ARADIGM CORP
Form 10-Q
November 12, 2010

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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, DC 20549
Form 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2010

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: 000-28402

Aradigm Corporation

(Exact name of registrant as specified in its charter)

California	**94-3133088**
(State or other jurisdiction of incorporation or organization)	*(I.R.S. Employer Identification No.)*

3929 Point Eden Way
Hayward, CA 94545

(Address of principal executive offices including zip code)

(510) 265-9000

(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 þ 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 o 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 o	Accelerated filer o	Non-accelerated filer o (do not check if a smaller reporting company)	Smaller reporting company þ

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

Indicate the number of shares outstanding of each of the issuer s classes of common stock, as of the latest practicable date.

(Class)	*(Outstanding at November 09, 2010)*
Common	*172,462,378*

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PART I. FINANCIAL INFORMATION
Item 1. FINANCIAL STATEMENTS

ARADIGM CORPORATION
CONDENSED BALANCE SHEETS
(In thousands, except share data)

	September 30, 2010 (Unaudited)	December 31, 2009 (Note 1)
ASSETS		
Current assets:		
Cash and cash equivalents	$ 7,367	$ 3,903
Short-term investments	270	5,228
Receivables	111	155
Prepaid and other current assets	164	328
Total current assets	7,912	9,614
Property and equipment, net	1,693	2,166
Notes receivable	53	52
Other assets	137	133
Total assets	$ 9,795	$ 11,965
LIABILITIES AND SHAREHOLDERS EQUITY (DEFICIT)		
Current liabilities:		
Accounts payable	$ 223	$ 572
Accrued clinical and cost of other studies	838	670
Accrued compensation	514	341
Facility lease exit obligation	141	263
Other accrued liabilities	395	357
Total current liabilities	2,111	2,203
Deferred rent	111	136
Facility lease exit obligation, non-current	754	828
Other non-current liabilities	75	75
Note payable and accrued interest		8,896
Total liabilities	3,051	12,138
Commitments and contingencies		
Shareholders equity (deficit):		
Preferred stock, 5,000,000 shares authorized, none outstanding		
Common stock, no par value; authorized shares: 213,527,214 at September 30, 2010; 150,000,000 at December 31, 2009; issued and	358,207	348,271

outstanding shares: 172,320,344 at September 30, 2010; 102,381,116 at December 31, 2009				
Accumulated other comprehensive income				2
Accumulated deficit		(351,463)		(348,446)
Total shareholders equity (deficit)		6,744		(173)
Total liabilities and shareholders equity (deficit)	$	9,795	$	11,965

See accompanying Notes to the Unaudited Condensed Financial Statements

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ARADIGM CORPORATION
CONDENSED STATEMENTS OF OPERATIONS
(In thousands, except per share data)
(Unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2010	**2009**	**2010**	**2009**
Revenue:				
Contract revenue	$	$ 4,883	$	$ 4,883
Royalty revenue	239		4,239	
Total revenue	239	4,883	4,239	4,883
Operating expenses:				
Research and development	2,403	2,426	7,976	9,079
General and administrative	895	1,323	3,530	4,089
Restructuring and asset impairment	11	1,638	37	1,860
Total operating expenses	3,309	5,387	11,543	15,028
Loss from operations	(3,070)	(504)	(7,304)	(10,145)
Interest income	3	16	17	58
Interest expense	(95)	(109)	(313)	(318)
Other income (expense), net	15	1	121	(3)
Gain from extinguishment of debt	4,462		4,462	
Net income/(loss)	$ 1,315	$ (596)	$ (3,017)	$ (10,408)
Basic and diluted net income/(loss) per common share	$ 0.01	$ (0.01)	$ (0.03)	$ (0.12)
Shares used in computing basic net income/(loss) per common share	139,167	99,347	114,787	89,888
Shares used in computing diluted net income/(loss) per common share	140,177	99,347	114,787	89,888

See accompanying Notes to the Unaudited Condensed Financial Statements

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ARADIGM CORPORATION
CONDENSED STATEMENTS OF CASH FLOWS
(In thousands)
(Unaudited)

	Nine months ended September 30, 2010	2009
Cash flows from operating activities:		
Net loss	$ (3,017)	$ (10,408)
Adjustments to reconcile net loss to cash used in operating activities:		
Impairment loss on property and equipment		1,654
Amortization and accretion of investments	26	6
Depreciation and amortization	471	899
Stock-based compensation expense	622	622
Loss on retirement and sale of property and equipment	7	3
Gain on debt extinguishment	(4,526)	
Facility lease exit cost		158
Changes in operating assets and liabilities:		
Receivables	44	150
Prepaid and other current assets	164	66
Other assets	(5)	(5)
Accounts payable	(349)	(494)
Accrued compensation	173	(115)
Other liabilities	516	425
Deferred rent	(25)	(56)
Deferred revenue		(4,122)
Facility lease exit obligation	(196)	(263)
Net cash used in operating activities	(6,095)	(11,480)
Cash flows from investing activities:		
Capital expenditures	(5)	185
Purchases of short-term investments	(270)	(9,649)
Proceeds from sales and maturities of short-term investments	5,200	3,380
Note receivable payments		(16)
Net cash provided by (used in) investing activities	4,925	(6,100)
Cash flows from financing activities:		
Proceeds from public offering of common stock, net		3,927
Proceeds from private placement of common stock and exercise of warrants, net	4,591	
Proceeds from issuance of common stock	43	37
Net cash provided by financing activities	4,634	3,964

Net increase (decrease) in cash and cash equivalents	3,464	(13,616)
Cash and cash equivalents at beginning of period	3,903	16,741
Cash and cash equivalents at end of period	$ 7,367	$ 3,125
Supplemental schedule of non-cash financing activities:		
Non-cash reduction in note payable and accrued interest from issuance of common stock	$ 4,680	$

See accompanying Notes to the Unaudited Condensed Financial Statements

ARADIGM CORPORATION
NOTES TO THE UNAUDITED CONDENSED FINANCIAL STATEMENTS
September 30, 2010

1. Organization, Basis of Presentation and Liquidity

Organization

Aradigm Corporation (the Company, we, our, or us) is a California corporation focused on the development and commercialization of drugs delivered by inhalation for the treatment of severe respiratory diseases. The Company s principal activities to date have included conducting research and development and developing collaborations. Management does not anticipate receiving any revenues from the sale of products in the upcoming year, except for royalty revenue from Zogenix, Inc. The Company operates as a single operating segment.

Basis of Presentation

The accompanying unaudited condensed financial statements have been prepared in accordance with United States generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Certain information and footnote disclosures normally included in financial statements prepared in accordance with United States generally accepted accounting principles have been condensed or omitted pursuant to the rules and regulations of the Securities and Exchange Commission (the SEC). In the opinion of management, the financial statements reflect all adjustments, which are of a normal recurring nature, necessary for fair presentation. The accompanying unaudited condensed financial statements should be read in conjunction with the financial statements and notes thereto included in the Company s Annual Report on Form 10-K for the year ended December 31, 2009, as filed with the SEC on March 24, 2010 (the 2009 Annual Report on Form 10-K). The results of the Company s operations for the interim periods presented are not necessarily indicative of operating results for the full fiscal year or any future interim period.

The balance sheet at December 31, 2009 has been derived from the audited financial statements at that date, but does not include all of the information and footnotes required by United States generally accepted accounting principles for complete financial statements. For further information, please refer to the financial statements and notes thereto included in the 2009 Annual Report on Form 10-K. We have evaluated events that have occurred after September 30, 2010 and through the date that the unaudited financial statements were issued.

Liquidity

The Company had cash, cash equivalents and short-term investments of approximately $7.6 million as of September 30, 2010. The Company believes that this amount, as well as anticipated recurring royalty payments from Zogenix and the anticipated Qualifying Therapeutic Discovery Project grants totaling approximately $733,000, will be sufficient to enable it to fund operations through at least the first quarter of 2011.

On June 21, 2010, the Company closed a private placement, in which the Company sold 34,702,512 shares of common stock and warrants to purchase an aggregate of 7,527,214 shares of common stock to accredited investors (which included a few existing significant investors) under the terms of a securities purchase agreement that was entered into with the investors on June 18, 2010 (the June 2010 Private Placement). At the closing of the June 2010 Private Placement, the Company received approximately $4.1 million in aggregate gross proceeds from the sale of the common stock and the warrants. After deducting for fees and expenses, the aggregate net proceeds from the sale of the common stock and the warrants were approximately $3.7 million. After the Company held a special meeting of shareholders on September 14, 2010 and obtained the requisite shareholder approval on a proposal to amend the Company s amended and restated articles of incorporation to increase the total number of authorized shares of common stock to cover the shares issuable upon exercise of the warrants, the warrants were exercised and the Company received approximately $891,000 in additional aggregate net proceeds from the exercise of the warrants.

The Company is currently focusing primarily on establishing funded partnering agreements and sale or out-licensing of non-strategic assets as the means to fund the further development of the cystic fibrosis indication for ARD-3100, as well as the anticipated costs of the Phase 3 liposomal ciprofloxacin bronchiectasis trials. If we are unable to find financing on acceptable terms, we may be required to further reduce or defer our activities or discontinue operations.

2. Summary of Significant Accounting Policies

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Use of Estimates

The preparation of financial statements, in conformity with United States generally accepted accounting principles, requires management to make estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. These estimates include useful lives for property and equipment and related depreciation calculations, estimated amortization period for payments received from product development and license agreements as they relate to revenue recognition, assumptions for valuing options and warrants, and income taxes. Actual results could differ materially from these estimates.

Cash and Cash Equivalents

The Company considers all liquid investments purchased with an initial maturity of three months or less to be cash equivalents. The Company invests cash and cash equivalents not needed for operations in money market funds, commercial paper, corporate bonds and government notes in accordance with the Company s investment policy.

Investments

Management determines the appropriate classification of the Company s investments, which consist solely of debt securities, at the time of purchase. All investments are classified as available-for-sale, carried at estimated fair value and reported in cash and cash equivalents or short-term investments. Unrealized gains and losses on available-for-sale securities are excluded from earnings and losses and are reported as a separate component in accumulated other comprehensive income in shareholders equity until realized. Fair values of investments are based on quoted market prices where available. Interest income is recognized when earned and includes interest, dividends, amortization of purchase premiums and discounts, and realized gains and losses on sales of securities. The cost of securities sold is based on the specific identification method. The Company regularly reviews all of its investments for other-than-temporary declines in fair value. When the Company determines that the decline in fair value of an investment below the Company s accounting basis is other-than-temporary, the Company reduces the carrying value of the securities held and records a loss equal to the amount of any such decline. No such reductions were required during any of the periods presented.

Property and Equipment

The Company records property and equipment at cost and calculates depreciation using the straight-line method over the estimated useful lives of the respective assets. Machinery and equipment includes external costs incurred for validation of the equipment. The Company does not capitalize internal validation expense. Computer equipment and software includes capitalized computer software. All of the Company s capitalized software is purchased; the Company has not internally developed computer software. Leasehold improvements are depreciated over the shorter of the term of the lease or useful life of the improvement.

Impairment of Long-Lived Assets

In accordance with Accounting Standards Codification (ASC) 360-10, *Property, Plant, and Equipment Overall*, the Company reviews for impairment whenever events or changes in circumstances indicate that the carrying amount of property and equipment may not be recoverable. Determination of recoverability is based on an estimate of undiscounted future cash flows resulting from the use of the asset and its eventual disposition. In the event that such cash flows are not expected to be sufficient to recover the carrying amount of the assets, the assets are written down to their estimated fair values and the loss is recognized in the statements of operations.

Accounting for Costs Associated with Exit or Disposal Activities

In accordance with ASC 420, *Exit or Disposal Cost Obligations* (ASC 420), the Company recognizes a liability for the cost associated with an exit or disposal activity that is measured initially at its fair value in the period in which the liability is incurred. According to ASC 420, costs to terminate an operating lease or other contracts are (a) costs to terminate the contract before the end of its term or (b) costs that will continue to be incurred under the contract for its remaining term without economic benefit to the entity. In periods subsequent to initial measurement, changes to the liability are measured using the credit-adjusted risk-free rate that was used to measure the liability initially.

Revenue Recognition

The Company recognizes revenue under the provisions of the SEC s Staff Accounting Bulletin 104, Topic 13, *Revenue Recognition Revised and Updated* (SAB 104) and ASC 605*, Revenue Recognition.* In addition, contract revenue from the Company s collaboration arrangements typically contain multiple elements and are accounted for under the guidance of ASC 605-25*, Revenue Recognition-Multiple Element Arrangements.*

Contract Revenue. Contract revenues consist of revenues from grants, collaboration agreements and feasibility studies. The Company records license fees, milestone fees and reimbursement of research and development expenses as contract revenue. The Company reviews all of these arrangements for the existence of multiple elements such as license fees, milestone fees, research and development reimbursements, product steering committee services and other performance obligations.

The Company reviews elements that have been delivered and determines whether such items have value to the Company s collaborators on a stand-alone basis and whether objective reliable evidence of fair value of the undelivered items exists. Deliverables that meet these criteria are considered a separate unit of accounting and are recognized as revenue when delivered and collection is reasonably assured. Deliverables that do not meet these criteria are combined and accounted for as a single unit of accounting. Revenue recognition criteria are identified and applied to each separate unit of accounting. The Company typically has not had reliable evidence of separate units and has treated the entire arrangement as a single unit of accounting.

Royalty Revenue. The Company earns royalty revenue under the terms of the asset sale agreement with Zogenix. Revenue is recognized when the amounts under this agreement can be determined and when collectability is probable. The Company has no performance obligations under this agreement. Revenue will be recognized from the quarterly royalty payments one quarter in arrears due to the contractual terms in the asset sale agreement that allow Zogenix sixty days to complete their royalty report following the end of the quarter. In the first quarter of 2010, the Company received the $4.0 million milestone payment that was due upon the first commercial sale by Zogenix of a product using the DosePro* technology. This one-time payment was recorded as royalty revenue for the three months ended March 31, 2010. The Company received the quarterly report and payment in August 2010 and recorded $239,000 in royalty revenue in the three months ended September 30, 2010.

Research and Development

Research and development expenses consist of costs incurred for company-sponsored, collaborative and contracted research and development activities. These costs include direct and research-related overhead expenses. Research and development expenses under collaborative and government grants approximate the revenue recognized under such agreements. The Company expenses research and development costs as such costs are incurred.

Stock-Based Compensation

The Company accounts for share-based payment arrangements in accordance with ASC 718, *Compensation-Stock Compensation* and ASC 505-50, *Equity-Equity Based Payments to Non-Employees* which requires the recognition of compensation expense, using a fair-value based method, for all costs related to share-based payments, including stock options and restricted stock awards and stock issued under the Company s employee stock purchase plan. This guidance requires companies to estimate the fair value of share-based payment awards on the date of the grant using an option-pricing model. The Company has adopted the simplified method to calculate the beginning balance of the additional paid-in capital, or APIC pool of excess tax benefits, and to determine the subsequent effect on the APIC pool and statement of cash flows of the tax effects of stock-based compensation awards.

Income Taxes

The Company makes certain estimates and judgments in determining income tax expense for financial statement purposes. These estimates and judgments occur in the calculation of certain tax assets and liabilities, which arise from differences in the timing of recognition of revenue and expense for tax and financial statement purposes. As part of the process of preparing the financial statements, the Company is required to estimate income taxes in each of the jurisdictions in which it operates. This process involves the Company estimating its current tax exposure under the most recent tax laws and assessing temporary differences resulting from differing treatment of items for tax and accounting purposes. These differences result in deferred tax assets and liabilities, which are included in the balance sheets.

The Company assesses the likelihood that it will be able to recover its deferred tax assets. It considers all available evidence, both positive and negative, including the historical levels of income and losses, expectations and risks associated with estimates of future taxable income and ongoing prudent and feasible tax planning strategies in assessing the need for a valuation allowance. If the Company does not consider it more likely than not that it will recover its deferred tax assets, the Company records a valuation allowance against the deferred tax assets that it estimates will not ultimately be recoverable. At September 30, 2010 and December 31, 2009, the Company believed that the amount of its deferred income taxes would not ultimately be recovered. Accordingly, the Company recorded a full valuation allowance for deferred tax assets. However, should there be a change in the Company s ability to recover its deferred tax assets, the Company would recognize a benefit to its tax provision in the period in which it determines that it is more likely than not that it will recover its deferred tax assets.

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Net Income/(Loss) Per Common Share

Basic net income/(loss) per common share is computed using the weighted-average number of shares of common stock outstanding during the period less the weighted-average number of restricted shares of common stock subject to repurchase. Diluted net income/(loss) per common share is based on the weighted average number of common and common equivalent shares, such as stock options and unvested restricted stock shares outstanding during the period. Potentially dilutive securities were included for the quarter ended September 30, 2010 but were excluded in all other periods presented, because inclusion of such shares would have been anti-dilutive.

Recently Issued Accounting Pronouncements

In April 2010, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) 2010-17, *Milestone Method of Revenue Recognition a consensus of the FASB Emerging Issues Task Force.* This standard provides guidance on defining a milestone and determining when it may be appropriate to apply the milestone method for revenue recognition for research and development arrangements. This standard provides guidance on the criteria that should be met to recognize revenue upon achievement of the related milestone event. The ASU is effective for fiscal years (and interim periods within those fiscal years) beginning on or after June 15, 2010. The Company adopted this guidance in the third quarter of 2010. The Company will evaluate the impact of this guidance upon entering into any future collaboration arrangements.

In February 2010, the FASB issued Accounting Standards Update No. 2010-09 (ASU 2010-09), Subsequent Events, Amendments to Certain Recognition and Disclosure Requirements, which clarifies certain existing evaluation and disclosure requirements in ASC 855 related to subsequent events. ASU 2010-09 requires SEC filers to evaluate subsequent events through the date on which the financial statements are issued and is effective immediately. The new guidance did not have an effect on our consolidated results of operations and financial condition.

On January 21, 2010, the FASB issued ASU 2010-06, *Improving Disclosures About Fair Value Measurements* which amends ASC 820 to add new requirements for disclosures about transfers into and out of Levels 1 and 2 and separate disclosures about purchases, sales, issuances, and settlements relating to Level 3 measurements. ASU 2010-06 also clarifies existing fair value disclosures about the level of disaggregation and about inputs and valuation techniques used to measure fair value. The Company adopted this guidance for the three months ended March 31, 2010. The adoption of this guidance did not have an impact on the Company s financial position or results of operations.

In September 2009, the FASB issued ASU 2009-13 *Revenue Recognition (Topic 605): Multiple-Deliverable Revenue Arrangements* (formerly EITF Issue No. 08-1 Revenue Arrangements with Multiple Deliverables). This standard modifies the revenue recognition guidance for arrangements that involve the delivery of multiple elements, such as product, license fees and research and development reimbursements, to a customer at different times as part of a single revenue generating transaction. This standard provides principles and application guidance to determine whether multiple deliverables exist, how the individual deliverables should be separated and how to allocate the revenue in the arrangement among those separate deliverables. The standard also significantly expands the disclosure requirements for multiple deliverable revenue arrangements. The Company will evaluate the impact of this standard for any multiple-deliverable arrangements that are entered into in the future.

3. Cash, Cash Equivalents and Short-Term Investments

A summary of cash and cash equivalents and short-term investments, classified as available-for-sale and carried at fair value is as follows (in thousands):

	Amortized Cost	Gross Unrealized Gain	Gross Unrealized (Loss)	Estimated Fair Value
September 30, 2010				
Cash and cash equivalents	$ 7,367	$	$	$ 7,367

Short-term investments:								
Commercial paper	$	270	$		$		$	270
Certificates of deposit								
U.S. treasury and agencies								
Total	$	270	$		$		$	270
December 31, 2009								
Cash and cash equivalents	$	3,903	$		$		$	3,903
Short-term investments:								
Commercial paper	$	500	$		$		$	500
Certificates of deposit		3,183		2				3,185
U.S. treasury and agencies		1,543						1,543
Total	$	5,226	$	2	$		$	5,228

All short-term investments at September 30, 2010 mature in less than one year. Unrealized holding gains and losses on securities classified as available-for-sale are recorded in other comprehensive income.

The Company considers all liquid investments purchased with a maturity of three months or less to be cash equivalents. The Company invests its cash and cash equivalents and short-term investments in money market funds, commercial paper and corporate and government notes.

4. Fair Value Measurements

The Company records its cash and cash equivalents and its short-term investments at fair value. The Company classifies these assets by using the fair value hierarchy which is based on the inputs used to measure fair value. The fair value hierarchy has three levels based on the reliability of the inputs used to determine fair value. Level 1 values are based on quoted prices in active markets. Level 2 values are based on significant other observable inputs. Level 3 values are based on significant unobservable inputs. The following table presents the fair value level for the assets that are measured at fair value on a recurring basis and are categorized using the fair value hierarchy. The Company does not have any liabilities that are measured at fair value. The following table summarizes the basis used to measure certain assets at fair value on a recurring basis at September 30, 2010 (in thousands):

		Fair Value Measurements		
Description	Balance September 30, 2010	Quoted Prices in Active Markets for Identical Assets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Cash and cash equivalents	$ 7,367	$ 2,286	$ 5,081	$
Short-term investments:				
Commercial paper	$ 270	$	$ 270	$
Total	$ 270	$	$ 270	$

The Company s cash and cash equivalents at September 30, 2010 consisted of cash, commercial paper and money market funds. Money market funds are valued using quoted market prices. The Company uses an independent third party pricing service to value its commercial paper, and other Level 2 investments. The pricing service uses observable inputs such as new issue money market rates, adjustment spreads, corporate actions and other factors and applies a series of matrices pricing models.

5. Sublease Agreement and Lease Exit Liability

On July 18, 2007, the Company entered into a sublease agreement with Mendel Biotechnology, Inc. (Mendel), under which the Company subleases to Mendel approximately 48,000 square feet of the 72,000 square foot facility located at 3929 Point Eden Way, Hayward, CA. The Company recorded a $2.1 million impairment expense related to the sublease for the year ended December 31, 2007.

The Company recorded this expense and the related lease exit liability because the monthly payments the Company expects to receive under the sublease are less than the amounts that the Company will owe the lessor for the sublease space. The fair value of the lease exit liability was determined using a credit-adjusted risk-free rate to discount the estimated future net cash flows, consisting of the minimum lease payments to the lessor for the sublease space and payments the Company will receive under the sublease. The sublease loss and ongoing accretion expense required to record the lease exit liability at its fair value using the interest method have been recorded as part of restructuring and asset impairment expense in the statement of operations.

The lease exit liability activity for the nine months ended September 30, 2010 is as follows (in thousands):

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		Nine Months Ended September 30, 2010
Balance at January 1, 2010	$	1,091
Accretion expense		37
Lease payments		(233)
Balance at September 30, 2010	$	895

As of September 30, 2010, $141,000 of the $895,000 balance was recorded as a current liability and $754,000 was recorded as a non-current liability.

6. Collaborations and Royalty Agreements

Zogenix

In August 2006, the Company sold all of its assets related to the Intraject needle-free injector technology platform and products, including 12 United States patents along with foreign counterparts, to Zogenix, Inc., a privately-held pharmaceutical company. Zogenix is responsible for further development and commercialization efforts of Intraject (now rebranded under the name DosePro). Under the terms of the asset sale agreement, the Company received a $4.0 million initial payment from Zogenix and was entitled to a $4.0 million milestone payment upon initial U.S. commercialization, as well as quarterly royalty payments in the amount of 3% of Net Sales of DosePro products. In December 2007, Zogenix submitted a New Drug Application (NDA) with the U.S. Food and Drug Administration (FDA) for the migraine drug sumatriptan using the needle-free injector DosePro (SUMAVEL* DosePro). The NDA was accepted for filing by the FDA in March 2008. The same month, Zogenix entered into a license agreement to grant exclusive rights in the European Union to Desitin Pharmaceuticals, GmbH to develop and commercialize SUMAVEL DosePro in the European Union.

On July 16, 2009, Zogenix announced that it had received approval from the FDA for its NDA for SUMAVEL DosePro needle-free delivery system. On August 3, 2009, Zogenix and Astellas Pharma US, Inc. announced that they had entered into an exclusive co-promotion agreement in the U.S. for the SUMAVEL DosePro needle-free delivery system. Under the announced terms of the agreement, the companies will collaborate on the promotion and marketing of SUMAVEL DosePro with Zogenix focusing their sales activities primarily on the neurology market while Astellas will focus mostly on primary care physicians. Zogenix will have responsibility for manufacturing and distribution of the product.

On January 13, 2010, Zogenix announced the U.S. commercial launch of its SUMAVEL DosePro product. The U.S. launch entitled the Company to the $4.0 million milestone payment which was received and recorded as royalty revenue during the three months ended March 31, 2010. In August 2010, the Company received the quarterly royalty payment and recorded $239,000 in royalty revenue for the three months ended September 30, 2010. The terms of the asset sale agreement provide for royalty payments of 3% of Net Sales to be based on cash received by Zogenix on their product sales and there is a sixty day period following the end of the quarter for Zogenix to complete their royalty reporting. The Company has been informed by Zogenix that wholesalers distributing the SUMAVEL DosePro product were given net 90 day payments terms for the first quarter sales, resulting in the effective delay of first quarter 2010 royalties until the second quarter 2010 royalty payment received in August 2010. After first quarter 2010, the payment terms for wholesalers reverted to net 30 days.

7. Stock-Based Compensation and Stock Options, Awards and Units

The following table shows the stock-based compensation expense included in the accompanying condensed statements of operations for the three and nine months ended September 30, 2010 and 2009 (in thousands):

	Three Months Ended September 30,	Nine Months Ended September 30,

	2010	**2009**	**2010**