THERAVANCE INC
Form 10-Q
November 05, 2015
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# UNITED STATES

# SECURITIES AND EXCHANGE COMMISSION

**WASHINGTON, D.C. 20549**

# FORM 10-Q

**(Mark One)**

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

**For the quarterly period ended September 30, 2015**

**OR**

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

**For the transition period from to**

**Commission File Number: 000-30319**

# THERAVANCE, INC.

(Exact Name of Registrant as Specified in its Charter)

| **Delaware** | **94-3265960** |
|---|---|
| (State or Other Jurisdiction of Incorporation or Organization) | (I.R.S. Employer Identification No.) |

**951 Gateway Boulevard**

**South San Francisco, CA 94080**

(Address of Principal Executive Offices)

**(650) 238-9600**

(Registrant s Telephone Number, Including Area Code)

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

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

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

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

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

The number of shares of registrant s common stock outstanding on October 30, 2015 was 117,425,815.

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## PART I FINANCIAL INFORMATION

### Item 1. Financial Statements

**THERAVANCE, INC.**

**CONDENSED CONSOLIDATED BALANCE SHEETS**

(In thousands, except per share data)

| | September 30, 2015 (unaudited) | December 31, 2014 * |
|---|---|---|
| **Assets** | | |
| Current assets: | | |
| Cash and cash equivalents | $ 78,746 | $ 96,800 |
| Short-term marketable securities | 127,446 | 143,698 |
| Related party receivables from collaborative arrangements | 16,947 | 10,550 |
| Prepaid expenses and other current assets | 615 | 1,134 |
| Total current assets | 223,754 | 252,182 |
| Marketable securities | | 42,856 |
| Property and equipment, net | 248 | 324 |
| Capitalized fees paid to a related party, net | 197,824 | 208,191 |
| Other assets | 15,805 | 18,101 |
| Total assets | $ 437,631 | $ 521,654 |
| | | |
| **Liabilities and Stockholders Deficit** | | |
| Current liabilities: | | |
| Accounts payable | $ 154 | $ |
| Payable to Theravance Biopharma, Inc. | | 1,056 |
| Accrued personnel-related expenses | 1,392 | 1,959 |
| Accrued interest payable | 6,390 | 7,551 |
| Other accrued liabilities | 2,457 | 2,108 |
| Deferred revenue | 885 | 1,082 |
| Total current liabilities | 11,278 | 13,756 |
| Convertible subordinated notes, due 2023 | 255,109 | 255,109 |
| Non-recourse notes, due 2029 | 488,976 | 470,527 |
| Deferred rent | 100 | 105 |
| Other long-term liabilities | 1,847 | 1,718 |
| Deferred revenue | 3,320 | 3,788 |
| Commitments and contingencies (Notes 3, 6, and 9) | | |
| Stockholders deficit: | | |
| Preferred stock: $0.01 par value, 230 shares authorized, no shares issued and outstanding | | |
| Common stock: $0.01 par value, 200,000 shares authorized, 117,575 and 116,445 shares issued as of September 30, 2015 and December 31, 2014, respectively | 1,176 | 1,164 |
| Treasury stock: 150 shares as of September 30, 2015 and December 31, 2014 | (3,263) | (3,263) |
| Additional paid-in capital | 1,375,805 | 1,452,504 |
| Accumulated other comprehensive income (loss) | 11 | (87) |
| Accumulated deficit | (1,696,728) | (1,673,667) |

| | | |
|---|---|---|
| Total stockholders deficit | (322,999) | (223,349) |
| Total liabilities and stockholders deficit | $ 437,631 | $ 521,654 |

*See accompanying notes to condensed consolidated financial statements.*

* Condensed consolidated balance sheet as of December 31, 2014 has been derived from audited consolidated financial statements.

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**THERAVANCE, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS**

(In thousands, except per share data)

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | 2015 | 2014 | 2015 | 2014 |
| Royalty revenue from a related party, net of amortization for capitalized fees paid to a related party of $3,455 and $3,233 for the three months ended September 30, 2015 and 2014 and $10,367 and $7,611 for the nine months ended September 30, 2015 and 2014 | $ 13,341 | $ 729 | $ 30,449 | $ 342 |
| Revenue from collaborative arrangements from a related party, net | 221 | 270 | 664 | 811 |
| Total net revenue | 13,562 | 999 | 31,113 | 1,153 |
| | | | | |
| Operating expenses: | | | | |
| Research and development | 547 | 1,909 | 1,897 | 6,721 |
| General and administrative | 4,581 | 8,632 | 14,929 | 28,491 |
| Total operating expenses | 5,128 | 10,541 | 16,826 | 35,212 |
| | | | | |
| Income (loss) from operations | 8,434 | (9,542) | 14,287 | (34,059) |
| | | | | |
| Other income (expense), net | (45) | 255 | 1,117 | 335 |
| Interest income | 90 | 93 | 291 | 446 |
| Interest expense | (13,063) | (12,355) | (38,756) | (24,326) |
| Loss from continuing operations before income taxes | (4,584) | (21,549) | (23,061) | (57,604) |
| Income tax expense (benefit) | | (278) | | |
| Loss from continuing operations, net of tax | (4,584) | (21,271) | (23,061) | (57,604) |
| | | | | |
| Loss from discontinued operations (Notes 1 and 11) | | | | (94,934) |
| Net loss | $ (4,584) | $ (21,271) | $ (23,061) | $ (152,538) |
| | | | | |
| Basic and diluted net loss per share: | | | | |
| Continuing operations, net of tax | $ (0.04) | $ (0.19) | $ (0.20) | $ (0.52) |
| Discontinued operations | | | | (0.85) |
| Basic and diluted net loss per share | $ (0.04) | $ (0.19) | $ (0.20) | $ (1.37) |
| | | | | |
| Cash dividend declared per common share | $ 0.25 | $ 0.25 | $ 0.75 | $ 0.25 |
| | | | | |
| Shares used to compute basic and diluted net loss per share | 115,787 | 113,100 | 115,381 | 111,306 |

*See accompanying notes to condensed consolidated financial statements.*

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**THERAVANCE, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE LOSS**

(In thousands)

(Unaudited)

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| | **2015** | **2014** | **2015** | **2014** |
| Net loss | $ (4,584) | $ (21,271) | $ (23,061) | $ (152,538) |
| Other comprehensive income: | | | | |
| Unrealized gain (loss) on marketable securities, net | 21 | (3,903) | 1,302 | (359) |
| Less: Realized gain on marketable securities, net | | | (1,204) | |
| Comprehensive loss | $ (4,563) | $ (25,174) | $ (22,963) | $ (152,897) |

*See accompanying notes to condensed consolidated financial statements.*

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**THERAVANCE, INC.**

**CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS**

(In thousands)

(Unaudited)

| | Nine Months Ended September 30, | |
|---|---|---|
| | **2015** | **2014** |
| **Cash flows from operating activities** | | |
| Net loss | $ (23,061) | $ (152,538) |
| Adjustments to reconcile net loss to net cash provided by (used in) operating activities: | | |
| Depreciation and amortization | 10,449 | 8,720 |
| Stock-based compensation | 5,223 | 26,013 |
| Amortization of premium on short-term investments | 526 | 1,539 |
| Interest added to the principal balance of the non-recourse term notes due 2029 | 18,449 | |
| Realized gain on sale of marketable securities, net | (1,204) | |
| Amortization of debt issuance costs | 2,296 | 1,550 |
| Other non-cash items | (2) | (2) |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | | 74 |
| Receivables from collaborative arrangements | (6,397) | (833) |
| Prepaid expenses and other current assets | 519 | (52) |
| Inventories | | (1,908) |
| Other assets | | 561 |
| Accounts payable | 154 | (7,122) |
| Payable to Theravance Biopharma, Inc., net | (1,056) | (16,166) |
| Accrued personnel-related expenses, accrued clinical and development expenses, and other accrued liabilities | (851) | 71 |
| Accrued interest payable | (1,161) | 16,667 |
| Deferred rent | (5) | 224 |
| Deferred revenue | (665) | (2,911) |
| Net cash provided by (used in) operating activities | 3,214 | (126,113) |
| | | |
| **Cash flows from investing activities** | | |
| Purchases of property and equipment | (6) | (556) |
| Purchases of marketable securities | (86,523) | (228,899) |
| Maturities of marketable securities | 89,311 | 292,666 |
| Sales of marketable securities | 57,098 | 5,000 |
| Capitalized fees paid to a related party | | (125,000) |
| Payments received on notes receivable | | 140 |
| Net cash provided by (used in) investing activities | 59,880 | (56,649) |
| | | |
| **Cash flows from financing activities** | | |
| Payments of cash dividends to stockholders | (87,144) | (28,338) |
| Proceeds from issuances of common stock, net | 5,996 | 35,629 |
| Cash and cash equivalents contributed to Theravance Biopharma, Inc. | | (277,541) |
| Change in restricted cash | | (5,600) |
| Proceeds from issuances of notes payable, net of debt issuance costs | | 434,677 |
| Net cash (used in) provided by financing activities | (81,148) | 158,827 |
| | | |
| **Net decrease in cash and cash equivalents** | (18,054) | (23,935) |

| | | | | |
|---|---|---|---|---|
| **Cash and cash equivalents at beginning of period** | | 96,800 | | 143,510 |
| **Cash and cash equivalents at end of period** | $ | 78,746 | $ | 119,575 |
| **Supplemental disclosure of cash flow information** | | | | |
| Cash paid for interest | $ | 19,169 | $ | 6,109 |
| **Supplemental disclosure of noncash information** | | | | |
| Contribution of net assets, excluding cash and cash equivalents to Theravance Biopharma, Inc. | $ | | $ | 125,337 |
| Conversion of convertible subordinated notes into common stock | $ | | $ | 32,391 |
| Guarantee issued in connection with the Spin-Off (Note 9) | $ | | $ | 1,300 |

*See accompanying notes to condensed consolidated financial statements.*

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**THERAVANCE, INC.**

**NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS**

(Unaudited)

**1. Description of Operations and Summary of Significant Accounting Policies**

***Description of Operations***

Theravance, Inc. ( Theravance , the Company , or we and other similar pronouns) is focused on bringing compelling new medicines to patients in areas of unmet need by leveraging its significant expertise in the development, commercialization and financial management of bio-pharmaceuticals. Theravance s portfolio is anchored by the respiratory assets partnered with Glaxo Group Limited ( GSK ), including RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA®, which were jointly developed by Theravance and GSK. Under the Long-Acting Beta *2* Agonist ( LABA ) Collaboration Agreement and the Strategic Alliance Agreement with GSK (referred to herein as the GSK Agreements ), Theravance is eligible to receive the associated royalty revenues from RELVAR ® /BREO ® ELLIPTA ® , ANORO® ELLIPTA ® and if approved and commercialized, VI monotherapy. Theravance is also entitled to 15% of any future payments made by GSK under its agreements originally entered into with us, and since assigned to Theravance Respiratory Company, LLC ( TRC ), relating to the combination FF/UMEC/VI and the Bifunctional Muscarinic Antagonist-Beta *2* Agonist ( MABA ) program, as monotherapy and in combination with other therapeutically active components, such as an inhaled corticosteroid, and any other product or combination of products that may be discovered and developed in the future under the LABA Collaboration Agreement ( LABA Collaboration ), which has been assigned to TRC other than RELVAR ®/BREO ® ELLIPTA ® , ANORO® ELLIPTA ® and VI monotherapy.

***Basis of Presentation***

The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ) for interim financial information. Accordingly, they do not include all of the information and notes required by GAAP for complete financial statements. In our opinion, the unaudited condensed consolidated financial statements have been prepared on the same basis as audited consolidated financial statements and include all adjustments, consisting of only normal recurring adjustments, necessary for the fair presentation of our financial position, results of operations, comprehensive loss and cash flows. The interim results are not necessarily indicative of the results of operations to be expected for the year ending December 31, 2015 or any other period.

The accompanying unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and notes thereto included in our Annual Report on Form 10-K for the year ended December 31, 2014 filed with the Securities and Exchange Commission ( SEC ) on February 27, 2015.

***Business Separation***

On June 1, 2014, we separated our biopharmaceutical research and drug development operations from our late-stage partnered respiratory assets by transferring our research and drug development operations into our then wholly-owned subsidiary, Theravance Biopharma, Inc. ( Theravance Biopharma ). We contributed $393.0 million of cash, cash equivalents and marketable securities to Theravance Biopharma and all outstanding shares of Theravance Biopharma were then distributed to Theravance stockholders as a pro-rata dividend distribution on June 2, 2014 by issuing one ordinary share of Theravance Biopharma for every 3.5 shares of our common stock to stockholders of record on May 15, 2014 (the Spin-Off ). The Spin-Off resulted in Theravance Biopharma becoming an independent, publicly traded company.

The results of operations for the former research and drug development operations conducted by us and by Theravance Biopharma until June 1, 2014 are included as part of this report as discontinued operations for the three and nine months ended September 30, 2014. Refer to Note 11 Discontinued Operations for further information.

***Variable Interest Entities***

We evaluate our ownership, contractual and other interest in entities to determine if they are variable interest entities ( VIE ), whether we have a variable interest in those entities and the nature and extent of those interests. Based on our evaluations, if we determine we are the primary beneficiary of such VIEs, we consolidate such entities into our financial statements. We consolidate the financial results of TRC, which we have determined to be a VIE, because we have the power to direct the economically significant activities of TRC and the obligation to absorb losses of, or the right to receive benefits from, TRC. The financial position and results of operations of TRC are not material for the periods presented.

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***Recently Issued Accounting Pronouncements Not Yet Adopted***

In May 2014, the Financial Accounting Standards Board ( FASB ) issued Accounting Standards Update ( ASU ) 2014-09, *Revenue from Contracts with Customers* ( ASU 2014-09 ), requiring an entity to recognize the amount of revenue to which it expects to be entitled to in exchange for the transfer of promised goods or services to customers. The new standard will replace nearly all existing revenue recognition guidance under GAAP when it becomes effective. In July 2015, the FASB decided to defer the effective date by one year. Thus, the new standard will be effective for us beginning January 1, 2018, at which time we may adopt the new standard under either the full retrospective method or the modified retrospective method. Early adoption on or after January 1, 2017 would be permitted. We are currently evaluating the effect that the new standard will have on our consolidated financial statements and related disclosures.

In April 2015, the FASB issued ASU 2015-03, *Interest Imputation of Interest*, to simplify the presentation of debt issuance costs. This standard amends existing guidance to require the presentation of debt issuance costs associated with term loans in the balance sheet as a deduction from the carrying amount of the related debt liability instead of a deferred charge. It will be effective for us on January 1, 2016, with early adoption permitted. We plan to adopt ASU 2015-03 on January 1, 2016. Upon adoption of ASU 2015-03, we will apply the guidance retrospectively to all periods presented and classify our debt issuance costs, which are currently included in other assets in the condensed consolidated financial statements, as a deduction to our long-term debt.

**2. Net Loss per Share**

Basic net loss per share is computed by dividing net loss by the weighted-average number of shares of common stock outstanding, less Restricted Stock Awards ( RSAs ) subject to forfeiture. Diluted net loss per share is computed by dividing net loss by the weighted-average number of shares of common stock outstanding, less RSAs subject to forfeiture, plus all additional common shares that would have been outstanding, assuming dilutive potential common shares had been issued for other dilutive securities.

For the three and nine months ended September 30, 2015 and 2014, diluted and basic net loss per common share were identical since potential common shares were excluded from the calculation, as their effect was anti-dilutive.

***Anti-Dilutive Securities***

The following common equivalent shares were not included in the computation of diluted net loss per share because their effect was anti-dilutive:

| | Three Months Ended September 30, | | Nine Months Ended September 30, | |
|---|---|---|---|---|
| **(In thousands)** | **2015 (1)** | **2014** | **2015 (2)** | **2014** |
| Outstanding options and awards granted under equity incentive plan and employee stock purchase plan | 5,070 | 6,771 | 5,459 | 6,218 |

| | | | | |
|---|---|---|---|---|
| Unvested RSAs | 1,489 | 1,782 | 1,738 | 1,782 |
| Shares issuable upon conversion of convertible subordinated notes | 12,904 | 12,100 | 12,904 | 12,100 |
| | 19,463 | 20,653 | 20,101 | 20,100 |

(1) Includes 4.0 million options, 0.3 million restricted stock units, and 0.8 million unvested RSAs retained by former employees who were transferred to Theravance Biopharma in connection with the Spin-Off during the three months ended September 30, 2015. Subsequent to the Spin-Off, stock-based compensation expense associated with the awards held by Theravance Biopharma employees granted prior to the Spin-Off is recognized by Theravance Biopharma.

(2) Includes 4.2 million options, 0.4 million restricted stock units, and 1.0 million unvested RSAs retained by former employees who were transferred to Theravance Biopharma in connection with the Spin-Off during the nine months ended September 30, 2015. Subsequent to the Spin-Off, stock-based compensation expense associated with the awards held by Theravance Biopharma employees granted prior to the Spin-Off is recognized by Theravance Biopharma.

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**3. Collaborative Arrangements**

***Net Revenue from Collaborative Arrangements***

Net revenue from collaborative arrangements from continuing operations relates to our collaborative arrangement with GSK. Net revenue from other collaborative arrangements is reflected as discontinued operations in the condensed consolidated statements of operations. Refer to Notes 1 and 11, Description of Operations and Summary of Significant Accounting Policies and Discontinued Operations for further information.

Net revenue recognized under our GSK Agreements was as follows:

| (In thousands) | Three Months Ended September 30, 2015 | 2014 | Nine Months Ended September 30, 2015 | 2014 |
|---|---|---|---|---|
| Royalties from a related party | $ 16,796 | $ 3,962 | $ 40,816 | $ 7,953 |
| Less: amortization of capitalized fees paid to a related party | (3,455) | (3,233) | (10,367) | (7,611) |
| Royalty revenue | 13,341 | 729 | 30,449 | 342 |
| Strategic alliance - MABA program | 221 | 270 | 664 | 811 |
| Total net revenue from GSK | $ 13,562 | $ 999 | $ 31,113 | $ 1,153 |

*LABA Collaboration*

As a result of the launch and approval of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® in the U.S., Japan and Europe, in accordance with the GSK Agreements, we were obligated to pay milestone fees to GSK totaling $220.0 million, all of which was paid as of December 31, 2014. Although we have no further milestone payment obligations to GSK, we continue to have ongoing development and commercialization activities under the GSK Agreements that are expected to continue over the life of the agreements. The milestone fees paid to GSK were recognized as capitalized fees paid to a related party, which are being amortized over their estimated useful lives commencing upon the commercial launch of the product.

We are entitled to receive annual royalties from GSK on sales of RELVAR®/BREO® ELLIPTA® as follows: 15% on the first $3.0 billion of annual global net sales and 5% for all annual global net sales above $3.0 billion. Sales of single-agent LABA medicines and combination medicines would be combined for the purposes of this royalty calculation. For other products combined with a LABA from the LABA Collaboration, such as ANORO® ELLIPTA®, royalties are upward tiering and range from 6.5% to 10%.

Amortization expense resulting from the milestone fees paid to GSK, which are recognized as capitalized fees paid to a related party, is a non-cash reduction to royalty revenue. In periods when amortization expense exceeded amounts recognized for royalty revenue, negative

revenue was reported in our condensed consolidated statements of operations.

*Agreements Entered into with GSK in Connection with the Spin-Off*

On March 3, 2014, in contemplation of the Spin-Off, we, Theravance Biopharma and GSK entered into a series of agreements, including amendments to the GSK Agreements, clarifying how the companies would implement the Spin-Off and operate following the Spin-Off. Pursuant to a three-way master agreement, by and among us, Theravance Biopharma and GSK, we agreed to sell a certain number of Theravance Biopharma shares withheld from a taxable dividend of Theravance Biopharma shares to GSK. After such Theravance Biopharma shares were sent to the transfer agent, we agreed to purchase the Theravance Biopharma shares from the transfer agent, rather than have them sold on the open market, in order to satisfy tax withholdings. GSK had a right to purchase these shares of Theravance Biopharma from us, but this right expired unexercised. During the nine months ended September 30, 2015, we sold all 436,802 ordinary shares of Theravance Biopharma that we held as of December 31, 2014. Refer to Note 4 Available-for-Sale Securities and Fair Value Measurements for further information.

*GSK Contingent Payments and Revenue*

The potential future contingent payments receivable related to the MABA program of $363.0 million are not deemed substantive milestones due to the fact that the achievement of the event underlying the payment predominantly relates to GSK s performance of future development, manufacturing and commercialization activities for product candidates after licensing the program.

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**4. Available-for-Sale Securities and Fair Value Measurements**

***Available-for-Sale Securities***

The classification of available-for-sale securities in the condensed consolidated balance sheets is as follows:

| (In thousands) | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Cash and cash equivalents | $ 76,077 | $ 95,090 |
| Short-term marketable securities | 127,446 | 143,698 |
| Marketable securities | | 42,856 |
| Total | $ 203,523 | $ 281,644 |

The estimated fair value of available-for-sale securities is based on quoted market prices for these or similar investments that were based on prices obtained from a commercial pricing service. Available-for-sale securities are summarized below:

| | September 30, 2015 | | | |
|---|---|---|---|---|
| (In thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Estimated Fair Value |
| U.S. government securities | $ 7,503 | $ 3 | $ | $ 7,506 |
| U.S. government agencies | 69,965 | 9 | (2) | 69,972 |
| Corporate notes | 27,485 | 3 | (2) | 27,486 |
| Commercial paper | 54,702 | | | 54,702 |
| Money market funds | 43,857 | | | 43,857 |
| Total | $ 203,512 | $ 15 | $ (4) | $ 203,523 |

| | December 31, 2014 | | | | |
|---|---|---|---|---|---|
| (In thousands) | Amortized Cost | Gross Unrealized Gains | Gross Unrealized Losses | Other Than Temporary Impairment Loss | Estimated Fair Value |
| U.S. government securities | $ 30,019 | $ 24 | $ | $ | $ 30,043 |
| U.S. government agencies | 34,756 | 6 | (12) | | 34,750 |
| Corporate notes | 80,880 | 5 | (110) | | 80,775 |
| Commercial paper | 34,469 | | | | 34,469 |
| Ordinary shares of Theravance Biopharma | 10,269 | | | (3,752) | 6,517 |
| Money market funds | 95,090 | | | | 95,090 |
| Total | $ 285,483 | $ 35 | $ (122) | $ (3,752) | $ 281,644 |

As of September 30, 2015, all of the available-for-sale securities had contractual maturities within one year and the weighted average duration of marketable securities was approximately three months. We do not intend to sell the investments that are in an unrealized loss position, and it is unlikely that we will be required to sell the investments before recovery of their amortized cost basis, which may be maturity. We have determined that the gross unrealized losses on our marketable securities as of September 30, 2015 were temporary in nature. As of

September 30, 2015, all marketable securities with unrealized losses have been in a loss position for less than twelve months.

During the nine months ended September 30, 2015, we recognized a gain of $1.2 million from the sale of all of the ordinary shares of Theravance Biopharma that we held as of December 31, 2014, which is included in other income (expense), net in the condensed consolidated statement of operations. In addition, we sold other available-for-sale securities totaling $49.4 million, and the related realized gains and losses were not significant during the nine months ended September 30, 2015.

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***Fair Value Measurements***

Our available-for-sale securities are measured at fair value on a recurring basis and our debt is carried at the amortized cost basis. The estimated fair values were as follows:

| | Estimated Fair Value Measurements as of September 30, 2015 Using: | | | |
|---|---|---|---|---|
| **Types of Instruments (In thousands)** | **Quoted Price in Active Markets for Identical Assets Level 1** | **Significant Other Observable Inputs Level 2** | **Significant Unobservable Inputs Level 3** | **Total** |
| *Assets* | | | | |
| U.S. government securities | $ 7,506 | $ | $ | $ 7,506 |
| U.S. government agencies | | 69,972 | | 69,972 |
| Corporate notes | | 27,486 | | 27,486 |
| Commercial paper | | 54,702 | | 54,702 |
| Money market funds | 43,857 | | | 43,857 |
| Total assets measured at estimated fair value | $ 51,363 | $ 152,160 | $ | $ 203,523 |
| *Liabilities* | | | | |
| Convertible subordinated notes due 2023 | $ | $ 169,362 | $ | $ 169,362 |
| Non-recourse notes due 2029 | | 464,527 | | 464,527 |
| Total fair value of liabilities | $ | $ 633,889 | $ | $ 633,889 |

| | Estimated Fair Value Measurements as of December 31, 2014 Using: | | | |
|---|---|---|---|---|
| **Types of Instruments (In thousands)** | **Quoted Price in Active Markets for Identical Assets Level 1** | **Significant Other Observable Inputs Level 2** | **Significant Unobservable Inputs Level 3** | **Total** |
| *Assets* | | | | |
| U.S. government securities | $ 30,043 | $ | $ | $ 30,043 |
| U.S. government agencies | | 34,750 | | 34,750 |
| Corporate notes | | 80,775 | | 80,775 |
| Commercial paper | | 34,469 | | 34,469 |
| Ordinary shares of Theravance Biopharma | 6,517 | | | 6,517 |
| Money market funds | 95,090 | | | 95,090 |
| Total assets measured at estimated fair value | $ 131,650 | $ 149,994 | $ | $ 281,644 |
| *Liabilities* | | | | |
| Convertible subordinated notes due 2023 | $ | $ 197,095 | $ | $ 197,095 |
| Non-recourse notes due 2029 | | 456,411 | | 456,411 |
| Total fair value of liabilities | $ | $ 653,506 | $ | $ 653,506 |

The fair value of our marketable securities classified within Level 2 were derived from observable inputs that may include benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data including market research publications.

The fair value of our convertible subordinated notes due 2023 and non-recourse notes due 2029 is based on recent trading prices of the instruments, if applicable, or pricing models that utilize current observable market characteristics for similar types of instruments.

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**5. Capitalized Fees Paid to a Related Party**

Capitalized fees paid to a related party, which consist of registrational and launch-related milestone fees paid to GSK, were as follows:

| | | September 30, 2015 | | | December 31, 2014 | | |
|---|---|---|---|---|---|---|---|
| (In thousands) | Weighted Average Remaining Amortization Period (Years) | Gross Carrying Value | Accumulated Amortization | Net Carrying Value | Gross Carrying Value | Accumulated Amortization | Net Carrying Value |
| Approval and launch related milestone payments under the LABA Collaboration | 14.4 | $ 220,000 | $ (22,176) | $ 197,824 | $ 220,000 | $ (11,809) | $ 208,191 |

These milestone fees are being amortized over their estimated useful lives commencing upon the commercial launch of the product in their respective regions with the amortization expense recorded as a reduction in revenue from collaborative arrangements. Additional information regarding these milestone fees is included in Note 3, Collaborative Arrangements . Amortization expense for the three and nine months ended September 30, 2015 was $3.5 million and $10.4 million, respectively. Amortization expense for the three and nine months ended September 30, 2014 was $3.2 million and $7.6 million, respectively. As of September 30, 2015, the remaining estimated amortization expense is $3.5 million for 2015, $13.8 million for each of the years from 2016 to 2020, and $125.3 million thereafter.

**6. Stock-Based Compensation**

***Equity Incentive Plan***

The 2012 Equity Incentive Plan (the 2012 Plan ) provides for the granting of incentive stock options, nonstatutory stock options, RSAs, restricted stock units ( RSUs ) and stock appreciation rights to employees, non-employee directors and consultants. As of September 30, 2015, the total shares remaining available for issuance under the 2012 Plan were 3,200,521.

***Employee Stock Purchase Plan***

Under the 2004 Employee Stock Purchase Plan (the ESPP ), our employees may purchase common stock through payroll deductions at a price equal to 85% of the lower of the fair market value of the stock at the beginning of the offering period or at the end of each applicable purchase period. The ESPP provides for consecutive and overlapping offering periods of 24 months in duration, with each offering period composed of four consecutive six-month purchase periods. The purchase periods end on either May 15 or November 15. ESPP contributions are limited to a

maximum of 15% of an employee s eligible compensation. The maximum number of shares that an employee may purchase in any purchase period is 2,500. An employee may not purchase shares with a value greater than $25,000 in any calendar year.

As of September 30, 2015, total shares remaining available for issuance under the ESPP were 278,971.

***Performance-Contingent RSAs***

Since 2011, the Compensation Committee of our Board of Directors (the Compensation Committee ) have approved grants of performance-contingent RSAs to senior management and a non-executive officer. Generally, these awards have dual triggers of vesting based upon the achievement of certain performance goals by a pre-specified date, as well as a requirement for continued employment. Recognition of stock-based compensation expense begins when the performance goals are deemed probable of achievement.

Included in these performance-contingent RSAs is the grant of 1,290,000 special long-term retention and incentive performance-contingent RSAs to senior management in 2011. The awards have dual triggers of vesting based upon the achievement of certain performance conditions over a six-year timeframe from 2011 through December 31, 2016 and require continued employment. As of March 31, 2014, we determined that the achievement of the requisite performance conditions for vesting of the first tranche of these awards was probable and the total stock-based compensation expense of $7.0 million for the first tranche was fully recognized through May 2014. In connection with the Spin-Off, our Compensation Committee approved the modification of the remaining tranches related to these awards as the performance conditions associated with the remaining portions of these awards were unlikely to be consistent with the new strategies of each company following the Spin-Off. The modification acknowledged the Spin-Off and

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permitted recognition of achievement of certain of the original performance conditions that were met prior to the Spin-Off, triggering service-based vesting for a portion of the equity awards, for which $3.8 million was recognized by us during the twelve-month period that commenced in June 2014. The remaining 63,000 RSAs for which service-based vesting was not triggered at the time of the Spin-Off remain subject to new performance conditions (as well as the original service conditions). In addition, the RSAs for which both the performance and service-based conditions were not achieved prior to the Spin-Off were entitled to the pro rata dividend distribution made by Theravance on June 2, 2014 of one ordinary share of Theravance Biopharma for every 3.5 shares of Theravance common stock subject to their awards, which will also be subject to the same new performance and service conditions as the original RSAs to which they relate. As of September 30, 2015, we determined that the achievement of the requisite performance conditions was not probable and, as a result, no compensation cost was recognized for the remaining equity awards.

***Stock-Based Compensation Expense***

Stock-based compensation expense is included in the condensed consolidated statements of operations as follows:

| (In thousands) | Three Months Ended September 30, 2015 | 2014 | Nine Months Ended September 30, 2015 | 2014 |
|---|---|---|---|---|
| Research and development | $ 220 | $ 1,357 | $ 687 | $ 2,589 |
| General and administrative | 1,248 | 3,375 | 4,536 | 11,795 |
| Stock-based compensation from continuing operations | 1,468 | 4,732 | 5,223 | 14,384 |
| Stock-based compensation from discontinued operations | | | | 11,629 |
| Total stock-based compensation expense | $ 1,468 | $ 4,732 | $ 5,223 | $ 26,013 |

As of September 30, 2015, unrecognized compensation expense, net of expected forfeitures for awards expected to vest, was as follows: $1.7 million related to unvested stock options; $2.1 million related to unvested RSUs; and $9.1 million related to unvested RSAs (including performance-contingent RSAs for which the performance milestones were determined to be probable of achievement).

At the time of the Spin-Off, all outstanding stock options, RSUs and RSAs held by former employees and directors, who transferred to Theravance Biopharma, were retained by them. As the vesting of these options and awards is based on continuing employment or service with Theravance Biopharma, all stock-based compensation expense associated with these options and awards is recognized by Theravance Biopharma.

***Valuation Assumptions***

No options were granted for the three and nine months ended September 30, 2015.

The range of assumptions used to estimate fair value of employee stock options granted during the three and nine months ended September 30, 2014 was as follows:

| | Three Months Ended September 30, 2014 | Nine Months Ended September 30, 2014 |
|---|---|---|
| Risk-free interest rate | 1.97% | 1.64%-2.05% |
| Expected term (in years) | 6 | 5-6 |
| Volatility | 58% | 52%-60% |
| Dividend yield | 4% | 4% |
| Weighted-average estimated fair value of stock options granted | $ 13.23 | $ 15.92 |

**7. Long-Term Debt**

Our long-term debt consists of:

| (In thousands) | September 30, 2015 | December 31, 2014 |
|---|---|---|
| Convertible Subordinated Notes due 2023 | $ 255,109 | $ 255,109 |
| Non-Recourse Notes Payable due 2029 | 488,976 | 470,527 |
| Total Long-Term Debt | $ 744,085 | $ 725,636 |

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***Convertible Subordinated Notes Due 2023***

In January 2013, we completed an underwritten public offering of $287.5 million aggregate principal amount of unsecured convertible subordinated notes, which will mature on January 15, 2023 (the 2023 Notes ). The financing raised proceeds, net of debt issuance costs, of approximately $281.2 million, less $36.8 million to purchase two privately-negotiated capped call option transactions in connection with the issuance of the notes. The 2023 Notes bear interest at the rate of 2.125% per year that is payable semi-annually in arrears in cash on January 15 and July 15 of each year, beginning on July 15, 2013.

The 2023 Notes were convertible, at the option of the holder, into shares of our common stock at an initial conversion rate of 35.9903 shares per $1,000 principal amount of the 2023 Notes, subject to adjustment in certain circumstances, which represents an initial conversion price of approximately $27.79 per share. Following the Spin-Off of Theravance Biopharma, a number of adjustments to the initial conversion rate have been made as described below. Holders of the 2023 Notes will be able to require us to repurchase some or all of their notes upon the occurrence of a Change of Control or a Termination of Trading (as contractually defined) following the original issuance of the 2023 Notes at 100% of the principal amount of the notes being repurchased plus accrued and unpaid interest. We may not redeem the 2023 Notes prior to their stated maturity date.

In connection with the offering of the 2023 Notes, we entered into two privately-negotiated capped call option transactions with a single counterparty. The capped call option transaction is an integrated instrument consisting of a call option on our common stock purchased by us with a strike price equal to the initial conversion price of $27.79 per share for the underlying number of shares and a cap price of $38.00 per share, both of which are subject to adjustments consistent with the 2023 Notes. The cap component is economically equivalent to a call option sold by us for the underlying number of shares with an initial strike price of $38.00 per share. As an integrated instrument, the settlement of the capped call coincides with the due date of the convertible debt. Upon settlement, we would receive from our hedge counterparty a number of shares of our common shares that would range from zero, if the stock price was below $27.79 per share, to a maximum of 2,779,659 shares, if the stock price is above $38.00 per share. However, if the market price of our common stock, as measured under the terms of the capped call transactions, exceeds $38.00 per share, there is no incremental anti-dilutive benefit from the capped call.

In accordance with the agreement for the 2023 Notes, the conversion rate was adjusted as a result of the completion of the Spin-Off of Theravance Biopharma. The conversion rate was adjusted based on the conversion rate immediately prior to the record date for the Spin-Off and the average of the stock dividend distributed to our common stockholders and our stock prices. This resulted in an adjusted conversion rate of 46.9087 shares per $1,000 principal amount of the 2023 Notes, which represents an adjusted conversion price of approximately $21.32 per share. As a result of the conversion rate adjustment, the capped call strike price and cap price were also adjusted accordingly to $21.32 and $29.16, respectively. On July 15, 2014, certain holders of the 2023 Notes converted their notes into 1,519,402 shares of our common stock at the adjusted conversion price of $21.32 per share. In connection with the partial conversion of the 2023 Notes, we received 149,645 shares of our common stock from our capped call option counterparty and the shares of common stock received were recorded as treasury stock.

In connection with the payments of subsequent cash dividends through September 30, 2015, the adjusted conversion rate with respect to our 2023 Notes was further adjusted from 46.9087 shares of our common stock per $1,000 principal amount of the 2023 Notes to 50.5818 shares of our common stock per $1,000 principal amount of the 2023 Notes, which represents an adjusted conversion price of approximately $19.77 per share. As a result of the conversion rate adjustment, the capped call strike price and cap price were also adjusted accordingly to $19.77 and $27.04.

***Non-Recourse Notes Due 2029***

In April 2014, we entered into certain note purchase agreements relating to the private placement of $450.0 million aggregate principal amount of non-recourse fixed rate term notes due 2029 (the 2029 Notes ) issued by our wholly-owned subsidiary.

The 2029 Notes are secured by a security interest in a segregated bank account established to receive 40% of royalties due to us under the LABA Collaboration with GSK commencing on April 1, 2014 and ending upon the earlier of full repayment of principal or May 15, 2029. The amounts in the segregated bank account can only be used to make interest and principal payments on the 2029 Notes. As of September 30, 2015, the balance of the segregated bank account was not material.

The 2029 Notes bear an annual interest rate of 9%, with interest and principal paid quarterly beginning November 15, 2014. The 2029 Notes may be redeemed at any time prior to maturity, in whole or in part, at specified redemption premiums. Prior to May 15, 2016, in the event that the specified portion of royalties received in a quarter is less than the interest accrued for the quarter, the principal amount of the 2029 Notes will increase by the interest shortfall amount for that period. Since issuance, $39.0 million of interest expense has been added to the principal balance of the 2029 Notes, of which $5.6 million and $18.4 million was added during the three and nine months ended September 30, 2015. No interest expense was added to the principal during the three and nine months

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ended September 30, 2014. Since the principal and interest payments on the 2029 Notes are based on royalties from GSK for product sales recorded, which will vary from quarter to quarter and are unknown to us, the 2029 Notes may be repaid prior to the final maturity date in May 2029.

In connection with the sale of the 2029 Notes, we incurred approximately $15.3 million in debt issuance costs, which are being amortized to interest expense over the estimated life of the 2029 Notes.

**8. Shareholders Deficit**

For the nine months ended September 30, 2015, options to purchase 111,156 shares of our common stock were exercised at a weighted-average exercise price of $13.75 per share, for total cash proceeds of approximately $1.5 million. For the nine months ended September 30, 2014, options to purchase 1,127,000 shares of our common stock were exercised at a weighted-average exercise price of $14.09 per share, for total cash proceeds of approximately $15.9 million.

During the nine months ended September 30, 2015, GSK purchased 424,081 shares of our common stock pursuant to its periodic top-up rights under our Amended and Restated Governance Agreement, dated as of June 4, 2004, as amended, among us, GSK and certain GSK affiliates (the Governance Agreement ), for an aggregate purchase price of approximately $6.5 million. GSK s periodic top-up rights terminated with the expiration of the Governance Agreement in September 2015.

On February 20, 2015, our Board of Directors declared a quarterly dividend of $0.25 per share of common stock to stockholders of record as of the close of business on March 12, 2015. This dividend was paid on March 31, 2015. On April 24, 2015, our Board of Directors declared a quarterly dividend of $0.25 per share of common stock to stockholders of record as of the close of business on June 12, 2015. This dividend was paid on June 30, 2015. On July 24, 2015, our Board of Directors declared a quarterly dividend of $0.25 per share of common stock to stockholders of record as of the close of business on September 10, 2015. This dividend was paid to our stockholders on September 30, 2015. During the three and nine months ended September 30, 2015, we paid an aggregate of $29.1 million and $87.1 million in dividends, respectively. Unvested RSAs and certain unvested RSUs as of the record date are also entitled to dividends, which will only be paid when the RSAs and such RSUs vest and are released. For further information on the impact of the cash dividend payments on the 2023 Notes, refer to Note 7, Long-Term Debt .

**9. Commitments and Contingencies**

***Lease Guarantee***

Upon the Spin-Off, our facility leases in South San Francisco, California were assigned to Theravance Biopharma. However, if Theravance Biopharma were to default on its lease obligations, we would be held liable by the landlord and thus, we have in substance guaranteed the lease payments for these facilities. We would also be responsible for lease-related payments including utilities, property taxes, and common area maintenance, which may be as much as the actual lease payments. As of September 30, 2015, the total remaining lease payments, which run

through May 2020, were $29.1 million. The carrying value of this lease guarantee was $1.3 million as of September 30, 2015 and is reflected in other long-term liabilities in our condensed consolidated balance sheet.

***Special Long-Term Retention and Incentive Cash Awards Program***

In 2011, we granted special long-term retention and incentive cash bonus awards to certain employees. The awards have dual triggers of vesting based upon the achievement of certain performance conditions over a six-year timeframe from 2011 through December 31, 2016 and continued employment.

As of March 31, 2014, we determined that the achievement of the requisite performance conditions for the first tranche of these awards was probable and, as a result, $9.1 million of cash bonus expense was recognized for the three months ended March 31, 2014, the majority of which is included in discontinued operations in the condensed consolidated statements of operations. In May 2014, the total cash bonus of $9.5 million for the first tranche was paid.

In connection with the Spin-Off, the Compensation Committee approved the modification of the remaining tranches related to these awards as the performance conditions associated with the remaining portions of these awards were unlikely to be consistent with the new strategies of each company following the Spin-Off. The modification acknowledged the Spin-Off and permitted recognition of achievement of certain of the original performance conditions that were met prior to the Spin-Off, triggering service-based vesting for a portion of the cash awards. The amount due by us under these modified cash bonus awards of $0.5 million was fully paid in June 2015. The remaining tranches of the cash awards were forfeited.

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**10. Income Taxes**

We did not record a provision for income taxes for the three and nine months ended September 30, 2015. The deferred tax assets remain fully offset by a valuation allowance or uncertain tax position liabilities.

As a part of the overall Spin-Off transaction on June 1, 2014, certain assets that were transferred by us to Theravance Biopharma resulted in taxable transfers pursuant to Section 367 of the Internal Revenue Code of 1986, as amended (the Code ), or other applicable provisions of the Code and Treasury Regulations. The taxable gain attributable to the transfer of the certain assets to Theravance Biopharma was the excess of the fair market value of each asset transferred over our adjusted tax basis in such asset. The U.S. federal income tax gain on transfer of the assets to Theravance Biopharma was approximately $400 million. This taxable income was substantially offset by our net operating loss from 2014 and carryforwards from prior years resulting in a net impact of zero to income tax expenses during the nine months ended September 30, 2014.

**11. Discontinued Operations**

On June 1, 2014, we separated our research and drug development businesses from our late-stage partnered respiratory assets. For further information on the Spin-Off, refer to Note 1 Description of Operations and Summary of Significant Accounting Policies . The significant components of the research and drug development operations, which are presented as discontinued operations on the condensed consolidated statements of operations, were as follows:

| | Nine Months Ended September 30, | |
|---|---|---|
| **(In thousands)** | **2015** | **2014** |
| Net revenues (1) | $ | $ 3,129 |
| Loss from discontinued operations (2) | | (94,934) |

There was no impact of the discontinued operations after the Spin-Off to our revenues and expenses for the three months ended September 30, 2015 and 2014.

(1) Net revenues primarily consist of revenue from collaborative arrangements and product sales. Revenue from collaborative arrangements was recognized from our agreement with R-Pharm CJSC, which was transferred to Theravance Biopharma as a part of the Spin-Off. Product sales were generated from sales of VIBATIV® in the U.S. through a limited number of distributors, and title and risk of loss transfer upon receipt by these distributors. VIBATIV® was transferred to Theravance Biopharma as part of the Spin-Off. Healthcare providers ordered VIBATIV® through these distributors. Commencing in the first quarter of 2014, revenue on the sale of VIBATIV® was recorded on a sell-through basis, once the distributors sold the product to healthcare providers. Product sales were recorded net of estimated government-mandated rebates and chargebacks, distribution fees, estimated product returns and other deductions.

(2) Included in the loss from discontinued operations for the three and nine months ended September 30, 2014 are reimbursements of research and development costs from our former collaborative arrangements, excluding GSK, which we accounted for as reductions to research and development expense. Reimbursement of research and development costs from discontinued operations from our collaborative arrangements was zero and $0.1 million for the three and nine months ended September 30, 2014. In addition, the loss from discontinued operations includes the additional stock-based compensation and cash bonus expense recognized due to the achievement of performance conditions under a special long-term retention and incentive equity and cash bonus awarded to certain employees in 2011. Refer to Note 6 Stock-Based Compensation and Note 9 Commitment and Contingencies for further information.

**12. Subsequent Events**

On October 28, 2015, we announced the acceleration of our capital return plan with a $150 million share repurchase program effective through the end of 2016 approved by our Board of Directors, replacing our quarterly dividend. As a component of the share repurchase plan, on October 30, 2015, we commenced a modified Dutch auction tender offer to purchase up to $75 million of our common stock, at a price per share of not less than $8.50 and not greater than $9.25, which will be contingent upon satisfaction of customary conditions.

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

**Forward-Looking Statements**

The information in this Quarterly Report on Form 10-Q contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933, as amended (Securities Act), and Section 21E of the Securities Exchange Act of 1934, as amended. Such forward-looking statements involve substantial risks, uncertainties and assumptions. All statements contained herein that are not of historical fact, including, without limitation, statements regarding our strategy, future operations, future financial position, future revenue, projected costs, prospects, plans, intentions, expectations, goals and objectives, may be forward-looking statements. The words anticipates, believes, could, designed, estimates, expects, goal, intends, may, objective, plans, projects, pursue, will, would and similar expressions (or thereof) are intended to identify forward-looking statements, although not all forward-looking statements contain these identifying words. We may not actually achieve the plans, intentions, expectations or objectives disclosed in our forward-looking statements and the assumptions underlying our forward-looking statements may prove incorrect. Therefore, you should not place undue reliance on our forward-looking statements. Actual results or events could materially differ from the plans, intentions, expectations and objectives disclosed in the forward-looking statements that we make. Factors that we believe could cause actual results or events to differ materially from our forward-looking statements include, but are not limited, to those discussed below in Risk Factors in Item 1A of Part II and in Management s Discussion and Analysis of Financial Condition and Results of Operations in this Item 2 of Part I. All forward-looking statements in this document are based on information available to us as of the date hereof and we assume no obligation to update any such forward-looking statements on account of new information, future events or otherwise, except as required by law.

**OVERVIEW**

**Executive Summary**

Theravance, Inc. ( Theravance , the Company or we and other similar pronouns) is focused on bringing compelling new medicines to patients in areas of unmet need by leveraging its significant expertise in the development, commercialization and financial management of bio-pharmaceuticals. Theravance s portfolio is anchored by the respiratory assets partnered with Glaxo Group Limited ( GSK ), including RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA®, which were jointly developed by Theravance and GSK. Under the Long-Acting Beta*2* Agonist ( LABA ) Collaboration Agreement and the Strategic Alliance Agreement with GSK (referred to herein collectively as the GSK Agreements ), Theravance is eligible to receive the associated royalty revenues from RELVAR®/BREO® ELLIPTA®, ANORO® ELLIPTA® and if approved and commercialized, VI monotherapy. Theravance is also entitled to 15% of any future payments made by GSK under its agreements originally entered into with us, and since assigned to Theravance Respiratory Company, LLC ( TRC ), relating to the combination FF/UMEC/VI and the Bifunctional Muscarinic Antagonist-Beta*2* Agonist ( MABA ) program, as monotherapy and in combination with other therapeutically active components, such as an inhaled corticosteroid, and any other product or combination of products that may be discovered and developed in the future under the LABA Collaboration Agreement, which has been assigned to TRC other than RELVAR®/BREO®ELLIPTA®, ANORO® ELLIPTA® and VI monotherapy.

On June 1, 2014, we separated our biopharmaceutical research and drug development operations from our late-stage partnered respiratory assets by transferring our research and drug development operations into our then wholly-owned subsidiary, Theravance Biopharma, Inc. ( Theravance Biopharma ). We contributed $393.0 million of cash, cash equivalents and marketable securities to Theravance Biopharma and all outstanding shares of Theravance Biopharma were then distributed to Theravance stockholders as a pro-rata dividend distribution on June 2, 2014 by issuing one ordinary share of Theravance Biopharma for every 3.5 shares of our common stock to stockholders of record on May 15, 2014 (the Spin-Off ). The Spin-Off resulted in Theravance Biopharma operating as an independent publicly-traded company. The results of operations for the former research and drug development operations conducted by us and by Theravance Biopharma until June 1, 2014 are included as part of this report as discontinued operations for the three and nine months ended September 30, 2014.

We have designed our company structure and organization to be tailored to our more focused activities following the Spin-Off, including managing our respiratory assets with GSK, the commercial and developmental obligations associated with the GSK Agreements, intellectual property, licensing operations, business development activities and providing for certain essential reporting and management functions of a public company. As of September 30, 2015, we had 13 employees. Our revenues currently consist of royalties and potential milestone payments, if any, from our respiratory partnership agreements with GSK.

**Financial Highlights**

For the nine months ended September 30, 2015, our net loss from our continuing operations was $23.1 million, a decrease of $34.5 million from $57.6 million for the nine months ended September 30, 2014. The decrease was primarily due to an increase in our royalty revenues, decrease in research and development expenses, and lower employee-related expenses, including stock-based

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compensation expense, as a result of decreased operations and headcount post Spin-Off, offset by an increase in interest expense from our non-recourse notes payable due 2029 (the 2029 Notes ). Cash, cash equivalents, and marketable securities, totaled $206.2 million as of September 30, 2015, a decrease of $77.1 million from December 31, 2014. The decrease was primarily due to payments of cash dividends of $87.1 million, partially offset by net proceeds of $6.0 million received from issuances of our common stock and cash provided by operations of $3.2 million.

**Recent Developments**

***Declaration and Payment of Cash Dividends***

On February 20, 2015, our Board of Directors declared a quarterly dividend of $0.25 per share of common stock to stockholders of record as of the close of business on March 12, 2015. A total of $28.8 million was paid to our stockholders on March 31, 2015. On April 24, 2015, our Board of Directors declared a quarterly dividend of $0.25 per share of common stock to stockholders of record as of the close of business on June 12, 2015. A total of $29.2 million was paid to our stockholders on June 30, 2015. On July 24, 2015, our Board of Directors declared a quarterly dividend of $0.25 per share of common stock to stockholders of record as of the close of business on September 10, 2015. A total of $29.1 million was paid to our stockholders on September 30, 2015. Unvested RSAs and certain unvested RSUs as of the record date are also entitled to dividends, which will only be paid when the RSAs and such RSUs vest and are released. In connection with the payments of the cash dividends during the nine months ended September 30, 2015, the conversion rate with respect to our 2.125% Convertible Subordinated Notes due 2023 (the 2023 Notes ) was further adjusted in total from 48.3294 shares of our common stock per $1,000 principal amount of the 2023 Notes at December 31, 2014 to 50.5818 shares of our common stock per $1,000 principal amount of the 2023 Notes at September 30, 2015, which represents an adjusted conversion price of approximately $19.77 per share. As a result of the conversion rate adjustment, the capped call strike price and cap price were also adjusted accordingly to $19.77 and $27.04.

***Share Repurchase Plan***

On October 28, 2015, we announced the acceleration of our capital return plan with a $150 million share repurchase program effective through the end of 2016 approved by our Board of Directors, replacing our quarterly dividend. We currently intend to repurchase our shares under the program through a combination of the tender offer referred to below and, open market purchases, and may also repurchase shares through private transactions, exchange offers, additional tender offers or other means. The repurchase program will be funded using our working capital.

Our announcement of our share repurchase program does not obligate us to repurchase any specific dollar amount or number of shares of common stock. We will determine when, if and how to proceed with any repurchase transactions under the program, as well as the amount of any such repurchase transactions, based upon, among other things, the results of the tender offer and our evaluation of our liquidity and capital needs (including for strategic and other opportunities), our business, results of operations, and financial position and prospects, general financial, economic and market conditions, prevailing market prices for our shares of common stock, corporate, regulatory and legal requirements, and other conditions and factors deemed relevant by our management and Board of Directors from time to time. The share repurchase program may be suspended or discontinued at any time. There can be no assurance as to the actual volume of any share repurchases in any given period or over the term of the program or as to the manner or terms of any such repurchases.

On October 30, 2015, we commenced a modified Dutch auction tender offer to purchase up to $75 million of our common stock, at a price per share of not less than $8.50 and not greater than $9.25. The tender offer is contingent upon satisfaction of customary conditions. Repurchases under the tender offer will be part of our share repurchase program. As of October 29, 2015, we had approximately 117.4 million shares outstanding. We intend to fund the tender offer and related expenses with available cash and cash equivalents.

The information above relating to the tender offer is for informational purposes only and is not an offer to buy or the solicitation of an offer to sell any shares of our common stock. The solicitation and offer to buy our common stock is being made only pursuant to the Offer to Purchase, and the related Letter of Transmittal. Stockholders and investors are urged to read our Tender Offer Statement on Schedule TO, that we filed with the SEC in connection with the tender offer, including the Offer to Purchase, the related Letter of Transmittal and the other offer materials and exhibits thereto, as well as any amendments or supplements to the Schedule TO that we file with the SEC, because they contain important information, including various terms and conditions of the tender offer.

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**Program Highlights**

- Theravance paid a cash dividend of $0.25 per share on September 30, 2015 to stockholders of record as of the close of business on September 10, 2015.

- In the third quarter of 2015, net sales of RELVAR®/BREO® ELLIPTA® by GSK were $97.8 million, comprised of $40.4 million in the U.S. market (an increase of 44 percent from the prior quarter in the U.S.) and $57.4 million in non-U.S. markets (a smaller increase of 7 percent from the prior quarter primarily due to slower summer sales in Europe and Japan).

- As of September 30, 2015, RELVAR®/BREO® ELLIPTA® has been approved in 73 countries for marketing and has been launched in 42 countries.

- In the third quarter of 2015, sales of ANORO® ELLIPTA® by GSK were $32.7 million, an increase of approximately 38 percent compared to the prior quarter. Sales were $22.0 million in the U.S. market (an increase of 23 percent from the prior quarter) and $10.7 million in non-U.S. markets (an increase of 82% from the prior quarter).

- As of September 30, 2015, ANORO® ELLIPTA® has been approved in 61 countries for marketing and has been launched in 33 countries.

**Collaborative Arrangements with GSK**

***LABA Collaboration***

As a result of the launch and approval of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® in the U.S., Japan and Europe, we were obligated to pay milestone fees to GSK totaling $220.0 million, which we have paid in their entirety in 2014. Although we have no further milestone payment obligations to GSK pursuant to the LABA Collaboration Agreement, we continue to have ongoing development and commercialization activities under the GSK Agreements that are expected to continue over the life of the agreements. The milestone fees paid to GSK were recognized as capitalized fees paid to a related party, which are being amortized over their estimated useful lives commencing upon the commercial launch of the product.

We are entitled to receive annual royalties from GSK on sales of RELVAR®/BREO® ELLIPTA® as follows: 15% on the first $3.0 billion of annual global net sales and 5% for all annual global net sales above $3.0 billion. Sales of single-agent LABA medicines and combination medicines would be combined for the purposes of this royalty calculation. For other products combined with a LABA from the LABA collaboration, such as ANORO ELLIPTA , royalties are upward tiering and range from 6.5% to 10%.

***2004 Strategic Alliance***

In March 2004, we entered into our Strategic Alliance Agreement with GSK where GSK received an option to license exclusive development and commercialization rights to product candidates from certain of our discovery programs on pre-determined terms and on an exclusive, worldwide basis. Upon GSK s decision to license a program, GSK is responsible for funding all future development, manufacturing and commercialization activities for product candidates in that program. In addition, GSK is obligated to use diligent efforts to develop and commercialize product candidates from any program that it licenses. If the program is successfully advanced through development by GSK, we are entitled to receive clinical, regulatory and commercial milestone payments and royalties on any sales of medicines developed from the program. For a detailed discussion of our alliance with GSK, see Management s Discussion and Analysis of Financial Condition and Results of Operations contained in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2014 filed with the SEC on February 27, 2015.

***Agreements Entered into with GSK in Connection with the Spin-Off***

On March 3, 2014, in contemplation of the Spin-Off, we, Theravance Biopharma and GSK entered into a series of agreements, including amendments to the GSK Agreements, clarifying how the companies would implement the Spin-Off and operate following the Spin-Off. Pursuant to a three-way master agreement, by and among us, Theravance Biopharma and GSK, we agreed to sell a certain number of Theravance Biopharma shares withheld from a taxable dividend of Theravance Biopharma shares to GSK. After such Theravance Biopharma shares were sent to the transfer agent, we agreed to purchase the Theravance Biopharma shares from the transfer agent, rather than have them sold on the open market, in order to satisfy tax withholdings. GSK had a right to purchase these shares of Theravance Biopharma from us, but this right expired unexercised. During the nine months ended September 30, 2015, we sold all 436,802 ordinary shares of Theravance Biopharma that we held as of December 31, 2014.

The amendments to the GSK Agreements did not change the economics or royalty rates under the GSK Agreements, though the assignment of the Strategic Alliance Agreement and portions of the LABA Collaboration Agreement to TRC do change how the

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economics are allocated between Theravance Biopharma and us. The amendments to the GSK Agreements do provide that upon regulatory approval in either the U.S. or the European Union of FF/UMEC/VI or a MABA in combination with FF, GSK s diligent efforts obligations as to commercialization matters under the GSK Agreements will have the objective of focusing on the best interests of patients and maximizing the net value of the overall portfolio of products under the GSK Agreements. As such, GSK s commercialization efforts may have the effect of reducing the overall value of our remaining interests in the GSK Agreements after the Spin-Off.

***Purchases of Common Stock by GSK***

Prior to 2015, affiliates of GSK purchased an aggregate of 31.6 million shares of our common stock. During the nine months ended September 30, 2015, GSK purchased 424,081 shares of our common stock pursuant to its periodic top-up rights under our Amended and Restated Governance Agreement, dated as of June 4, 2004, as amended, among us, GSK and certain GSK affiliates (the Governance Agreement ), for an aggregate purchase price of approximately $6.5 million. GSK s periodic top-up rights terminated with the expiration of the Governance Agreement in September 2015. As of October 30, 2015, GSK beneficially owned approximately 27% of our outstanding capital stock.

**Critical Accounting Policies and Estimates**

Our management s discussion and analysis of our financial condition and results of operations is based on our financial statements, which have been prepared in accordance with U.S. generally accepted accounting principles ( GAAP ). The preparation of these financial statements requires us to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent assets and liabilities at the date of the financial statements, as well as the reported revenue generated and expenses incurred during the reporting periods. Our estimates are based on our historical experience and on various other factors that we believe are reasonable under the circumstances, the results of which form the basis for making judgments about the carrying value of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions or conditions.

During the nine months ended September 30, 2015, there were no significant changes to our critical accounting policies and estimates. Management s Discussion and Analysis of Financial Condition and Results of Operations contained in Part II, Item 7 of our Annual Report on Form 10-K for the year ended December 31, 2014 filed with the SEC on February 27, 2015 provides a more complete discussion of our critical accounting policies and estimates.

**Results of Operations**

***Net Revenue***

Total net revenue from continuing operations, as compared to the prior year periods, was as follows:

| (In thousands) | Three Months Ended September 30, 2015 | 2014 | Change $ | Change % | Nine Months Ended September 30, 2015 | 2014 | Change $ | Change % |
|---|---|---|---|---|---|---|---|---|
| Royalties from a related party | $ 16,796 | $ 3,962 | $ 12,834 | 324% | $ 40,816 | $ 7,953 | $ 32,863 | 413% |
| Less: amortization of capitalized fees paid to a related party | (3,455) | (3,233) | (222) | 7 | (10,367) | (7,611) | (2,756) | 36 |
| Royalty revenue | 13,341 | 729 | 12,612 | * | 30,499 | 342 | 30,107 | * |
| Strategic alliance - MABA program | 221 | 270 | (49) | (18) | 664 | 811 | (147) | (18) |
| Total net revenue from GSK | $ 13,562 | $ 999 | $ 12,563 | *% | $ 31,113 | $ 1,153 | $ 29,960 | *% |

*Not meaningful

Total net revenue increased for the three and nine months ended September 30, 2015 compared to the same periods a year ago. The increases are primarily due to higher sales of RELVAR®/BREO® ELLIPTA®, ANORO® ELLIPTA® not having been commercially launched until April 2014 and the approval in April 2015 of BREO® ELLIPTA® (FF/VI) as a once-daily inhaled treatment of asthma in patients aged 18 years and older in the U.S. Royalty revenue is reduced by amortization expense for capitalized fees paid to a related party.

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***Research & Development***

Research and development expenses from continuing operations, as compared to the prior year periods, were as follows:

| (In thousands) | Three Months Ended September 30, 2015 | 2014 | Change $ | Change % | Nine Months Ended September 30, 2015 | 2014 | Change $ | Change % |
|---|---|---|---|---|---|---|---|---|
| Research and development expenses | $ 547 | $ 1,909 | $ (1,362) | (71)% | $ 1,897 | $ 6,721 | $ (4,824) | (72)% |

Research and development expenses decreased for the three and nine months ended September 30, 2015 compared to the same periods a year ago primarily due to fewer allocated costs as our ongoing operations are significantly smaller as a result of the Spin-Off in June 2014 and lower stock-based compensation expense. Stock-based compensation expense was higher during the three and nine months ended September 30, 2014 due to the achievement of performance conditions under a specified long-term retention and incentive equity awarded to certain employees in 2011. Currently, our research and development expenses are primarily due to expenses related to the late-stage partnered respiratory assets with GSK.

***General & Administrative***

General and administrative expenses from continuing operations, as compared to the prior periods, were as follows:

| (In thousands) | Three Months Ended September 30, 2015 | 2014 | Change $ | Change % | Nine Months Ended September 30, 2015 | 2014 | Change $ | Change % |
|---|---|---|---|---|---|---|---|---|
| General and administrative expenses | $ 4,581 | $ 8,632 | $ (4,051) | (47)% | $ 14,929 | $ 28,491 | $ (13,562) | (48)% |

General and administrative expenses decreased for the three and nine months ended September 30, 2015 compared to the same periods a year ago primarily due to lower stock-based compensation expense and employee-related costs. For the three and nine months ended September 30, 2014, stock-based compensation expense and employee-related costs were higher primarily due to the probable achievement of performance conditions under a special long-term retention and incentive equity and cash bonus awarded to certain employees in 2011.

We structured our organization to be tailored to our more focused activities following the Spin-Off, including managing our respiratory assets with GSK, the commercial and developmental obligations associated with the GSK Agreements, intellectual property, licensing operations, business development activities and providing for certain essential reporting and management functions of a public company.

***Other Income (Expense), net and Interest Income***

Other income (expense), net and interest income, as compared to the prior year periods, were as follows:

| | Three Months Ended September 30, | | Change | | Nine Months Ended September 30, | | Change | |
|---|---|---|---|---|---|---|---|---|
| **(In thousands)** | **2015** | **2014** | **$** | **%** | **2015** | **2014** | **$** | **%** |
| Other income (expense), net | $ (45) | $ 255 | $ (300) | (118)% | $ 1,117 | $ 335 | $ 782 | 233% |
| Interest income | 90 | 93 | (3) | (3) | 291 | 446 | (155) | (35) |

Other income (expense), net increased for the nine months ended September 30, 2015 compared to the same period in 2014 primarily related to a realized gain of $1.2 million on the sale of all of the ordinary shares of Theravance Biopharma that we held as of December 31, 2014 in the first quarter of 2015.

Interest income decreased for the three and nine months ended September 30, 2015 as compared to the same periods a year ago primarily due to lower average cash balances resulting from the cash contribution to Theravance Biopharma in June 2014.

***Interest Expense***

Interest expense, as compared to the prior year periods, was as follows:

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| (In thousands) | Three Months Ended September 30, 2015 | 2014 | Change $ | Change % | Nine Months Ended September 30, 2015 | 2014 | Change $ | Change % |
|---|---|---|---|---|---|---|---|---|
| Interest expense | $ 13,063 | $ 12,355 | $ 708 | 6% | $ 38,756 | $ 24,326 | $ 14,430 | 59% |

Interest expense increased for the three and nine months ended September 30, 2015 compared to the same periods a year ago primarily due to the issuance of our 2029 Notes in April 2014, and a subsequent increase of $39.0 million to the outstanding principal balance from interest short falls. See Liquidity section below for further information.

***Discontinued Operations***

On June 1, 2014, we separated our research and drug development businesses from our late-stage partnered respiratory assets. The significant components of the research and drug development operations, which are presented as discontinued operations on the condensed consolidated statements of operations, were as follows:

| (In thousands) | Nine Months Ended September 30, 2015 | 2014 |
|---|---|---|
| Net revenue | $ | $ 3,129 |
| Loss from discontinued operations | | 94,934 |

There was no impact of the discontinued operations after the Spin-Off to our revenues and expenses for the three months ended September 30, 2015 and 2014.

Net revenues for the nine months ended September 30, 2014 includes revenue from collaborative arrangements with R-Pharm CJSC, which was transferred to Theravance Biopharma as a part of the Spin-Offs and products sales from sales of VIBATIV® in the U.S. for which revenue recognition commenced in the first quarter of 2014 which was transferred to Theravance Biopharma as a part of the Spin-Off.

Loss from discontinued operations for the nine months ended September 30, 2014 primarily relates to research and development expenses incurred prior to June 1, 2014 in addition to external legal and accounting fees in connection with our separation strategy and the additional stock-based compensation and cash bonus expense recognized due to the achievement of performance conditions under a special long-term retention and incentive equity and cash bonus awarded to certain employees in 2011, both of which we started to incur in 2013.

**Liquidity and Capital Resources**

***Liquidity***

Since our inception, we have financed our operations primarily through private placements and public offerings of equity and debt securities and payments received under collaborative arrangements. In 2015, we have also received royalty payments from GSK from sales of RELVAR®/ BREO® ELLIPTA®, which was launched in the fourth quarter of 2013, and from ANORO® ELLIPTA®, which was launched during 2014. As of September 30, 2015, we had $206.2 million in cash, cash equivalents, and marketable securities.

As discussed above under Recent Developments on October 28, 2015, we announced that our Board of Directors approved a $150 million share repurchase program, and on October 30, 2015, we commenced a modified Dutch auction tender offer to purchase up to $75 million of our common stock, at a price per share of not less than $8.50 and not greater than $9.25. As discussed above, there can be no assurance as to the actual volume of any share repurchases in any given period or over the term of the program or as to the manner or terms of any such repurchases.

On February 20, 2015, our Board of Directors declared a quarterly dividend of $0.25 per share of common stock to stockholders of record as of the close of business on March 12, 2015. On April 24, 2015, our Board of Directors declared a quarterly dividend of $0.25 per share of common stock to stockholders of record as of the close of business on June 12, 2015. On July 24, 2015, our Board of Directors declared a quarterly dividend of $0.25 per share of common stock to stockholders of record as of the close of business on September 10, 2015. During the three and nine months ended September 30, 2015, we paid $29.1 million and $87.1 million of dividends in cash.