expense of approximately \$0.2 million to restructuring expenses during the three months ended March 31, 2018. The Company recorded no stock-based compensation expense related to this modification during the three months ended March 31, 2019.

During the three months ended June 30, 2018, the Company initiated a reduction in headquarter-based workforce by approximately 40 employees associated with the Company's separation. Certain share-based payment awards were modified in connection with the reduction in workforce. As a result of the modifications, the Company recorded an insignificant amount of share-based compensation expense to restructuring expenses during the three months ended March 31, 2019.

In February 2019, following further analysis of the Company's strategy and core business needs, and in an effort to further strengthen the operational efficiency of the organization, the Company commenced a reduction in workforce by 35 employees, primarily based in the home office. Certain share-based payment awards were modified in connection with the reduction in workforce. As a result of the modifications, the Company recorded share-based compensation expense of approximately \$0.5 million to restructuring expenses during the three months ended March 31, 2019.

In connection with certain other modifications of share-based payment awards during the three months ended March 31, 2019, the Company recognized approximately \$2.4 million in share-based compensation expense.

A summary of stock option activity for the three months ended March 31, 2019 is as follows:

	Number of Shares (in thousands)	Weighted- Average Fair Value
Outstanding at December 31, 2018	20,458	\$ 13.47
Granted	4,383	12.92
Exercised	(415)	8.41
Cancelled	(346)	14.61
Outstanding at March 31, 2019	24,080	\$ 13.44

The weighted-average assumptions used to estimate the fair value of the stock options using the Black-Scholes option-pricing model were as follows for the three months ended March 31, 2019 and 2018:

	Three Months Ended March 31,			
	2019		2018	
Expected volatility	46.2	%	43.6	%
Expected term (in years)	6.1		6.0	
Risk-free interest rate	2.6	%	2.7	%
Expected dividend yield	—	%	—	%

The Company utilizes RSUs in addition to stock options as part of the equity compensation it provides to its employees, each RSU representing the right to receive one share of the Company's Class A Common Stock pursuant to the terms of the applicable award agreement and granted pursuant to the terms of the Company's 2010 Equity Plan. The RSUs generally vest 25% per year on the approximate anniversary of the date of grant until fully vested, provided the employee remains continuously employed with the Company through each vesting date. Shares of the Company's Class A Common Stock are delivered to the employee upon vesting, subject to payment of applicable withholding taxes. The fair value of all RSUs is based on the market value of the Company's Class A Common Stock on the date of grant. Compensation expense, including the effect of estimated forfeitures, is recognized over the applicable service period.

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A summary of RSU activity for the three months ended March 31, 2019 is as follows (in thousands):

	Number of Shares	Weighted- Average Grant Date Fair Value
Unvested as of December 31, 2018	3,058	\$ 15.53
Granted	1,664	\$ 12.89
Vested	(796)	\$ 14.93
Forfeited	(285)	\$ 14.36
Unvested as of March 31, 2019	3,641	\$ 14.55

10. Cycleron Separation

Prior to the Separation on April 1, 2019, as described in Note 1, Nature of Business, Cycleron was a wholly owned subsidiary of the Company. On March 30, 2019, the Company entered into certain agreements with Cycleron relating to the Separation, including a separation agreement, a tax matters agreement, and an employee matters agreement.

The separation agreement with Cycleron, dated as of March 30, 2019, sets forth, among other things, the Company's agreements with Cycleron regarding the principal actions to be taken in connection with the Separation, including the distribution, which was effective as of April 1, 2019. The separation agreement identifies assets transferred, liabilities assumed by and contracts assigned to each of Cycleron and Ironwood as part of the Separation, and it provides for when and how these transfers, assumptions and assignments occur. The purpose of the separation agreement is to provide Cycleron and Ironwood with assets to operate their respective businesses and retain or assume liabilities related to those assets.

The tax matters agreement, dated as of March 30, 2019, governs each party's rights, responsibilities and obligations with respect to taxes, including taxes, if any, incurred as a result of any failure of the Separation to qualify as tax-free. In general, if the parties incur tax liabilities in the event that the Separation is not tax-free, each party is expected to be responsible for any taxes imposed on Ironwood or Cycleron that arise from the failure of the Separation to qualify as a transaction that is generally tax-free for U.S. federal income tax purposes, under Sections 355 and 368(a)(1)(D) and certain other relevant provisions of the Internal Revenue Code of 1986, as amended, to the extent that the failure to so qualify is attributable to an acquisition of stock or assets of, or certain actions, omissions or failures to act of, such

party. If both Ironwood and Cyclorion are responsible for such failure, liability will be shared according to relative fault. U.S. tax otherwise resulting from the failure of the Separation to qualify as a transaction that is tax-free generally will be the responsibility of Ironwood. Cyclorion agreed to certain covenants that contain restrictions intended to preserve the tax-free status of the distribution and certain related transactions.

The employee matters agreement, dated as of March 30, 2019, allocates assets, liabilities and responsibilities relating to the employment, compensation, and employee benefits of Ironwood and Cyclorion employees, and other related matters in connection with the Separation, including the treatment of outstanding Ironwood incentive equity awards. Pursuant to the employee matters agreement, the outstanding Ironwood equity awards held by Cyclorion and Ironwood employees were adjusted immediately prior to the Separation, with the intent to maintain, immediately following the Separation, the economic value of the awards.

Additionally, upon Separation on April 1, 2019, the Company entered into certain agreements with Cyclorion relating to the Separation, including two transitional services agreements and a development agreement.

Pursuant to the transitional service agreements, the Company will provide and receive certain transitional services related to corporate functions, such as finance, procurement, facilities and development. Services provided by the Company to Cyclorion will continue for an initial term of between one to two years (as applicable), unless earlier terminated or extended according to the terms of the transitional services agreement. Services provided by Cyclorion to the Company will continue for an initial term of one year, unless earlier terminated or extended according to the terms of such transitional services agreement. Services received and performed are paid at a mutually agreed upon rate.

Pursuant to the development agreement, Cyclorion will provide the Company with certain research and development services with respect to certain of Ironwood's products and product candidates, including MD-7246

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(linaclotide delayed release) and IW-3718 upon Separation. Such research and development activities will be governed by a joint steering committee comprised of representatives from both Cyclerion and Ironwood. Services received are paid at a mutually agreed upon rate.

11. Related Party Transactions

In September 2009, Allergan became a related party when the Company sold to Allergan 2,083,333 shares of the Company's convertible preferred stock. Amounts due to and due from Allergan are reflected as related party accounts payable and related party accounts receivable, respectively. These balances are reported net of any balances due to or from the related party. As of March 31, 2019 and December 31, 2018, the Company had approximately \$69.3 million and approximately \$60.0 million, respectively, in related party accounts receivable, net of related party accounts payable, associated with Allergan.

The Company has and currently obtains health insurance services for its employees from an insurance provider whose President and Chief Executive Officer became a member of the Company's Board of Directors in April 2016. The Company paid approximately \$2.5 million and approximately \$3.3 million in insurance premiums to this insurance provider during the three months ended March 31, 2019 and 2018, respectively. At both March 31, 2019 and December 31, 2018, the Company had no accounts payable due to this related party.

The Company has and currently obtains commercial market and prescription data from a vendor whose Senior Vice President of Strategy, Marketing and Communications became a member of the Company's Board of Directors in April 2018. The Company paid approximately \$0.5 million and approximately \$0.6 million in fees to this company during the three months ended March 31, 2019 and 2018, respectively. As of both March 31, 2019 and December 31, 2018, the Company had an insignificant amount of accounts payable due to this related party.

12. Workforce Reduction

On January 30, 2018, the Company commenced an initiative to evaluate the optimal mix of investments for the lesinurad franchise. As part of this effort, the Company reduced its field-based workforce by approximately 60 employees, primarily consisting of field-based sales representatives that promoted DUZALLO or ZURAMPIC in the first position. During the three months ended March 31, 2018, the Company substantially completed the implementation of this reduction in field-based workforce and, in accordance with ASC 420, Exit or Disposal Activities ("ASC 420"), recorded approximately \$2.4 million of costs including employee severance, benefits and

related costs. These costs are reflected in the condensed consolidated statement of operations as approximately \$2.4 million in restructuring expenses.

On June 27, 2018, the Company determined the initial organizational designs of the two new businesses, including employees' roles and responsibilities, in connection with the Separation. As part of this process, the Company initiated a reduction in its headquarter-based workforce by approximately 40 employees. During the three months ended March 31, 2019, the Company recorded an insignificant amount of costs in connection with the reduction in workforce associated with the separation in accordance with ASC 420. These costs are reflected in the condensed consolidated statement of operations as restructuring expenses.

On August 16, 2018, the Company initiated a reduction in its workforce by approximately 100 employees, primarily consisting of field-based sales representatives in connection with the termination of the Lesinurad License. During the three months ended March 31, 2019, the Company recorded an insignificant amount of costs in accordance with ASC 420. These costs are reflected in the condensed consolidated statement of operations as restructuring expenses.

On February 7, 2019, following further analysis of the Company's strategy and core business needs, and in an effort to further strengthen the operational efficiency of the organization, the Company commenced a reduction in workforce by 35 employees, primarily based in the home office. During the three months ended March 31, 2019, the Company substantially completed the implementation of this reduction in workforce and, in accordance with ASC 420, recorded approximately \$3.3 million of costs including employee severance, benefits, and related costs that are reflected in the condensed consolidated statement of operations as restructuring expenses.

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The following table summarizes the accrued liabilities activity recorded in connection with the reduction in workforce for the three months ended March 31, 2019 (in thousands):

	Amounts Accrued at		Amount Paid	Adjustments	Amounts Accrued at
	December 31, 2018	Charges			March 31, 2019
Employee severance, benefits and related costs					
June 2018 Reduction	1,114	15	(652)	(25)	452
August 2018 Reduction	1,756	—	(1,635)	(44)	77
February 2019 Reduction	—	2,827	(504)	—	2,323
Total	\$ 2,870	\$ 2,842	\$ (2,791)	\$ (69)	\$ 2,852
Contract related costs					
August 2018 Reduction	\$ 433	\$ —	\$ (287)	\$ (42)	\$ 104
Total	\$ 433	\$ —	\$ (287)	\$ (42)	\$ 104

During the three months ended March 31, 2019 and 2018, the Company recorded approximately \$3.3 million and approximately \$2.4 million in restructuring expenses, respectively.

13. Subsequent Events

As described in Note 1, Nature of Business, and Note 10, Cycleron Separation, the Company completed the Separation on April 1, 2019. Effective upon the completion of the Separation, Ironwood appointed Mark Mallon as the chief executive officer of the Company.

On April 1, 2019, the Company amended its lease (the "2019 Lease Amendment") with BMR-Rogers Street LLC, the building landlord of the Facility, to reduce its existing leased premises to approximately 108,000 rentable square feet of office space on the first and third floors. The Company surrendered a portion of its prior premises by approximately 114,000 rentable square feet on the second and first floor of the building. The surrendered portion of its prior premises is now occupied by Cycleron under a direct lease between Cycleron and the building landlord. As part of the Separation, certain improvements are being completed in Cycleron's leased premises. To accommodate the post-Separation completion of such improvements, Ironwood has entered into a short-term swing space sublease of approximately 24,000 rentable square feet with Cycleron in Ironwood's remaining premises in the Facility to allow a portion of Cycleron's employees to continue to operate while such improvements are completed. The sublease is for an initial one-month term with several one-month extension options.

On April 16, 2019, the Company announced an adjustment to the conversion rate applicable to the existing 2022 Notes, effective April 15, 2019. The adjustment was effected pursuant to the indenture, dated as of June 15, 2015, as supplemented April 5, 2019, between the Company and U.S. Bank National Association, as trustee, pursuant to which the 2022 Notes were originally issued. In connection with the Separation, on April 1, 2019, Ironwood distributed to its stockholders one share of Cyclorion common stock for every 10 shares of Ironwood common stock held as of the close of business on March 19, 2019, the record date for the distribution. As a result of the Separation, effective April 15, 2019, the conversion rate under the indenture was adjusted from 60.3209 to 68.9172 shares of Ironwood common stock per \$1,000 principal amount of the 2022 Notes, which is equal to an adjusted conversion price of approximately \$14.51 per share and 23,135,435 shares. In connection with the adjustment to the conversion rate of the indenture, the exercise price of the Convertible Note Hedges and the Note Hedge Warrants were adjusted to \$14.51 per share and \$18.82 per share, respectively.

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On April 24, 2019, the Company and Allergan entered into a new agreement for the continued promotion of VIBERZI in the U.S. The agreement is effective from April 1, 2019 through December 31, 2019. Under the terms of the new VIBERZI agreement with Allergan, the Company's will be compensated at a fixed rate for each detailing of VIBERZI in the second position performed by its clinical sales specialists to targeted health care practitioners, subject to a cap of approximately \$4.1 million. In addition, the Company has the potential to receive additional consideration if a pre-specified number of units of VIBERZI are sold during the term of the agreement.

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

Forward-Looking Information

The following discussion of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and the notes to those financial statements appearing elsewhere in this Quarterly Report on Form 10-Q and the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K. This discussion contains forward-looking statements that involve significant risks and uncertainties. As a result of many factors, such as those set forth under "Risk Factors" in Item 1A of this Quarterly Report on Form 10-Q, our actual results may differ materially from those anticipated in these forward-looking statements.

Overview

We are a gastrointestinal, or GI, healthcare company focused on creating medicines that make a difference for people living with GI diseases. We are advancing innovative product opportunities in areas of large unmet need, capitalizing on our proven development and commercial capabilities and our deep expertise in GI diseases. On April 1, 2019, we completed our tax-free spin-off of our soluble guanylate cyclase, or sGC, business into a separate, publicly traded company, called Cyclerion Therapeutics, Inc. or Cyclerion.

Our commercial product, linaclotide, is available to adult men and women suffering from irritable bowel syndrome with constipation, or IBS-C, or chronic idiopathic constipation, or CIC, in certain countries around the world. Linaclotide is available under the trademarked name LINZESS® to adult men and women suffering from IBS-C or CIC in the United States, or the U.S., and Mexico, and to adult men and women suffering from IBS-C in Japan. Linaclotide is available under the trademarked name CONSTELLA® to adult men and women suffering from IBS-C or CIC in Canada, and to adult men and women suffering from IBS-C in certain European countries.

We have formed strategic partnerships with leading pharmaceutical companies to support the development and commercialization of linaclotide throughout the world. We and our partner Allergan plc (together with its affiliates), or Allergan, began commercializing LINZESS in the U.S. in December 2012. Under our collaboration with Allergan for North America, total net sales of LINZESS in the U.S., as recorded by Allergan, are reduced by commercial costs incurred by each party, and the resulting amount is shared equally between us and Allergan. Allergan has an exclusive license from us to develop and commercialize linaclotide in the Allergan License Territory, which is comprised of all countries other than China, Hong Kong, Macau, Japan and the countries and territories of North America. On a country-by-country and product-by-product basis in the Allergan License Territory, Allergan pays us royalties as a percentage of net sales of products containing linaclotide as an active ingredient. In addition, Allergan has exclusive rights to commercialize linaclotide in Canada as CONSTELLA and in Mexico as LINZESS.

Astellas Pharma Inc., or Astellas, our partner in Japan, has an exclusive license to develop and commercialize linaclotide in Japan. In March 2017, Astellas began commercializing LINZESS for the treatment of adults with IBS-C in Japan, and in September 2018, Astellas began commercializing LINZESS for the treatment of adult patients with chronic constipation in Japan. In October 2012, we entered into a collaboration agreement with AstraZeneca AB (together with its affiliates), or AstraZeneca, to co-develop and co-commercialize linaclotide in China, Hong Kong and Macau, with AstraZeneca having primary responsibility for the local operational execution. In January 2019, the National Medical Products Administration approved the marketing application for LINZESS for adults with IBS-C in China.

We and Allergan are exploring ways to enhance the clinical profile of LINZESS by studying linaclotide in additional indications, populations and formulations to assess its potential to treat various conditions. In July 2018, we announced the initiation of a Phase IIIb trial evaluating the efficacy and safety of linaclotide 290 mcg on multiple abdominal symptoms in addition to pain, including bloating and discomfort, in adult patients with IBS-C.

We and Allergan are also advancing MD-7246, a delayed release form of linaclotide, as an oral, intestinal, non-opioid pain relieving agent for patients suffering from abdominal pain associated with irritable bowel syndrome with diarrhea, or IBS-D.

We are also advancing another GI development program, IW-3718, a gastric retentive formulation of a bile acid sequestrant, for the potential treatment of persistent gastroesophageal reflux disease, or persistent GERD. In June 2018, we initiated two Phase III clinical trials evaluating the safety and efficacy of IW-3718 in patients with persistent GERD.

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As part of our strategy, we have also established development and commercial capabilities that we plan to leverage as we seek to bring multiple medicines to patients. We intend to play an active role in the development and commercialization of our products in the U.S., and to establish a strong global brand by out-licensing commercialization rights in other territories to high-performing partners.

In January 2017, we and Allergan entered into a commercial agreement under which the adjustments to our or Allergan's share of the net profits under the share adjustment provision of the collaboration agreement for linaclotide in North America were eliminated, in full, in 2018 and all subsequent years. In addition, Allergan appointed us, on a non-exclusive basis, to promote CANASA® (mesalamine), approved for the treatment of ulcerative proctitis in the U.S. for approximately two years. In December 2017, this agreement was amended to include the promotion of VIBERZI, for treatment for adults suffering from IBS-D, through December 31, 2018. In December 2018, we and Allergan entered into an agreement to discontinue our promotion of CANASA effective December 31, 2018, and to extend our promotion of VIBERZI through March 31, 2019. In March 2019, we amended existing agreements with Allergan to continue sales detailing activities for VIBERZI through April 2019. As of March 31, 2019, we have fulfilled all of our obligations under the commercial agreement. These agreements are more fully described in Note 3, Collaboration, License, Co-Promotion and Other Commercial Agreements, to our condensed consolidated financial statements appearing elsewhere in this Quarterly Report on Form 10-Q.

We were incorporated in Delaware on January 5, 1998 as Microbia, Inc. On April 7, 2008, we changed our name to Ironwood Pharmaceuticals, Inc. We operate in one reportable business segment—human therapeutics.

To date, we have dedicated a majority of our activities to the research, development and commercialization of linaclotide and the commercialization of lesinurad, as well as to the research and development of our other product candidates. We have incurred significant operating losses since our inception in 1998. As of March 31, 2019, we had an accumulated deficit of approximately \$1.7 billion. We are unable to predict the extent of any future losses or guarantee when, or if, our company will become cash flow positive.

On April 1, 2019, we completed the previously announced separation of our sGC business, and certain other assets and liabilities, into a separate, independent publicly traded company, or the Separation. The Separation was effected by means of a distribution of all of the outstanding shares of common stock, with no par value, of Cyclorion, through a dividend of Cyclorion's common stock to our stockholders of record as of the close of business on March 19, 2019. Cyclorion is a clinical-stage biopharmaceutical company harnessing the power of sGC pharmacology to discover, develop, and commercialize breakthrough treatments for serious and orphan diseases. Cyclorion's portfolio is comprised of several sGC stimulators, including olinciguat a vascular sGC stimulator in Phase II development, praliciguat a systemic sGC stimulator in Phase II development, and IW-6463, a central nervous system-penetrant sGC stimulator in Phase I development.

Additionally, we have periodically entered into co-promotion agreements to maximize our salesforce productivity. In December 2018 and in March 2019, we extended the VIBERZI Amendment, and in April 2019, we entered into a new

agreement with Allergan to continue sales detailing activities for VIBERZI, for treatment for adults suffering from IBS-D through December 2019.

Financial Overview

Revenues. Our revenues are generated primarily through our collaborative arrangements and license agreements related to research and development and commercialization of linaclotide, as well as co-promotion arrangements in the U.S. and product revenue related to the commercial sale of ZURAMPIC and DUZALLO in the U.S. Effective January 1, 2018, we adopted Accounting Standards Codification, or ASC, Topic 606, Revenue from Contracts with Customers, or ASC 606, using the modified retrospective transition method. The adoption of ASC 606 represents a change in accounting principle that aims to more closely align revenue recognition with the delivery of our services and will provide financial statement readers with enhanced disclosures. In accordance with ASC 606, we recognize revenue when the customer obtains control of a promised good or service, in an amount that reflects the consideration which we expect to receive in exchange for the good or service. The reported results for the three months ended as of March 31, 2019 and 2018 reflect the application of ASC 606 guidance. Upon adoption of ASC 606, we concluded that no cumulative-effect adjustment to the accumulative deficit as of January 1, 2018 was necessary. The adoption of ASC 606 had no impact on our condensed consolidated statement of operations, condensed consolidated balance sheets, or condensed consolidated statement of cash flows.

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The terms of the collaborative research and development, license and co-promotion agreements contain multiple performance obligations which may include (i) licenses, (ii) research and development activities, (iii) the manufacture of finished drug product, active pharmaceutical ingredient, or API, or development materials for a partner which are reimbursed at a contractually determined rate, and (iv) co-promotion activities by our clinical sales specialists. Payments to us may include (i) up-front license fees, (ii) payments for research and development activities, (iii) payments for the manufacture of finished drug product, API or development materials, (iv) payments based upon the achievement of certain milestones, (v) payments for sales detailing, promotional support services and medical education initiatives and (vi) royalties on product sales. Additionally, we receive our share of the net profits or bear our share of the net losses from the sale of linaclotide in the U.S. and China.

We record our share of the net profits and losses from the sales of LINZESS in the U.S. on a net basis and present the settlement payments to and from Allergan as collaboration expense or collaborative arrangements revenue, as applicable. Net profits or losses consist of net sales to third-party customers and sublicense income in the U.S. less the cost of goods sold as well as selling, general and administrative expenses. Although we expect net sales to increase over time, the settlement payments between Allergan and us, resulting in collaborative arrangements revenue or collaboration expense, are subject to fluctuation based on the ratio of selling, general and administrative expenses incurred by each party. In addition, our collaborative arrangements revenue may fluctuate as a result of the timing and amount of license fees and clinical and commercial milestones received and recognized under our current and future strategic partnerships as well as timing and amount of royalties from the sales of linaclotide in the European, Canadian or Mexican markets or any other markets where linaclotide receives approval.

Product revenue was recognized when a particular national wholesaler or a selected regional wholesaler, or a Distributor, obtained control of our product, which occurred at a point in time, typically upon shipment of ZURAMPIC and DUZALLO, or the Lesinurad Products, to the Distributor.

Cost of Revenues. Cost of revenues primarily includes cost of collaborative arrangements revenue related to the sales of linaclotide API and drug product. Cost related to the sales of linaclotide API and drug product are recognized upon shipment of linaclotide API and drug product to certain of our partners outside of the U.S. Our cost of collaborative arrangements revenue for linaclotide consists of the internal and external costs of producing such API and drug product for certain of our partners outside of the U.S.

Research and Development Expense. Research and development expense consists of expenses incurred in connection with the discovery and development of our product candidates. These expenses consist primarily of compensation, benefits and other employee-related expenses, research and development related facility costs, third-party contract costs relating to nonclinical study and clinical trial activities, development of manufacturing processes, regulatory registration of third-party manufacturing facilities, as well as licensing fees for our product candidates. We charge all research and development expenses to operations as incurred. Under our linaclotide collaboration agreements with Allergan for the U.S. and AstraZeneca for China, Hong Kong and Macau, we are reimbursed for certain research and development expenses, and we net these reimbursements against our research and development expenses as incurred. Amounts owed to Allergan or AstraZeneca for such linaclotide territories are recorded as incremental research and development expense.

The core of our research and development strategy is to leverage our development capabilities, as well as our pharmacologic expertise, to bring multiple medicines to patients. We are advancing innovative product opportunities in areas of large unmet need, including IBS-C and CIC, abdominal pain associated with lower GI disorders, and persistent GERD.

Linaclotide. Linaclotide is the first FDA-approved guanylate cyclase type-C, or GC-C, agonist. Linaclotide is approved and commercially available in the U.S., Japan and in a number of E.U. and other countries. In January 2019, the National Medical Products Administration approved the marketing application for LINZESS for adults with IBS-C in China.

We and Allergan are exploring ways to enhance the clinical profile of LINZESS by studying linaclotide in additional indications, populations and formulations to assess its potential to treat various conditions. In January 2017, the FDA approved a 72 mcg dose of LINZESS for adults with CIC, which became available in the U.S. in March 2017. In July 2018, we announced the initiation of a Phase IIIb trial evaluating the efficacy and safety of linaclotide 290 mcg on multiple abdominal symptoms in addition to pain, including bloating and discomfort, in adult patients with IBS-C. In

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addition, we and Allergan have established a plan with the FDA for clinical pediatric programs with linaclotide, as described below.

MD-7246. We and Allergan are exploring MD-7246, an oral, intestinal, non-opioid pain relieving agent, for patients suffering from IBS-D.

IW-3718. We are advancing our persistent GERD program through the development of IW-3718, a gastric retentive formulation of a bile acid sequestrant. IW-3718 is designed to release in the stomach over an extended period of time, bind to bile that refluxes into the stomach, and potentially provide symptomatic relief in patients with persistent GERD. In June 2018, we announced the initiation of two Phase III clinical trials evaluating the safety and efficacy of IW-3718 in patients with persistent GERD.

We have additional assets in early development that we continue to advance, and we are exploring strategic options for further development of these assets.

Discovery Research. Prior to the Separation, our discovery efforts were primarily focused on identifying novel clinical candidates that drew on our proprietary and expanding expertise in GI disorders and GC pathways. Our discovery efforts are now focused on supporting our development stage GI programs.

The following table sets forth our research and development expenses related to our product pipeline for the three months ended March 31, 2019 and 2018. These expenses relate primarily to internal compensation, benefits and other employee-related expenses and external costs associated with nonclinical studies and clinical trial costs for our product candidates. We allocate costs related to facilities, depreciation, share-based compensation, research and development support services, laboratory supplies and certain other costs directly to programs.

	Three Months Ended	
	March 31,	
	2019	2018
	(in thousands)	
Linaclotide(1)	\$ 9,863	\$ 7,291
Lesinurad(2)	216	1,947
Development candidates:		
GI disorders (two compounds)(3)	17,050	5,308
Vascular and fibrotic disorders (two compounds)(3,4)	17,127	13,100
Central nervous system disorders (one compound)(3,4)	2,790	3,282
Total development candidates	36,967	21,690

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Discovery research	6,944	5,577
Total research and development expenses	\$ 53,990	\$ 36,505

- (1) Includes linaclotide immediate release in all indications, populations and formulations, and costs associated with MD-7246.
- (2) Includes lesinurad in all indications, populations and formulations.
- (3) Number of compounds includes clinical-stage development candidates for the three months ended March 31, 2019.
- (4) These development candidates transferred to Cyclerion effective April 1, 2019.

Since 2004, the date we began tracking costs by program, we have incurred approximately \$472.5 million of research and development expenses related to linaclotide. The expenses for linaclotide include both our portion of the research and development costs incurred by Allergan for the U.S. and AstraZeneca for China, Hong Kong and Macau and invoiced to us under the cost-sharing provisions of our collaboration agreements, as well as the unreimbursed portion of research and development costs incurred by us under such cost-sharing provisions.

The lengthy process of securing regulatory approvals for new drugs requires the expenditure of substantial resources. Any failure by us to obtain, or any delay in obtaining, regulatory approvals would materially adversely affect our product development efforts and our business overall.

In connection with the FDA approval of LINZESS, we are required to conduct certain nonclinical and clinical studies, including those aimed at understanding: (a) whether orally administered linaclotide can be detected in breast milk, (b) the potential for antibodies to be developed to linaclotide, and if so, (c) whether antibodies specific for

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linaclotide could have any therapeutic or safety implications. In addition, we and Allergan established a nonclinical and clinical post-marketing plan with the FDA to understand the efficacy and safety of LINZESS in pediatric patients. We and Allergan are advancing clinical pediatric programs in IBS-C patients age seven to 17 and functional constipation patients age six to 17. We and Allergan are also exploring development opportunities to enhance the clinical profile of LINZESS by studying linaclotide in additional indications, populations and formulations to assess its potential to treat various conditions. We cannot currently estimate with any degree of certainty the amount of time or money that we will be required to expend in the future on linaclotide for other geographic markets within IBS-C and CIC, or in additional indications, populations or formulations.

Given the inherent uncertainties that come with the development of pharmaceutical products, we cannot estimate with any degree of certainty how our programs will evolve, and therefore the amount of time or money that would be required to obtain regulatory approval to market them.

As a result of these uncertainties surrounding the timing and outcome of any approvals, we are currently unable to estimate precisely when, if ever, linaclotide's utility will be expanded within its currently approved indications; if or when linaclotide will be developed outside of its current markets, indications, populations or formulations; or when, if ever, any of our other product candidates will generate revenues and cash flows.

We invest carefully in our pipeline, and the commitment of funding for each subsequent stage of our development programs is dependent upon the receipt of clear, supportive data. In addition, we intend to access externally discovered drug candidates that fit within our core strategy. In evaluating these potential assets, we apply the same investment criteria as those used for investments in internally discovered assets.

The successful development of our product candidates is highly uncertain and subject to a number of risks including, but not limited to:

- The duration of clinical trials may vary substantially according to the type, complexity and novelty of the product candidate.
- The FDA and comparable agencies in foreign countries impose substantial and varying requirements on the introduction of therapeutic pharmaceutical products, typically requiring lengthy and detailed laboratory and clinical testing procedures, sampling activities and other costly and time-consuming procedures.
- Data obtained from nonclinical and clinical activities at any step in the testing process may be adverse and lead to discontinuation or redirection of development activity. Data obtained from these activities also are susceptible to varying interpretations, which could delay, limit or prevent regulatory approval.

- The duration and cost of discovery, nonclinical studies and clinical trials may vary significantly over the life of a product candidate and are difficult to predict.
- The costs, timing and outcome of regulatory review of a product candidate may not be favorable, and, even if approved, a product may face post-approval development and regulatory requirements.
- There may be substantial costs, delays and difficulties in successfully integrating externally developed product candidates into our business operations.
- The emergence of competing technologies and products and other adverse market developments may negatively impact us.

As a result of the factors discussed above, including the factors discussed under “Risk Factors” in Item 1A of this Quarterly Report on Form 10-Q, we are unable to determine the duration and costs to complete current or future nonclinical and clinical stages of our product candidates or when, or to what extent, we will generate revenues from the commercialization and sale of our product candidates. Development timelines, probability of success and development costs vary widely. We anticipate that we will make determinations as to which additional programs to pursue and how much funding to direct to each program on an ongoing basis in response to the data of each product candidate, the competitive landscape and ongoing assessments of such product candidate’s commercial potential.

We expect to invest in our development programs for the foreseeable future. We will continue to invest in linaclotide, including the investigation of ways to enhance the clinical profile within its currently approved indications,

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and the exploration of its potential utility in other indications, populations and formulations. We will also continue to invest in our other GI-focused product candidates as we advance them through clinical trials, in addition to funding full-time equivalents for research and development activities under our external collaboration and license agreements.

Selling, General and Administrative Expense. Selling, general and administrative expense consists primarily of compensation, benefits and other employee-related expenses for personnel in our administrative, finance, legal, information technology, business development, commercial, sales, marketing, communications and human resource functions. Other costs include the legal costs of pursuing patent protection of our intellectual property, general and administrative related facility costs, insurance costs and professional fees for accounting and legal services. As we continue to invest in the commercialization of LINZESS, we expect our selling, general and administrative expenses will be substantial for the foreseeable future. We record all selling, general and administrative expenses as incurred.

Under our AstraZeneca collaboration agreement for linaclotide, we are reimbursed for certain selling, general and administrative expenses and we net these reimbursements against our selling, general and administrative expenses as incurred. We include Allergan's selling, general and administrative cost-sharing payments in the calculation of the net profits and net losses from the sale of LINZESS in the U.S. and present the net payment to or from Allergan as collaboration expense or collaborative arrangements revenue, respectively.

Restructuring Expenses. We record costs and liabilities associated with exit and disposal activities in accordance with ASC 420, Exit or Disposal Cost Obligations. Such costs are based on estimates of fair value in the period the liabilities are incurred in accordance with ASC 420. We evaluate and adjust these costs as appropriate for changes in circumstances as additional information becomes available.

Other (Expense) Income. Interest expense consists primarily of cash and non-cash interest costs related to the 2022 Notes and the 2026 Notes. Non-cash interest expense consists of amortization of the debt discount and associated debt issuance costs associated with the 2022 Notes and 2026 Notes. We amortize these costs using the effective interest rate method over the life of the respective note agreements as interest expense in our condensed consolidated statements of operations.

In June 2015, in connection with the issuance of the 2022 Notes, we entered into convertible note hedge transactions, or the Convertible Note Hedges. Concurrently with entering into the Convertible Note Hedges, we also entered into certain warrant transactions in which we sold note hedge warrants, or the Note Hedge Warrants, to the Convertible Note Hedge counterparties to acquire 20,249,665 shares of our Class A common stock, subject to customary anti-dilution adjustments. Gain (loss) on derivatives consists of the change in fair value of the Convertible Note Hedges and Note Hedge Warrants, which are recorded as derivative assets and liabilities. The Convertible Note Hedges and the Note Hedge Warrants are recorded at fair value at each reporting period and changes in fair value are recorded in our condensed consolidated statements of operations. This transaction is more fully described in Note 8, Notes Payable, to our condensed consolidated financial statements appearing elsewhere in this Quarterly Report on Form 10-Q.

In September 2016, we closed a direct private placement, pursuant to which we issued \$150.0 million in aggregate principal amount of 8.375% notes due 2026 on January 5, 2017, or the Funding Date. This transaction is more fully described in Note 8, Notes Payable, to our condensed consolidated financial statements appearing elsewhere in this Quarterly Report on Form 10-Q.

Interest income consists of interest earned on our cash, cash equivalents and marketable securities.

Critical Accounting Policies and Estimates

Our discussion and analysis of our financial condition and results of operations is based upon our condensed consolidated financial statements prepared in accordance with U.S. generally accepted accounting principles. The preparation of these financial statements requires us to make certain estimates and assumptions that may affect the reported amounts of assets and liabilities and disclosure of contingent assets and liabilities at the date of the condensed consolidated financial statements, and the amounts of revenues and expenses during the reported periods. Significant estimates and assumptions in our condensed consolidated financial statements include those related to revenue recognition; available-for-sale securities; accounts receivable; inventory valuation, and related reserves; impairment of long-lived assets; including goodwill; initial valuation procedures for right-of-use assets and operating lease liabilities; initial valuation procedures for the issuance of convertible notes; fair value of derivatives; balance sheet classification of notes payable and convertible notes; income taxes, including the valuation allowance for deferred tax assets; research and development expenses; contingencies and share-based compensation. We base our estimates on our historical

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experience and on various other assumptions that are believed to be reasonable, the results of which form the basis for making judgments about the carrying values of assets and liabilities. Actual results may differ materially from our estimates under different assumptions or conditions. Changes in estimates are reflected in reported results in the period in which they become known.

Except as outlined below, during the three months ended March 31, 2019, there were no material changes to our critical accounting policies as reported in our Annual Report on Form 10-K for the year ended December 31, 2018, which was filed with the Securities and Exchange Commission, or SEC, on February 25, 2019, or the 2018 Annual Report on Form 10-K.

Leases

Effective January 1, 2019, we adopted Accounting Standards Codification, or ASC, Topic 842, Leases, or ASC 842, using the optional transition method. The adoption of ASC 842 represents a change in accounting principle that aims to increase transparency and comparability among organizations by requiring the recognition of right-of-use, or ROU, assets and lease liabilities on the balance sheet for both operating and finance leases. In addition, the standard requires enhanced disclosures that meet the objective of enabling financial statement users to assess the amount, timing, and uncertainty of cash flows arising from leases. The reported results for the three months ended March 31, 2019 reflect the application of ASC 842 guidance, while the reported results for prior periods were prepared in conjunction with ASC 840, Leases, or ASC 840. Because there were no material changes to the values of existing capital leases as a result of the adoption of ASC 842, we concluded that no cumulative-effect adjustment to the accumulated deficit as of January 1, 2019 was necessary. The recognition of right-of-use assets and lease liabilities related to our operating leases under ASC 842 has had a material impact on our condensed consolidated financial statements.

As part of the ASC 842 adoption, we have utilized certain practical expedients outlined in the guidance. These practical expedients include:

- A policy election to use the short-term lease exception by asset class;

- Election of the practical expedient package during transition, which includes:
 - o An entity need not reassess whether any expired or existing contracts are or contain leases.
 - o An entity need not reassess the classification for any expired or existing leases. As a result, all leases that were classified as operating leases in accordance with ASC 840 are classified as operating leases under ASC 842, and all leases that were classified as capital leases in accordance with ASC 840 are classified as finance leases under ASC 842.
 - o An entity need not reassess initial direct costs for any existing leases.

Our lease portfolio includes: a property lease for our headquarters location, a data center colocation lease, vehicle leases for our salesforce representatives, and leases for computer and office equipment. We determine if an

arrangement is a lease at the inception of the contract. The asset component of our operating leases are recorded as operating lease right-of-use asset, and the liability component of is recorded as current portion of operating lease liabilities and operating lease liabilities, net of current portion in our condensed consolidated balance sheet. As of March 31, 2019, we did not have any finance leases.

Right-of-use assets and operating lease liabilities are recognized based on the present value of lease payments over the lease term at the commencement date. Existing leases in the Company's lease portfolio as of the adoption date were valued as of January 1, 2019. We use an incremental borrowing rate based on the information available at commencement date in determining the present value of lease payments if an implicit rate of return is not provided with the lease contract. Operating lease right-of-use assets are adjusted for incentives received.

Lease cost is recognized on a straight-line basis over the lease term, and includes amounts related to short-term leases.

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Results of Operations

The following discussion summarizes the key factors our management believes are necessary for an understanding of our condensed consolidated financial statements.

	Three Months Ended March 31,	
	2019	2018
	(in thousands)	
Revenues:		
Collaborative arrangements revenue	\$ 66,152	\$ 63,086
Product revenue, net	—	635
Sale of active pharmaceutical ingredient	2,578	5,434
Total revenues	68,730	69,155
Cost and expenses:		
Cost of revenues, excluding amortization of acquired intangible assets	1,043	2,607
Research and development	53,990	36,505
Selling, general and administrative	64,741	59,501
Amortization of acquired intangible assets	—	3,476
Loss on fair value remeasurement of contingent consideration	—	512
Restructuring expenses	3,328	2,422
Total cost and expenses	123,102	105,023
Loss from operations	(54,372)	(35,868)
Other (expense) income:		
Interest expense	(9,592)	(9,273)
Interest and investment income	736	681
Gain on derivatives	3,944	1,316
Other expense, net	(4,912)	(7,276)
Net loss	\$ (59,284)	\$ (43,144)

Three months ended March 31, 2019 Compared to Three months ended March 31, 2018

Revenues

	Three Months Ended March 31,		Change	
	2019	2018	\$	%
	(dollars in thousands)			

Revenues:					
Collaborative arrangements revenue	\$ 66,152	\$ 63,086	\$ 3,066	5	%
Product revenue, net	—	635	(635)	(100)	%
Sale of active pharmaceutical ingredient	2,578	5,434	(2,856)	(53)	%
Total revenues	\$ 68,730	69,155	(425)	(1)	%

Collaborative Arrangements Revenue. The increase in revenue from collaborative arrangements of approximately \$3.1 million for the three months ended March 31, 2019 compared to the three months ended March 31, 2018 was primarily related to an approximately \$3.1 million increase in our share of the net profits from the sale of LINZESS in the U.S. driven by increased prescription demand, and an approximately \$0.5 million from an up front payment received in connection with a license agreement. The increases were partially offset by an approximately \$0.7 million decrease attributable to activities associated with VIBERZI.

Product Revenue, net. The decrease in net product revenue of approximately \$0.6 million for the three months ended March 31, 2019 compared to the three months ended March 31, 2018, was primarily due to our termination of the license agreement with AstraZeneca for the development, manufacture, and commercialization of products in the U.S. containing lesinurad as an active ingredient, or the Lesinurad License, in January 2019. As a result of such termination, we are no longer commercializing ZURAMPIC and DUZALLO.

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Sale of Active Pharmaceutical Ingredient. The decrease in sale of API of approximately \$2.9 million for the three months ended March 31, 2019, compared to the three months ended March 31, 2018, was primarily due to decreased shipments of linaclotide API to Astellas in Japan.

Cost and Expenses

	Three Months Ended		Change	
	March 31, 2019	2018	\$	%
	(dollars in thousands)			
Cost and expenses:				
Cost of revenues, excluding amortization of acquired intangible assets	\$ 1,043	\$ 2,607	\$ (1,564)	(60) %
Research and development	53,990	36,505	17,485	48 %
Selling, general and administrative	64,741	59,501	5,240	9 %
Amortization of acquired intangible assets	—	3,476	(3,476)	(100) %
Loss on fair value remeasurement of contingent consideration	—	512	(512)	(100) %
Restructuring expenses	3,328	2,422	906	37 %
Total cost and expenses	\$ 123,102	\$ 105,023	\$ 18,079	17 %

Cost of Revenue, excluding amortization of acquired intangible assets. The decrease of approximately \$1.6 million for the three months ended March 31, 2019 compared to the three months ended March 31, 2018 was primarily related to a decrease in linaclotide API sales to Astellas in Japan.

Research and Development Expense. The increase in research and development expense of approximately \$17.5 million for the three months ended March 31, 2019 compared to the three months ended March 31, 2018 was primarily related to an increase of approximately \$16.1 million in research costs related to our early-stage pipeline candidates; an increase of approximately \$2.3 million related to linaclotide development; an increase of approximately \$0.5 million in costs associated with the Separation; and an increase of approximately \$0.5 million in operating costs including facilities. These increases were partially offset by a decrease of \$1.2 million in compensation, benefits and other employee-related expenses; and a decrease of approximately \$0.4 million related to lesinurad development due to the termination of the Lesinurad License.

Selling, General and Administrative Expense. Selling, general and administrative expenses increased approximately \$5.2 million for the three months ended March 31, 2019 compared to the three months ended March 31, 2018. The increase was primarily as a result of an approximately \$18.7 million increase in costs associated with the Separation, including approximately \$11.5 million in consulting and investment banking costs; an approximately \$3.9 million increase in compensation, benefits and employee-related expenses; an approximately \$2.0 million increase in legal

expenses; and an approximately \$1.1 million increase in facilities and operating expenses. The increases associated with the Separation were partially offset by decreases in other selling, general and administrative expenses of approximately \$13.5 million, including an approximately \$7.7 million decrease in sales and marketing programs; an approximately \$4.2 million decrease in other compensation, benefits and employee-related expenses; an approximately \$2.2 million decrease in other consulting costs; and an approximately \$0.5 million decrease in other facilities and operating costs. These decreases were partially offset by an approximately \$1.0 million increase in non-separation legal expenses.

Amortization of Acquired Intangible Assets. The decrease in amortization of acquired intangible assets expense of approximately \$3.5 million for the three months ended March 31, 2019 compared to the three months ended March 31, 2018 was primarily due to the impairment of the ZURAMPIC and DUZALLO intangible assets as a result of revised cash flow assumptions and the termination of the Lesinurad License.

Loss on Fair Value Remeasurement of Contingent Consideration. The decrease in the loss on fair value of the contingent consideration obligation of approximately \$0.5 million for the three months ended March 31, 2019 compared to the three months ended March 31, 2018 was primarily due to the termination of the Lesinurad License.

Restructuring Expenses. The increase in restructuring expenses of approximately \$0.9 million for the three months ended March 31, 2019 compared to the three months ended March 31, 2018 was primarily due to costs associated with the workforce reduction in February 2019 to optimize operational efficiencies, which exceeded the costs incurred in the January 2018 workforce reduction.

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Other (Expense) Income, Net

	Three Months Ended		Change	
	March 31, 2019	2018	\$	%
	(dollars in thousands)			
Other (expense) income:				
Interest expense	\$ (9,592)	\$ (9,273)	\$ (319)	3 %
Interest and investment income	736	681	55	8 %
Gain on derivatives	3,944	1,316	2,628	200 %
Total other expense, net	\$ (4,912)	\$ (7,276)	\$ 2,364	(32) %

Interest expense increased by approximately \$0.3 million during the three months ended March 31, 2019 compared to the three months ended March 31, 2018, mainly due to an increase of approximately \$0.3 million in interest expense associated with the 2022 Notes.

Interest and investment income increased by an insignificant amount during the three months ended March 31, 2019 compared to the three months ended March 31, 2018.

For the three months ended March 31, 2019, we recorded a gain on derivatives of approximately \$3.9 million resulting from an approximately \$9.5 million increase in the fair value of the Convertible Note Hedges and an approximately \$5.6 million increase in the fair value of the Note Hedge Warrants. For the three months ended March 31, 2018, we recorded a gain on derivatives of approximately \$1.3 million resulting from an approximately \$5.2 million increase in the fair value of the Convertible Note Hedges and an approximately \$3.9 million increase in the fair value of the Note Hedge Warrants.

Liquidity and Capital Resources

At March 31, 2019, we had approximately \$119.0 million of unrestricted cash and cash equivalents. Our cash equivalents include amounts held in money market funds and repurchase agreements. We invest cash in excess of immediate requirements in accordance with our investment policy, which limits the amounts we may invest in any one type of investment and requires all investments held by us to be at least A- rated, with a remaining final maturity when purchased of less than twenty-four months, so as to primarily achieve liquidity and capital preservation.

During the three months ended March 31, 2019, our balances of cash and cash equivalents decreased approximately \$54.1 million. This decrease is primarily due to approximately \$42.4 million of cash used to operate our business, including payments related to, among other things, research and development, and selling, general and administrative expenses, including payroll and compensation expense, as we continue to invest in our research pipeline and support the continued commercialization of our products to effect the Separation. We also made principal payments on the 2026 Notes of approximately \$12.3 million and invested approximately \$3.2 million in capital expenditures. These cash outflows were partially offset by approximately \$3.5 million in proceeds from the exercise of stock options.

We may from time to time seek to retire, redeem or repurchase all or part of our outstanding debt through cash purchases and/or exchanges, in open market purchases, privately negotiated transactions, by tender offer or otherwise. Such repurchases, redemptions or exchanges, if any, will depend on prevailing market conditions, liquidity requirements, contractual restrictions and other factors, and the amounts involved may be material.

Sources of Liquidity

We have incurred losses since our inception in 1998 and, as of March 31, 2019, we had an accumulated deficit of approximately \$1.7 billion. We have financed our operations to date primarily through both the private sale of our preferred stock and the public sale of our common stock, including approximately \$203.2 million of net proceeds from our initial public offering, or IPO, in February 2010, and approximately \$413.4 million of net proceeds from our follow-on public offerings; payments received under our strategic collaborative arrangements, including upfront and milestone payments, royalties and our share of net profits, as well as reimbursement of certain expenses; and debt financings, including approximately \$324.0 million of net proceeds from the private placement of our 2022 Notes in June 2015 and approximately \$11.2 million of net proceeds from the issuance of \$150.0 million in aggregate principal amount of the 2026 Notes in January 2017.

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Funding Requirements

We began commercializing LINZESS in the U.S. with our collaboration partner, Allergan, in the fourth quarter of 2012, and we currently derive substantially all of our revenue from this collaboration. We are also deploying significant resources to advance product opportunities in IBS-C and CIC, abdominal pain associated with IBS and persistent GERD, as well as to fulfill FDA requirements for linaclotide. Our goal is to become cash flow positive, driven by increased revenue generated through sales of LINZESS and linaclotide API and financial discipline. However, we have not achieved positive cash flows from operations to date.

Under our collaboration with Allergan for North America, total net sales of LINZESS in the U.S., as recorded by Allergan, are reduced by commercial costs incurred by each party, and the resulting amount is shared equally between us and Allergan. Additionally, we receive royalties from Allergan based on sales of linaclotide in its licensed territories outside of the U.S. We believe revenues from our LINZESS partnership for the U.S. with Allergan will continue to constitute a significant portion of our total revenue for the foreseeable future and we cannot be certain that such revenues, as well as the revenues from our other commercial activities, will enable us to become cash flow positive, or to do so in the timeframes we expect. We also anticipate that we will continue to incur substantial expenses for the next several years as we further develop and commercialize linaclotide in the U.S., China and other markets, develop and commercialize other products, and continue to invest in our pipeline and potentially other external opportunities. We believe that our cash on hand as of March 31, 2019 will be sufficient to meet our projected operating needs at least through the next twelve months from the issuance of these financial statements.

Our forecast of the period of time through which our financial resources will be adequate to support our operations, including the underlying estimates regarding the costs to develop our product candidates and obtain regulatory approvals and the costs to commercialize linaclotide in the U.S., China and other markets, and develop and commercialize other products, as well as our goal to become cash flow positive, are forward-looking statements that involve risks and uncertainties. Our actual results could vary materially and negatively from these and other forward-looking statements as a result of a number of factors, including the factors discussed in the “Risk Factors” section of this Quarterly Report on Form 10-Q. We have based our estimates on assumptions that may prove to be wrong, and we could utilize our available capital resources sooner than we currently expect.

Due to the numerous risks and uncertainties associated with the development and commercialization of our product candidates, we are unable to estimate precisely the amounts of capital outlays and operating expenditures necessary to develop, obtain regulatory approval for, and commercialize linaclotide and our other product candidates, in each case, for all of the markets, indications, populations and formulations for which we believe each is suited. Our funding requirements will depend on many factors, including, but not limited to, the following:

- the revenue generated by sales of LINZESS, CONSTELLA, and any other products;

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- the rate of progress and cost of our commercialization activities, including the expense we incur in marketing and selling LINZESS and any other products;
- the success of our third-party manufacturing activities;
- the time and costs involved in developing, and obtaining regulatory approvals for, our product candidates, as well as the timing and cost of any post-approval development and regulatory requirements;
- the success of our research and development efforts;
- the emergence of competing or complementary products;
- the costs of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights;
- the terms and timing of any additional collaborative, licensing or other arrangements that we may establish, including royalties or other payments due or payable under such agreements; and
- the acquisition of businesses, products and technologies and the impact of other strategic transactions, as well as the cost and timing of integrating any such assets into our business operations.

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Financing Strategy

We may, from time to time, consider additional funding through a combination of new collaborative arrangements, strategic alliances, and additional equity and debt financings or from other sources. We will continue to manage our capital structure and to consider all financing opportunities, whenever they may occur, that could strengthen our long-term liquidity profile. Any such capital transactions may or may not be similar to transactions in which we have engaged in the past. There can be no assurance that any such financing opportunities will also be available on acceptable terms, if at all.

Contractual Commitments and Obligations

The disclosure of our contractual obligations and commitments was reported in our 2018 Annual Report on Form 10-K. There have not been any material changes from the contractual commitments and obligations previously disclosed in our 2018 Annual Report on Form 10-K.

Off-Balance Sheet Arrangements

We do not have any relationships with unconsolidated entities or financial partnerships, such as entities often referred to as structured finance or special purpose entities, that would have been established for the purpose of facilitating off-balance sheet arrangements (as that term is defined in Item 303(a)(4)(ii) of Regulation S-K) or other contractually narrow or limited purposes. As such, we are not exposed to any financing, liquidity, market or credit risk that could arise if we had engaged in those types of relationships. We enter into guarantees in the ordinary course of business related to the guarantee of our own performance and the performance of our subsidiaries.

New Accounting Pronouncements

For a discussion of recent accounting pronouncements, please refer to Note 2, Summary of Significant Accounting Policies, in our 2018 Annual Report on Form 10-K and Note 1, Nature of Business, appearing elsewhere in this Quarterly Report on Form 10-Q. We did not otherwise adopt any new accounting pronouncements during the three months ended March 31, 2019 that had a material effect on our condensed consolidated financial statements included in this report.

Item 3. Quantitative and Qualitative Disclosures about Market Risk

Interest Rate Risk

We are exposed to market risk related to changes in interest rates. We invest our cash in a variety of financial instruments, principally securities issued by the U.S. government and its agencies, collateralized reverse repurchase agreements, and money market instruments. The goals of our investment policy are preservation of capital, fulfillment of liquidity needs and fiduciary control of cash and investments. We also seek to maximize income from our investments without assuming significant risk.

Our primary exposure to market risk is interest income sensitivity, which is affected by changes in the general level of interest rates, particularly because our investments are in short-term marketable securities. Due to the primarily short-term duration of our investment portfolio and the low risk profile of our investments, an immediate 1% change in interest rates would not have a material effect on the fair market value of our portfolio. Accordingly, we would not expect our operating results or cash flows to be affected to any significant degree by the effect of a sudden change in market interest rates on our investment portfolio.

We do not believe our cash and cash equivalents have significant risk of default or illiquidity. While we believe our cash and cash equivalents do not contain excessive risk, we cannot provide absolute assurance that in the future our investments will not be subject to adverse changes in market value. In addition, we maintain significant amounts of cash and cash equivalents at one or more financial institutions that are in excess of federally insured limits. Given the potential instability of financial institutions, we cannot provide assurance that we will not experience losses on these deposits.

Our capital lease obligations, 2026 Notes and 2022 Notes bear interest at a fixed rate and therefore have minimal exposure to changes in interest rates; however, because these interest rates are fixed, we may be paying a higher interest rate, relative to market, in the future if our credit rating improves or other circumstances change.

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Equity Price Risk

2022 Notes

Our 2022 Notes include conversion and settlement provisions that are based on the price of our Class A common stock at conversion or at maturity of the 2022 Notes. The amount of cash we may be required to pay is determined by the price of our Class A common stock. The fair value of our 2022 Notes is dependent on the price and volatility of our Class A common stock and will generally increase or decrease as the market price of our Class A common stock changes.

The 2022 Notes were convertible into Class A common stock at an initial conversion rate of 60.3209 shares of Class A common stock (subject to adjustment as provided for in the Indenture) per \$1,000 principal amount of the 2022 Notes, which was equal to an initial conversion price of approximately \$16.58 per share. The 2022 Notes will mature on June 15, 2022 unless earlier converted or repurchased. The 2022 Notes bear cash interest at an annual rate of 2.25%, payable on June 15 and December 15 of each year, which began on December 15, 2015. As of March 31, 2019, the fair value of the 2022 Notes was estimated by us to be \$370.1 million. The 2022 Notes are more fully described in Note 4, Fair Value of Financial Instruments, and Note 8, Notes Payable, in the accompanying notes to our condensed consolidated financial statements appearing elsewhere in this Quarterly Report on Form 10-Q.

On April 16, 2019, the Company announced an adjustment to the conversion rate applicable to the existing 2022 Notes, effective April 15, 2019. The adjustment was effected pursuant to the indenture, dated as of June 15, 2015, as supplemented April 5, 2019, between the Company and U.S. Bank National Association, as trustee, pursuant to which the 2022 Notes were originally issued. In connection with the Separation, on April 1, 2019, Ironwood distributed to its stockholders one share of Cyclerion common stock for every 10 shares of Ironwood common stock held as of the close of business on March 19, 2019, the record date for the distribution. As a result of the Separation, effective April 15, 2019, the conversion rate under the indenture was adjusted to equal 68.9172 shares of Ironwood common stock per \$1,000 principal amount of the 2022 Notes, which is equal to an adjusted conversion price of approximately \$14.51 per share and 23,135,435 shares. The adjustment is more fully described in Note 13, Subsequent Events, in the accompanying notes to our condensed consolidated financial statements appearing elsewhere in this Quarterly Report on Form 10-Q.

Convertible Note Hedge and Warrant Transactions with Respect to 2022 Notes

To minimize the impact of potential dilution to our common stock upon conversion of the 2022 Notes, we entered into Convertible Note Hedges. Concurrently with entering into the Convertible Note Hedges, we entered into warrant

transactions whereby we sold Note Hedge Warrants to acquire, subject to customary adjustments, 20,249,665 shares of our Class A common stock at an initial strike price of approximately \$21.50 per share, subject to adjustment. The Convertible Note Hedges and Note Hedge Warrants are more fully described in Note 8, Notes Payable, in the accompanying notes to our condensed consolidated financial statements appearing elsewhere in this Quarterly Report on Form 10-Q.

Foreign Currency Risk

We have no significant operations outside the U.S. and we do not expect to be impacted significantly by foreign currency fluctuations.

Effects of Inflation

We do not believe that inflation and changing prices over the three months ended March 31, 2019 and 2018 had a significant impact on our results of operations.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures

As required by Rule 13a-15(b) of the Securities Exchange Act of 1934, or the Exchange Act, our management, including our principal executive officer and our principal financial officer, conducted an evaluation as of the end of the period covered by this Quarterly Report on Form 10-Q of the effectiveness of the design and operation of our disclosure

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controls and procedures. Based on that evaluation, our principal executive officer and principal financial officer concluded that our disclosure controls and procedures are effective at the reasonable assurance level in ensuring that information required to be disclosed by us in the reports that we file or submit under the Exchange Act is recorded, processed, summarized and reported within the time periods specified in the SEC's rules and forms. Disclosure controls and procedures include, without limitation, controls and procedures designed to ensure that information required to be disclosed by us in the reports we file under the Exchange Act is accumulated and communicated to our management, including our principal executive officer and principal financial officer, as appropriate to allow timely decisions regarding required disclosure.

Changes in Internal Control

As required by Rule 13a-15(d) of the Exchange Act, our management, including our principal executive officer and our principal financial officer, conducted an evaluation of the internal control over financial reporting to determine whether any changes occurred during the period covered by this Quarterly Report on Form 10-Q that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Effective on April 1, 2019, Mark Mallon was appointed Chief Executive Officer of our Company by our Board of Directors.

Based on that evaluation, our principal executive officer and principal financial officer concluded no other changes during the period covered by this Quarterly Report on Form 10-Q materially affected, or were reasonably likely to materially affect, our internal control over financial reporting.

PART II OTHER INFORMATION

Item 1. Legal Proceedings

Actions in which we are the Plaintiff

LINZESS

We and Allergan have received Paragraph IV certification notice letters, or Notice Letters, regarding Abbreviated New Drug Applications, or ANDAs, submitted to the FDA by generic drug manufacturers requesting approval to engage in commercial manufacture, use, sale and offer for sale of (i) 145 mcg and 290 mcg linaclotide capsules, or the Potential Generic Products, and/or (ii) 72 mcg linaclotide capsules, or the Potential 72mcg Generic Products, each proposed generic versions of our FDA-approved drug LINZESS.

In October 2016, we received a Notice Letter relating to an ANDA that was submitted to the FDA by Teva Pharmaceuticals USA, Inc., or Teva. Teva's Notice Letter contends that United States patents for LINZESS (U.S. Patent Nos. 7,371,727, 7,704,947, 7,745,409, 8,080,526, and 8,110,553 (expiring 2024); 7,304,036 (expiring 2026); and 8,748,573, 8,802,628, and 8,933,030 (expiring 2031), or the Challenged Patents) listed in the FDA's list of Approved Drug Products with Therapeutic Equivalence Evaluations, commonly referred to as the Orange Book, are invalid, unenforceable and/or would not be infringed by Teva's manufacture, use, sale or offer for sale of the Potential Generic Products. In September 2017, we received a second Notice Letter relating to the ANDA submitted to the FDA by Teva contending that U.S. Patent No. 9,708,371 (expiring 2033) listed in the Orange Book is invalid and/or would not be infringed by Teva's manufacture, use, sale or offer for sale of the Potential Generic Products. In December 2017, we received a Notice Letter relating to an ANDA that was submitted to the FDA by Teva, contending that U.S. Patent Nos. 7,371,727, 7,704,947, 7,745,409, 8,080,526, and 8,110,553; 7,304,036; 8,933,030; and 9,708,371, or the 72mcg Challenged Patents, are invalid, unenforceable and/or would not be infringed by Teva's manufacture, use, sale or offer for sale of the Potential 72 mcg Generic Product.

In November 2016, we received a Notice Letter relating to an ANDA that was submitted to the FDA by Sandoz Inc., or Sandoz, contending that all of the Challenged Patents are invalid, unenforceable and/or would not be infringed by Sandoz's manufacture, use, sale or offer for sale of the Potential Generic Products. In January 2018, we received a second Notice Letter relating to the ANDA submitted to the FDA by Sandoz contending that U.S. Patent No. 9,708,371

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is invalid and/or would not be infringed by Sandoz's manufacture, use, sale or offer for sale of the Potential Generic Products.

In response to the ANDAs for which we received Notice Letters in 2016, we and Allergan filed a lawsuit against the generic drug manufacturers in Delaware District Court in November 2016. We asserted that the Challenged Patents are valid and infringed by Teva and Sandoz. In accordance with the Hatch-Waxman Act, the timely filing of the lawsuits against the ANDA filers with respect to the Challenged Patents triggered an automatic stay of the FDA's approval of the ANDAs until February 29, 2020 (unless there is a final court decision adverse to us and Allergan sooner). In October 2017 and January 2018, we and Allergan filed lawsuits against Teva and Sandoz, respectively, each in Delaware District Court, related to each of their respective second Notice Letters. We asserted that U.S. Patent No. 9,708,371 is valid and infringed by each of Teva and Sandoz. The lawsuits filed in October 2017 and January 2018 against Teva and Sandoz, respectively, have been consolidated with the lawsuit filed in November 2016.

In January 2017, each of Teva and Sandoz filed an answer and counterclaims seeking declaratory judgment of invalidity and non-infringement of the Challenged Patents. In November 2017 and February 2018, each of Teva and Sandoz, respectively, filed an answer and counterclaims seeking declaratory judgment of invalidity and non-infringement of U.S. Patent No. 9,708,371. In February 2018, we and Allergan filed a lawsuit against Teva in Delaware District Court asserting that the 72mcg Challenged Patents are valid and infringed. This lawsuit was consolidated with the lawsuit filed in November 2016.

In May 2018 and August 2018, we, Allergan, Teva and Sandoz stipulated to dismiss without prejudice all claims, counterclaims and defenses with respect to U.S. Patent Nos. 9,708,371 and 8,933,030, respectively.

We and Allergan previously entered into settlement agreements with Sun Pharma Global FZE, Aurobindo Pharma Ltd. and an affiliate of Aurobindo, and Mylan Pharmaceuticals Inc.

Trial is scheduled in June 2019 for the action involving Teva and Sandoz.

Item 1A. Risk Factors

In addition to the other information in this Quarterly Report on Form 10-Q, any of the factors described below could significantly and negatively affect our business, financial condition, results of operations or prospects. The trading price of our common stock may decline due to these risks.

Risks Related to Our Business and Industry

We are highly dependent on the commercial success of LINZESS in the U.S. for the foreseeable future; we cannot guarantee when, or if, we will attain profitability or positive cash flows.

We and our partner, Allergan plc (together with its affiliates), or Allergan, began selling LINZESS in the U.S. during December 2012. Revenues from our LINZESS collaboration constitute a significant portion of our total revenue, and we believe they will continue to do so for the foreseeable future. The commercial success of LINZESS depends on a number of factors, including:

- the effectiveness of LINZESS as a treatment for adult patients with IBS-C or CIC;
- the size of the treatable patient population;
- the effectiveness of the sales, managed markets and marketing efforts by us and Allergan;
- the adoption of LINZESS by physicians, which depends on whether physicians view it as safe and effective treatment for adult patients with IBS-C and CIC;
- our success in educating and activating adult IBS-C and CIC patients to enable them to more effectively communicate their symptoms and treatment history to their physicians;

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- our ability to both secure and maintain adequate reimbursement for, and optimize patient access to, LINZESS and our ability to demonstrate that LINZESS is safer, more efficacious and/or more cost-effective than alternative therapies;
- the effectiveness of our partners' distribution networks;
- the occurrence of any side effects, adverse reactions or misuse, or any unfavorable publicity in these or other areas, associated with linaclotide; and
- the development or commercialization of competing products or therapies for the treatment of IBS-C or CIC, or their associated symptoms.

Our revenues from the commercialization of LINZESS are subject to these factors, and therefore may be unpredictable from quarter-to-quarter. Ultimately, we may never generate sufficient revenues from LINZESS to reach or maintain profitability for our company or to sustain our anticipated levels of operations.

Our products may cause undesirable side effects or have other properties that could limit their commercial potential.

The most commonly reported adverse reaction since linaclotide became commercially available, as well as in the clinical trials for linaclotide in IBS-C and CIC, has been diarrhea. In the linaclotide Phase III IBS-C and CIC trials, severe diarrhea was reported in 2% or less of the linaclotide-treated patients and its incidence was similar between the IBS-C and CIC populations. Linaclotide has been prescribed to millions of patients since its launch in the U.S. and other territories beginning in December 2012, and, as a result, it has been used in wider populations and in less rigorously controlled environments than in the clinical studies supporting its approval.

Further, as we and our partners conduct clinical trials, including in new or existing territories, indications, populations or formulations, as well as explore potential combination products, the number of patients treated with our products within and outside of such products' currently approved indications and patient populations has grown and continues to do so.

As patient experience increases and expands, we and others may identify previously unknown side effects, known side effects may be found to be more frequent or severe than in the past, and we and others may detect unexpected safety signals for our products or any products perceived to be similar to our products. The foregoing, or the perception of the foregoing, may have the following effects, among others:

- sales of our products may be impaired;

- regulatory approvals for our products may be delayed, denied, restricted or withdrawn;
- we or our partners may decide to, or be required to, change the products' label or send product warning letters or field alerts to physicians, pharmacists and hospitals;
- reformulation of the products, additional nonclinical or clinical studies, changes in labeling or changes to or re-approvals of manufacturing facilities may be required;
- we or our partners may be precluded from pursuing approval of linaclotide in new territories or from studying additional development opportunities to enhance our products' clinical profiles, including within new or existing indications, populations and formulations, as well as in potential combination products;
- our or our products' reputation in the marketplace may suffer; and
- government investigations or lawsuits, including class action suits, may be brought against us or our partners.

Any of the above occurrences would harm or prevent sales of our products, increase expenses and impair our and our partners' ability to successfully commercialize our products.

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In addition, the U.S. Food and Drug Administration, or FDA, -approved label for LINZESS contains a boxed warning about its use in pediatric patients. LINZESS is contraindicated in pediatric patients up to six years of age based on nonclinical data from studies in neonatal mice approximately equivalent to human pediatric patients less than two years of age. There is also a warning advising physicians to avoid the use of LINZESS in pediatric patients six to less than 18 years of age. This warning is based on data in young juvenile mice and the lack of clinical safety and efficacy data in pediatric patients of any age group. We and Allergan have established a nonclinical and clinical post-marketing plan with the FDA to understand the safety and efficacy of LINZESS in pediatric patients, which is discussed below. These and other restrictions could limit the commercial potential of LINZESS.

We rely entirely on contract manufacturers, our partners and other third parties to manufacture and distribute linaclotide. If they are unable to comply with applicable regulatory requirements, unable to source sufficient raw materials, experience manufacturing or distribution difficulties, or are otherwise unable to manufacture and distribute sufficient quantities to meet demand, our commercialization efforts may be materially harmed.

We have no internal manufacturing or distribution capabilities. Instead, we rely on a combination of contract manufacturers and our partners to manufacture active pharmaceutical ingredient, or API, and final drug product. We rely on our partners to store and distribute linaclotide to third party purchasers. We and certain of our partners have commercial supply agreements with independent third parties to manufacture the linaclotide API used to support all of our partnered territories. Each of Allergan and Astellas is responsible for linaclotide drug product and finished goods manufacturing (including bottling and packaging) for its respective territories, and distributing the finished goods to wholesalers. Under our collaboration with AstraZeneca, we are accountable for drug product and finished goods manufacturing for China and for drug product manufacturing for Hong Kong and Macau, with AstraZeneca accountable for finished goods manufacturing for Hong Kong and Macau. Neither we nor AstraZeneca have experience manufacturing linaclotide on a commercial scale and we and AstraZeneca are working to achieve sufficient redundancy in this component of the linaclotide supply chain.

Each of our API and drug product manufacturers must comply with current good manufacturing practices, or GMP, and other stringent regulatory requirements enforced by the FDA and foreign regulatory authorities in other jurisdictions. These requirements include, among other things, quality control, quality assurance and the maintenance of records and documentation, which occur in addition to our own quality assurance releases. Manufacturers of our products may be unable to comply with these GMP requirements and with other regulatory requirements. We have little control over our manufacturers' or partners' compliance with these regulations and standards.

Our manufacturers may experience problems with their respective manufacturing and distribution operations and processes, including for example, quality issues, such as product specification and stability failures, procedural deviations, improper equipment installation or operation, utility failures, contamination and natural disasters. In addition, the raw materials necessary to make API for our products are acquired from a limited number of sources. Any delay or disruption in the availability of these raw materials or a change in raw material suppliers could result in production disruptions, delays or higher costs with consequent adverse effects on us.

The manufacture of pharmaceutical products requires significant expertise and capital investment, including the development of advanced manufacturing techniques and process controls. Manufacturers of pharmaceutical products often encounter difficulties in commercial production. These problems include difficulties with production costs and yields, quality control, including stability of the product and quality assurance testing, and shortages of qualified personnel, as well as compliance with federal, state and foreign regulations and the challenges associated with complex supply chain management. Even if our manufacturers or partners do not experience problems and commercial manufacturing is achieved, their maximum or available manufacturing capacities may be insufficient to meet commercial demand. Finding alternative manufacturers or adding additional manufacturers requires a significant amount of time and involves significant expense. New manufacturers would need to develop and implement the necessary production techniques and processes, which along with their facilities, would need to be inspected and approved by the regulatory authorities in each applicable territory.

If our API or drug product manufacturers fail to adhere to applicable GMP or other regulatory requirements, experience delays or disruptions in the availability of raw materials or experience manufacturing or distribution problems, we will suffer significant consequences, including product seizures or recalls, loss of product approval, fines and sanctions, reputational damage, shipment delays, inventory shortages, inventory write-offs and other product-related

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charges and increased manufacturing costs. If we experience any of these results, or if our manufacturers' maximum or available capacities are insufficient to meet demand, we may not be able to successfully commercialize our products.

The transition of lesinurad to AstraZeneca could require additional substantial financial and managerial resources, and we may not be successful.

In June 2016, we entered into a license agreement for exclusive rights to commercialize products containing lesinurad in the U.S., and we terminated such license effective January 2019. We have encountered and may continue to encounter costs and delays related to transitioning lesinurad to AstraZeneca. We have never undertaken the process of transitioning a marketed product to a third party, and we may encounter challenges and costs that we do not currently anticipate. Our reputation with patients or physicians may be harmed as a result of transitioning lesinurad, and unforeseen complications with the FDA or other regulatory agencies could arise. In addition, we are still in discussions with AstraZeneca regarding the costs involved in the termination and transition process and have not reached an agreement. If we are unable to reach agreement with AstraZeneca, this could potentially lead to costly administrative procedures or litigation, distract management from other business activities, and could have an adverse impact on our financial condition. For additional information relating to our costs and expenses of exiting lesinurad, see Note 12, Workforce Reduction, to our condensed consolidated financial statements appearing elsewhere in this Quarterly Report on Form 10-Q.

If any of our linaclotide partners undergoes a change in control or in management, this may adversely affect our collaborative relationship or the success of the commercialization of linaclotide in the U.S. or in the other countries where it is approved, or the ability to achieve regulatory approval, launch and commercialize linaclotide in other territories.

We work jointly and collaboratively with each of our partners on many aspects of the development, manufacturing and commercialization of linaclotide. In doing so, we have established relationships with several key members of the management teams of our linaclotide partners in functional areas such as development, quality, regulatory, drug safety and pharmacovigilance, operations, marketing, sales, field operations and medical science. Further, the success of our collaborations is highly dependent on the resources, efforts and skills of our partners and their key employees. As we and our partners commercialize linaclotide in the U.S. and the other countries where it is approved, and develop, launch and commercialize linaclotide in other parts of the world, the drug's success becomes more dependent on us maintaining highly collaborative and well aligned partnerships. If any of our linaclotide partners undergo a change of control or in management in the future, we would need to reestablish many relationships and confirm continued alignment on our development and commercialization strategy for linaclotide. Further, in connection with any change of control or in management, there is inherent uncertainty and disruption in operations, which could result in distraction, inefficiencies, and misalignment of priorities. As a result, in the event of a change of control or in management at one of our linaclotide partners, we cannot be sure that we will be able to successfully execute on our development and commercialization strategy for linaclotide in an effective and efficient manner and without disruption or reduced performance. Finally, any change of control or in management may result in a reprioritization of linaclotide within a partner's portfolio, or such partner may fail to maintain the financial or other resources necessary to continue supporting its portion of the development, manufacturing or commercialization of linaclotide.

If any of our linaclotide partners undergoes a change of control and the acquirer either (i) is unable to perform such partner's obligations under its collaboration or license agreement with us or (ii) does not comply with the divestiture or certain other provisions of the applicable agreement, we have the right to terminate the collaboration or license agreement and reacquire that partner's rights with respect to linaclotide. If we elect to exercise these rights in such circumstances, we will need to either establish the capability to develop, manufacture and commercialize linaclotide in that partnered territory on our own or we will need to establish a relationship with a new partner. We have assembled a team of specialists in manufacturing, quality, sales, marketing, payer, pricing and field operations, and specialized medical scientists, who represent the functional areas necessary for a successful commercial launch of a high potential, gastrointestinal, or GI, therapy and who support the commercialization of LINZESS in the U.S. If Allergan was subject to a change of control that allowed us to further commercialize LINZESS in the U.S. on our own, and we chose to do so, we would need to enhance each of these functional aspects to replace the capabilities that Allergan was previously providing to the collaboration. Any such transition might result in a period of reduced efficiency or performance by our operations and commercialization teams, which could adversely affect our ability to commercialize LINZESS.

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Although many members of our global operations, commercial and medical affairs teams have strategic oversight of, and a certain level of involvement in, their functional areas globally, we do not have corresponding operational capabilities in these areas outside of the U.S. If Allergan, Astellas or AstraZeneca was subject to a change of control that allowed us to continue linaclotide's development or commercialization anywhere outside of the U.S. on our own, and we chose to do so rather than establishing a relationship with a new partner, we would need to build operational capabilities in the relevant territory. In any of these situations, the timeline and likelihood of achieving regulatory approval and, ultimately, the commercialization of linaclotide could be negatively impacted.

We must work effectively and collaboratively with Allergan to market and sell LINZESS in the U.S. in order for it to achieve its maximum commercial potential.

We are working closely with Allergan to execute our joint commercialization plan for LINZESS. The commercialization plan includes an agreed upon marketing campaign that targets the physicians who see patients who could benefit from LINZESS treatment. Our marketing campaign also targets the adult men and women who suffer from IBS-C or CIC. Our commercialization plan also includes an integrated call plan for our sales forces to optimize the education of specific gastroenterologists and primary care physicians on whom our and Allergan's sales representatives call, and the frequency with which the representatives meet with them.

In order to optimize the commercial potential of LINZESS, we and Allergan must execute upon this commercialization plan effectively and efficiently. In addition, we and Allergan must continually assess and modify our commercialization plan in a coordinated and integrated fashion in order to adapt to the promotional response. Further, we and Allergan must continue to focus and refine our marketing campaign to ensure a clear and understandable physician-patient dialogue around IBS-C, CIC and the potential for LINZESS as an appropriate therapy. In addition, we and Allergan must provide our sales forces with the highest quality support, guidance and oversight in order for them to continue to effectively promote LINZESS to gastroenterologists and primary care physicians. If we and Allergan fail to perform these commercial functions in the highest quality manner and in accordance with our joint commercialization plan and related agreements, LINZESS will not achieve its maximum commercial potential and we may suffer financial harm. Our efforts to further target and engage adult patients with IBS-C or CIC may not effectively increase appropriate patient awareness or patient/physician dialogue, and may not increase the revenues that we generate from LINZESS.

We are subject to uncertainty relating to pricing and reimbursement policies in the U.S. which, if not favorable for our products, could hinder or prevent our products' commercial success.

Our and our partner's ability to commercialize our products successfully depend in part on the coverage and reimbursement levels set by governmental authorities, private health insurers and other third-party payers. In determining whether to approve reimbursement for our products and at what level, we expect that third-party payers will consider factors that include the efficacy, cost effectiveness and safety of our products, as well as the availability of other treatments including generic prescription drugs and over-the-counter alternatives. Further, in order to obtain

and maintain acceptable reimbursement levels and access for patients at copay levels that are reasonable and customary, we may face increasing pressure to offer discounts or rebates from list prices or discounts to a greater number of third-party payers or other unfavorable pricing modifications. Obtaining and maintaining favorable reimbursement can be a time consuming and expensive process, and there is no guarantee that we or Allergan will be able to negotiate or continue to negotiate pricing terms with third-party payers at levels that are profitable to us, or at all. Certain third-party payers also require prior authorization for, or even refuse to provide, reimbursement for our products, and others may do so in the future. Our business would be materially adversely affected if we and our partners are not able to receive approval for reimbursement of our products from third-party payers on a broad, timely or satisfactory basis; if reimbursement is subject to overly broad or restrictive prior authorization requirements; or if reimbursement is not maintained at satisfactory levels or becomes subject to prior authorization. In addition, our business could be adversely affected if government healthcare programs, private health insurers, including managed care organizations, or other reimbursing bodies or payers limit or reduce the indications for or conditions under which our products may be reimbursed.

We expect to experience pricing pressures in connection with the sale of our current and future products due to the healthcare reforms discussed below, as well as the trend toward programs aimed at reducing healthcare costs, the increasing influence of managed care, the scrutiny of pharmaceutical pricing, the ongoing debates on reducing government spending and additional legislative proposals. There have been several recent federal and state efforts to address drug costs, which generally have focused on increasing transparency around drug costs or limiting drug prices or price increases. Healthcare reform efforts or any future legislation or regulatory actions aimed at controlling and

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reducing healthcare costs, including through measures designed to limit reimbursement, restrict access or impose unfavorable pricing modifications on pharmaceutical products, could impact our and our partners' ability to obtain or maintain reimbursement for our products at satisfactory levels, or at all, which could materially harm our business and financial results.

We and our linaclotide partners are subject to uncertainty relating to pricing and reimbursement policies outside the U.S., as well as risks relating to the improper importation of linaclotide and sale of counterfeit versions of linaclotide. If such policies are not favorable, or if linaclotide is improperly imported or is counterfeited, our business and financial results could be adversely affected.

In some foreign countries, particularly Canada, the countries of Europe, Japan and China, the pricing and payment of prescription pharmaceuticals is subject to governmental control. In these countries, pricing negotiations with governmental authorities can take six to 12 months or longer after the receipt of regulatory approval and product launch. Reimbursement sources are different in each country, and each country may include a combination of distinct potential payers, including private insurance and governmental payers. Some countries may restrict the range of medicinal products for which their national health insurance systems provide reimbursement and control the prices of medicinal products for human use. To obtain favorable reimbursement for the indications sought or pricing approval in some countries, we and our partners may be required to conduct a clinical trial that compares the cost and clinical effectiveness of linaclotide to other available therapies. In addition, in countries in which linaclotide is the only approved therapy for a particular indication, such as CONSTELLA as the only prescription product approved for the symptomatic treatment of moderate to severe IBS-C in adults in Europe and LINZESS as the only prescription treatment approved for the treatment of adults with IBS-C in Japan, there may be disagreement as to what the most comparable product is, or if there even is one. Further, several countries have implemented government measures to either freeze or reduce pricing of pharmaceutical products. Many third-party payers and governmental authorities also consider the price for which the same product is being sold in other countries to determine their own pricing and reimbursement strategy, so if linaclotide is priced low or gets limited reimbursement in a particular country, this could result in similarly low pricing and reimbursement in other countries. If reimbursement for linaclotide is unavailable in any country in which reimbursement is sought, limited in scope or amount, or if pricing is set at or reduced to unsatisfactory levels, our and our partners' ability to successfully commercialize linaclotide in such country would be impacted negatively. Furthermore, if these measures prevent us or any of our partners from selling linaclotide on a profitable basis in a particular country, they could prevent the commercial launch or continued sale of linaclotide in that country.

CONSTELLA was first launched in certain European countries for the symptomatic treatment of moderate to severe IBS-C in adults in the second quarter of 2013 and our partner Allergan is currently commercializing CONSTELLA in a number of European countries, including the United Kingdom, Italy and Spain. LINZESS was first launched in Japan for the treatment of IBS-C in adults in the first quarter of 2017, and for the treatment of chronic constipation in adults in the third quarter of 2018, and our partner Astellas is currently commercializing LINZESS in Japan. In the first quarter of 2019, the National Medical Products Administration approved the marketing application for LINZESS for adults with IBS-C in China. The pricing and reimbursement strategy is a key component of our partners' commercialization plans for CONSTELLA in Europe and LINZESS in Japan and China. Our revenues may suffer if our partners are unable to successfully and timely conclude reimbursement, price approval or funding processes and market CONSTELLA in key member states of the E.U. or LINZESS in Japan or China, or if coverage and

reimbursement for either CONSTELLA or LINZESS is limited or reduced. If our partners are not able to obtain coverage, pricing or reimbursement on acceptable terms or at all, or if such terms change in any countries in its territory, our partners may not be able to, or may decide not to, sell either CONSTELLA or LINZESS in such countries.

We and our partners also face the risk that linaclotide is imported or reimported into markets with relatively higher prices from markets with relatively lower prices, which would result in a decrease of sales and any payments we receive from the affected market. Additionally, third parties may illegally produce, distribute and/or sell counterfeit or otherwise unfit or adulterated versions of linaclotide. In either case, we and our partners may not be able to detect or, if detected, prevent or prohibit the sale of such products, which could result in dangerous health consequences for patients, loss of confidence in us, our partners and our products, and adverse regulatory or legal consequences. Any of the foregoing or other consequences could adversely impact our reputation, financial results and business.

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Because we work with partners to develop, manufacture and commercialize our products, we are dependent upon third parties, and our relationships with those third parties, in our efforts to obtain regulatory approval for, and to commercialize, our products, as well as to comply with regulatory and other obligations with respect to such products.

Allergan played a significant role in the conduct of the clinical trials for linaclotide and in the subsequent collection and analysis of data, and Allergan holds the new drug application, or NDA, for LINZESS. In addition, we are commercializing LINZESS in the U.S. with Allergan. Allergan is also responsible for the development, regulatory approval and commercialization of linaclotide in countries worldwide other than Japan, China, Hong Kong and Macau. Allergan is commercializing LINZESS in Mexico and CONSTELLA in Canada, as well as commercializing CONSTELLA in certain countries in Europe. Astellas, our partner in Japan, is responsible for completing the clinical programs and obtaining regulatory approval of linaclotide in its territory. Astellas is commercializing LINZESS in Japan. Further, we are jointly overseeing the development and commercialization of linaclotide in China, Hong Kong and Macau through our collaboration with AstraZeneca, with AstraZeneca having primary responsibility for the local operational execution. Each of Astellas, AstraZeneca and Allergan is responsible for commercializing linaclotide in its respective territory, if approved. Each of our partners is responsible for reporting adverse event information from its territory to us. Finally, each of our partners, other than AstraZeneca, is responsible for drug product manufacturing of linaclotide and making it into finished goods (including bottling and packaging) for its respective territory, and AstraZeneca is responsible for finished goods manufacturing for Hong Kong and Macau. The integration of our efforts with our partners' efforts is subject to the uncertainty of the markets for pharmaceutical products in each partner's respective territories, and accordingly, these relationships must evolve to meet any new challenges that arise in those regions.

These integrated functions may not be carried out effectively and efficiently if we fail to communicate and coordinate with our linaclotide partners, and vice versa. Our linaclotide partnering strategy imposes obligations, risks and operational requirements on us as the central node in our global network of partners. If we do not effectively communicate with each partner and ensure that the entire network is making integrated and cohesive decisions focused on the global brand for linaclotide, linaclotide will not achieve its maximum commercial potential. Further, we have limited ability to control the amount or timing of resources that our partners devote to linaclotide. If any of our partners fails to devote sufficient time and resources to linaclotide, or if its performance is substandard, it will delay the potential submission or approval of regulatory applications for linaclotide, as well as the manufacturing and commercialization of linaclotide in the particular territory. A material breach by any of our partners of our collaboration or license agreement with such partner, or a significant disagreement between us and a partner, could also delay the regulatory approval and commercialization of linaclotide, potentially lead to costly litigation, and could have a material adverse impact on our financial condition. Moreover, although we have non-compete restrictions in place with each of our linaclotide partners, they may have competitive products or relationships with other commercial entities, some of which may compete with us. If any of our partners competes with us or assists our competitors, it could harm our competitive position.

In addition, adverse event reporting requires significant coordination with our partners and third parties. We are the holder of the global safety database for linaclotide responsible for coordinating the safety surveillance and adverse event reporting efforts worldwide with respect to linaclotide, and an AstraZeneca partner is the holder of the global safety database for lesinurad responsible for coordinating the safety surveillance and adverse event reporting efforts worldwide with respect to lesinurad. If we or AstraZeneca's partner fails to perform such activities and maintain each

safety database or if such parties do not report adverse events related to such products, or fail to do so in a timely manner, we may not receive the information that we are required to report to the FDA regarding such products. Furthermore, we or such parties may fail to adequately monitor, identify or investigate adverse events, or to report adverse events to the FDA or foreign regulatory authority accurately and within the prescribed timeframe. If we or such parties are unsuccessful in any of the foregoing due to poor process, execution, systems, oversight, communication, adjudication or otherwise, then we may suffer any number of consequences, including the imposition of additional restrictions on the use of such products, removal of such products from the market, criminal prosecution, the imposition of civil monetary penalties, seizure of such products, or delay in approval of future products.

Even though LINZESS is approved by the FDA, it faces post-approval development and regulatory requirements, which present additional challenges.

In August 2012, the FDA approved LINZESS as a once-daily treatment for adult men and women suffering from IBS-C or CIC. LINZESS is subject to ongoing FDA requirements, including those governing the testing,

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manufacturing, labeling, packaging, storage, advertising, promotion, sale, distribution, recordkeeping and submission of safety and other post-market information.

LINZESS is contraindicated in pediatric patients up to six years of age based on nonclinical data from studies in neonatal mice approximately equivalent to human pediatric patients less than two years of age. There is also a boxed warning advising physicians to avoid the use of LINZESS in pediatric patients six to less than 18 years of age. This warning is based on data in young juvenile mice and the lack of clinical safety and efficacy data in pediatric patients of any age group. We and Allergan have established a nonclinical and clinical post-marketing plan with the FDA to understand the safety and efficacy of LINZESS in pediatric patients, are advancing clinical pediatric programs in IBS-C patients age seven to 17 and functional constipation patients age six to 17. Our ability to conduct clinical studies in younger pediatric patients will depend, in part, on the safety and efficacy data from our clinical programs in older pediatric patients. Our ability to ever expand the indication or label information for LINZESS to pediatrics will depend on, among other things, our successful completion of pediatric clinical programs. In addition, we and Allergan have also committed to certain nonclinical and clinical studies aimed at understanding: (a) whether orally administered linaclotide can be detected in breast milk, (b) the potential for antibodies to be developed to linaclotide, and if so, (c) whether antibodies specific for linaclotide could have any therapeutic or safety implications. We expect to complete these studies over the next two to four years.

In addition, as the holder of the approved NDA for each of ZURAMPIC and DUZALLO, we are obligated to monitor and report adverse events and any failure of such products to meet the specifications in the applicable NDA, to submit new or supplemental applications and to obtain FDA approval for certain changes to such products, including changes to product labeling and manufacturing processes. The FDA has required a post-marketing clinical study to further evaluate the renal and cardiovascular safety of lesinurad, and has required that enrollment include patients with moderate renal impairment. In connection with the termination of the lesinurad license, we are in the process of ending the post-marketing clinical study.

These post-approval requirements impose burdens and costs on us. Failure to effectively, appropriately and timely conduct and complete the required studies relating to our products, monitor and report adverse events and meet our other post-approval commitments would lead to negative regulatory action at the FDA, which could include withdrawal of regulatory approval of our products for their currently approved indications and patient populations.

Manufacturers of drug products and their facilities are subject to continual review and periodic inspections by the FDA and other regulatory authorities for compliance with GMP and other applicable regulations. If we or a regulatory agency discovers previously unknown problems with a product, such as adverse events of unanticipated severity or frequency, or problems with a facility where the product is manufactured, a regulatory agency may impose restrictions on that product or the manufacturer, including withdrawal of the product from the market or suspension of manufacturing. If we, our partners or the manufacturing facilities for our products fail to comply with applicable regulatory requirements, a regulatory agency may take the following actions, among others:

issue warning letters or untitled letters;

impose civil or criminal penalties;

suspend or withdraw regulatory approval;

suspend any ongoing clinical trials;

refuse to approve pending applications or supplements to applications submitted by us or our partners;

impose restrictions on operations, including costly new manufacturing requirements; or

seize or detain products or require us to initiate a product recall.

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Even though linaclotide is approved for marketing in the U.S. and in a number of other countries, we or our partners may never receive approval to commercialize linaclotide in additional parts of the world.

In order to market any products outside of the countries where linaclotide is currently approved, we or our partners must comply with numerous and varying regulatory requirements of other jurisdictions regarding, among other things, safety and efficacy. Approval procedures vary among jurisdictions and can involve product testing and administrative review periods different from, and greater than, those in the U.S. and the other countries where linaclotide is approved. Potential risks include that the regulatory authorities:

- may not deem linaclotide safe and effective;
- may not find the data from nonclinical studies and clinical trials sufficient to support approval;
- may not approve of manufacturing processes and facilities;
- may not approve linaclotide for any or all indications or patient populations for which approval is sought;
- may require significant warnings or restrictions on use to the product label for linaclotide; or
- may change their approval policies or adopt new regulations.

If any of the foregoing were to occur, our receipt of regulatory approval in the applicable jurisdiction could be delayed or we may never receive approval at all. Further, regulatory approval in one jurisdiction does not ensure regulatory approval in another, but a failure or delay in obtaining regulatory approval in one jurisdiction may have a negative effect on the regulatory processes in others. If linaclotide is not approved for all indications or patient populations or with the label requested, this would limit the uses of linaclotide and have an adverse effect on its commercial potential or require costly post-marketing studies.

We face potential product liability exposure, and, if claims brought against us are successful, we could incur substantial liabilities.

The use of our product candidates in clinical trials and the sale of our approved products, including the sale of linaclotide and lesinurad, expose us to product liability claims. If we do not successfully defend ourselves against product liability claims, we could incur substantial liabilities. In addition, regardless of merit or eventual outcome, product liability claims may result in:

- decreased demand for approved products;
- impairment of our business reputation;
- withdrawal of clinical trial participants;
- initiation of investigations by regulators;
- litigation costs;
- distraction of management's attention from our primary business;
- substantial monetary awards to patients or other claimants;
- loss of revenues; and
- the inability to commercialize our product candidates.

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We currently have product liability insurance coverage for the commercial sale of linaclotide and lesinurad and for the clinical trials of our product candidates which is subject to industry-standard terms, conditions and exclusions. Our insurance coverage may not be sufficient to reimburse us for expenses or losses associated with claims. Moreover, insurance coverage is becoming increasingly expensive, and, in the future, we may not be able to maintain insurance coverage at a reasonable cost or in sufficient amounts to protect us against losses. On occasion, large judgments have been awarded in lawsuits based on drugs that had unanticipated side effects. A successful product liability claim or series of claims could cause our stock price to decline and, if judgments exceed our insurance coverage, could decrease our cash and adversely affect our business.

We face competition and new products may emerge that provide different or better alternatives for treatment of the conditions that our products are approved to treat.

The pharmaceutical industry and the markets in which we operate are intensely competitive. We compete in the marketing and sale of our products, the development of new products and the acquisition of rights to new products with commercial potential. Certain of our competitors have substantially greater financial, technical and human resources than us. Mergers and acquisitions in the pharmaceutical industry may result in even more resources being concentrated in our competitors and enable them to compete more effectively. For example, in March 2019, Bausch Health Companies Inc., or Bausch Health, acquired TRULANCE (plecanatide), which, as referenced below, is a competitor to LINZESS, from Synergy Pharmaceuticals, Inc. Competition may also increase further as a result of advances made in the commercial applicability of technologies and greater availability of capital for investment in these fields. Additionally, new developments, including the development of other drug technologies and methods of preventing the incidence of disease, occur in the pharmaceutical and medical technology industries at a rapid pace. These developments may render our products obsolete or noncompetitive.

Our products compete with certain prescription therapies and over-the-counter products for the treatment of the indications for which they are approved, or their associated symptoms, and in many cases with products that have attained significant levels of market acceptance. The availability of prescription competitors and over-the-counter products for such conditions could limit the demand, and the price we are able to charge, for our products unless we are able to achieve market acceptance among the medical community and patients and differentiate our products on the basis of their cost and/or actual or perceived benefits. For example, Takeda Pharmaceuticals Limited's AMITIZA (lubiprostone) is approved by the FDA for sale in the U.S. for the treatment of IBS-C, CIC and opioid-induced constipation, Bausch Health's TRULANCE (plecanatide) is approved by the FDA for sale in the U.S. for the treatment of adults with IBS-C and CIC, Shire plc's MOTEGRITY (prucalopride) is approved by the FDA for sale in the U.S. for the treatment of CIC in adults, and US WorldMeds Holdings, LLC's ZELNORM (tegaserod) has been reintroduced and approved for sale in the U.S. for treatment of IBS-C in women under the age of 65. Additionally, we believe other companies are developing products which could compete with our products, should they be approved by the FDA or foreign regulatory authorities. Currently, there are other compounds in late stage development and other potential competitors are in earlier stages of development for the treatment of the indications for which our products are approved. If our current or potential competitors are successful in completing drug development for their drug candidates and obtain approval from the FDA or foreign regulatory authorities, they could limit the demand for our products.

We will incur significant liability if it is determined that we are promoting any “off-label” uses of our products.

Physicians are permitted to prescribe drug products and medical devices for uses that are not described in the product’s labeling and that differ from those approved by the FDA or other applicable regulatory agencies. Such “off-label” uses are common across medical specialties. Although the FDA and other regulatory agencies do not regulate a physician’s choice of treatments, the FDA and other regulatory agencies do restrict communications on the subject of off-label use. Companies are not permitted to promote drugs or medical devices for off-label uses. Accordingly, we do not permit promotion of any approved product that we develop, license, commercialize, promote, co-promote or otherwise partner for any indication, population or use not described in such product’s label. The FDA and other regulatory and enforcement authorities actively enforce laws and regulations prohibiting promotion of off-label uses and the promotion of products for which marketing approval has not been obtained. A company that is found to have promoted off-label uses will be subject to significant liability, including civil and administrative remedies as