

THERAVANCE INC
Form 10-Q
November 05, 2015
[Table of Contents](#)

UNITED STATES
SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, D.C. 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended September 30, 2015

OR

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

For the transition period from _____ to _____

Commission File Number: 000-30319

THERAVANCE, INC.

(Exact Name of Registrant as Specified in its Charter)

Delaware
(State or Other Jurisdiction of
Incorporation or Organization)

94-3265960
(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)

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

Indicate by check mark whether the registrant has submitted electronically 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 No

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

Large accelerated filer
Non-accelerated filer
(Do not check if a smaller reporting company)

Accelerated filer
Smaller reporting company

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

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

Table of Contents

TABLE OF CONTENTS

PART I FINANCIAL INFORMATION

Item 1. Financial Statements

Condensed Consolidated Balance Sheets as of September 30, 2015 (unaudited) and December 31, 2014 3

Condensed Consolidated Statements of Operations for the Three and Nine Months Ended September 30, 2015 and 2014 (unaudited) 4

Condensed Consolidated Statements of Comprehensive Loss for the Three and Nine Months Ended September 30, 2015 and 2014 (unaudited) 5

Condensed Consolidated Statements of Cash Flows for the Nine Months Ended September 30, 2015 and 2014 (unaudited) 6

Notes to Condensed Consolidated Financial Statements (unaudited) 7

Item 2. Management's Discussion and Analysis of Financial Condition and Results of Operations 17

Item 3. Quantitative and Qualitative Disclosures About Market Risk 25

Item 4. Controls and Procedures 25

PART II. OTHER INFORMATION

Item 1A. Risk Factors 26

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds 39

Item 6. Exhibits 40

Signatures 41

Exhibits

Table of Contents**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)

Edgar Filing: THERAVANCE INC - Form 10-Q

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.

Table of Contents**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.

Table of Contents

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.

Table of Contents

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)

Edgar Filing: THERAVANCE INC - Form 10-Q

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.

Table of Contents

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.

Table of Contents***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:

(In thousands)	Three Months Ended September 30,		Nine Months Ended September 30,	
	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

Edgar Filing: THERAVANCE INC - Form 10-Q

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.

Table of Contents**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,		Nine Months Ended September 30,	
	2015	2014	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.

Table of Contents**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:

(In thousands)	Amortized Cost	September 30, 2015		Estimated Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	
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

(In thousands)	Amortized Cost	December 31, 2014			Estimated Fair Value
		Gross Unrealized Gains	Gross Unrealized Losses	Other Than Temporary Impairment Loss	
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

Edgar Filing: THERAVANCE INC - Form 10-Q

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.

Table of Contents**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:

Types of Instruments (In thousands)	Estimated Fair Value Measurements as of September 30, 2015 Using:			
	Quoted Price in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total
<i>Assets</i>				
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
<i>Liabilities</i>				
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

Types of Instruments (In thousands)	Estimated Fair Value Measurements as of December 31, 2014 Using:			
	Quoted Price in Active Markets for Identical Assets Level 1	Significant Other Observable Inputs Level 2	Significant Unobservable Inputs Level 3	Total
<i>Assets</i>				
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
<i>Liabilities</i>				
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.

Table of Contents**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:

(In thousands)	Weighted Average Remaining Amortization Period (Years)	September 30, 2015			December 31, 2014		
		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

Edgar Filing: THERAVANCE INC - Form 10-Q

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

Table of Contents

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,		Nine Months Ended September 30,	
	2015	2014	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.

Edgar Filing: THERAVANCE INC - Form 10-Q

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

Table of Contents

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

Edgar Filing: THERAVANCE INC - Form 10-Q

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

Table of Contents

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.

Table of Contents**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:

(In thousands)	Nine Months Ended September 30,	
	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.

Table of Contents

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 (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 Beta2 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-Beta2 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.

Edgar Filing: THERAVANCE INC - Form 10-Q

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

Table of Contents

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.

Edgar Filing: THERAVANCE INC - Form 10-Q

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.

Table of Contents

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

Table of Contents

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:

Edgar Filing: THERAVANCE INC - Form 10-Q

(In thousands)	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2015	2014	\$	%	2015	2014	\$	%
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.

Table of Contents**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,		Change		Nine Months Ended September 30,		Change	
	2015	2014	\$	%	2015	2014	\$	%
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,		Change		Nine Months Ended September 30,		Change	
	2015	2014	\$	%	2015	2014	\$	%
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:

(In thousands)	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	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:

Table of Contents

(In thousands)	Three Months Ended September 30,		Change		Nine Months Ended September 30,		Change	
	2015	2014	\$	%	2015	2014	\$	%
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	\$ 94,934
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.

Table of Contents

On June 1, 2014, we contributed \$393.0 million of cash, cash equivalents and marketable securities to Theravance Biopharma as initial funds for their operations, based on anticipated operating plans and financial forecasts at the separation date. Although our cash on hand was reduced as a result of the Spin-Off, our operating expenses have decreased significantly as our ongoing operations are significantly smaller due to our focus on royalty management activities. As a result of the reduction in our operations, we believe that cash from future royalty revenues, net of operating expenses, debt service and cash on hand, will be sufficient to fund our operations for at least the next twelve months.

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 9% fixed rate term notes due 2029 (2029 Notes). The 2029 Notes are secured exclusively by a security interest in a segregated bank account established to receive 40% of the royalties from global net sales occurring on or after April 1, 2014 and ending upon the earlier of full repayment of principal or May 15, 2029 due to us under the LABA Collaboration Agreement with GSK. 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. As of September 30, 2015, interest expense of \$39.0 million has been added to the principal balance of the 2029 Notes. From the net proceeds of the offering of approximately \$434.7 million, we established a milestone payment reserve account to fund 40% of any future milestone payments that could become payable under the LABA Collaboration Agreement with GSK. As of September 30, 2015, the balance of the milestone reserve account was zero as we have fulfilled our obligation related to the milestone payments during the fourth quarter of 2014. 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.

Adequacy of cash resources to meet future needs

We believe that our cash, cash equivalents and marketable securities will be sufficient to meet our anticipated operating needs, including the funding of the share repurchase program discussed above, for at least the next twelve months based upon current operating plans and financial forecasts. If our current operating plans and financial forecasts change, we may require additional funding sooner in the form of public or private equity offerings or debt financings or may need to reduce or stop our quarterly dividend. Furthermore, if in our view favorable financing opportunities arise, we may seek additional funding at any time. However, future financing may not be available in amounts or on terms acceptable to us, if at all. This could leave us without adequate financial resources to fund our operations as currently planned. In addition, we regularly explore debt restructuring and/or reduction alternatives, including through tender offers, redemptions, repurchases or otherwise, all consistent with the terms of our debt agreements.

Cash Flows

Cash flows, as compared to the prior year periods, were as follows:

(In thousands)	Nine Months Ended September 30,		Change
	2015	2014	
Net cash provided by (used in) operating activities	\$ 3,214	\$ (126,113)	\$ 129,327
Net cash provided by (used in) investing activities	59,880	(56,649)	116,529
Net cash (used in) provided by financing activities	(81,148)	158,827	(239,975)

Cash Flows from Operating Activities

Cash provided by or used in operating activities is primarily driven by net loss, excluding the effect of non-cash charges and net changes in our operating assets and liabilities.

Net cash provided by operating activities for the nine months ended September 30, 2015 of \$3.2 million was primarily due to:

- \$34.4 million provided by receipt of royalties from a related party and revenue from collaborative arrangements, after adjusting for a \$6.4 million increase in receivables from collaborative arrangements and \$0.7 million decrease in deferred revenue;
- \$11.5 million used for operating expenses, after adjusting for \$5.2 million of non-cash related items, consisting primarily of stock-based compensation expense;
- \$19.2 million used for interest payments on convertible subordinated notes, due 2023 and non-recourse notes, due 2029; and
- \$0.9 million used to decrease accrued personnel-related expenses due to the timing of payments.

Net cash used in operating activities for the nine months ended September 30, 2014 of \$126.1 million was primarily due to:

Table of Contents

- \$114.7 million used for operating expenses, after adjusting for non-cash related items of \$37.8 million consisting primarily of stock-based compensation expense of \$26.0 million and depreciation and amortization expenses of \$8.7 million and amortization on premium of marketable securities of \$1.5 million and amortization of debt issuance cost of \$1.6 million;
- \$16.2 million decrease in payable to Theravance Biopharma;
- \$16.7 million used for interest accruals on convertible subordinated notes, due 2023 and non-recourse notes, due 2029;
- \$1.9 million used to increase inventories;
- \$7.1 million decrease in accounts payable primarily due to the timing of payments and our ongoing operations being significantly smaller due to the Spin-Off; and
- \$2.9 million provided by decrease in deferred revenue.

Cash Flows from Investing Activities

Net cash provided by investing activities for the nine months ended September 30, 2015 of \$59.9 million was primarily due to \$146.4 million of proceeds received from the sale of marketable securities and maturities of marketable securities, partially offset by \$86.5 million in purchases of marketable securities.

Net cash provided by investing activities for the nine months ended September 30, 2014 of \$56.6 million was primarily due to \$125.0 million used for registrational and launch-related milestone payments to GSK, partially offset by \$68.8 million from the sale and maturities of marketable securities, net of purchases.

Cash Flows from Financing Activities

Net cash used in financing activities for the nine months ended September 30, 2015 of \$81.1 million was primarily due to \$87.1 million of cash dividends paid to our stockholders, offset by \$6.0 million of net proceeds received from the issuance of our common stock.

Net cash provided by financing activities for the nine months ended September 30, 2014 of \$158.8 million was primarily due to net proceeds of \$434.7 million received from the private placement of our 2029 Notes and \$35.6 million received from the issuances of our common stock, partially offset by \$277.5 million of cash and cash equivalents contributed to Theravance Biopharma as a result of the Spin-Off and payments of cash dividends of \$28.3 million to our stockholders.

Off-Balance Sheet Arrangements

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.

Commitments and Contingencies

We indemnify our officers and directors for certain events or occurrences, subject to certain limits. We may be subject to contingencies that may arise from matters such as product liability claims, legal proceedings, shareholder suits and tax matters, as such, we are unable to estimate the potential exposure related to these indemnification agreements. We have not recognized any liabilities relating to these agreements as of September 30, 2015.

Special Long-Term Retention and Incentive Cash Awards Program

In 2011, we granted special long-term retention and incentive RSAs to members of senior management and 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.

In connection with the Spin-Off, the Compensation Committee of our Board of Directors 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-

Table of Contents

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 and equity awards. Stock-based compensation expense of \$3.8 million associated with this portion of the equity awards after the modification 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. The Theravance Biopharma shares will be subject to the same new performance and service conditions as the original RSAs to which they relate. The amount due by us under the modified cash bonus awards of \$0.5 million is fully paid in June 2015 and the remaining tranches of the cash bonus awards were forfeited.

Contractual Obligations and Commercial Commitments

There have been no significant changes in our payments due under contractual obligations, compared to those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014.

Item 3. Quantitative and Qualitative Disclosure about Market Risk

During the nine months ended September 30, 2015, there have been no significant changes in our market risk or how our market risk is managed compared to those disclosed in our Annual Report on Form 10-K for the year ended December 31, 2014.

Item 4. Controls and Procedures

Evaluation of Disclosure Controls and Procedures.

We conducted an evaluation as of September 30, 2015, under the supervision and with the participation of our management, including our Chief Executive Officer and Chief Financial Officer, of the effectiveness of the design and operation of our disclosure controls and procedures, which are defined under SEC rules as controls and other procedures of a company that are designed to ensure that information required to be disclosed by a company in the reports that it files under the Securities Exchange Act of 1934 (Exchange Act) is recorded, processed, summarized and reported within required time periods. Based upon that evaluation, our Chief Executive Officer and Chief Financial Officer concluded that, as of such date, our disclosure controls and procedures were effective at the reasonable assurance levels.

Limitations on the Effectiveness of Controls

Edgar Filing: THERAVANCE INC - Form 10-Q

Our management, including our Chief Executive Officer and Chief Financial Officer, does not expect that our disclosure controls and procedures or our internal control over financial reporting will prevent all error and all fraud. A control system, no matter how well conceived and operated, can provide only reasonable, not absolute, assurance that the objectives of the control system are met. Further, the design of a control system must reflect the fact that there are resource constraints, and the benefit of controls must be considered relative to their costs. Because of the inherent limitations in all control systems, no evaluation of controls can provide absolute assurance that all control issues and instances of fraud, if any, within Theravance have been detected. Also, projections of any evaluation of effectiveness to future periods are subject to the risk that controls may become inadequate because of changes in conditions, or that the degree of compliance with the policies or procedures may deteriorate.

Changes in Internal Control over Financial Reporting

There were no changes in our internal control over financial reporting (as defined in Rule 13a-15(f) of the Exchange Act) that occurred during the quarter ended September 30, 2015 that have materially affected, or are reasonably likely to materially affect, our internal control over financial reporting.

Table of Contents

PART II. OTHER INFORMATION

Item 1A. Risk Factors

Risks Related to our Business

For the foreseeable future we will derive all of our royalty revenues from GSK and our future success depends on GSK's ability to successfully develop and commercialize the products in the respiratory programs partnered with GSK.

Pursuant to the GSK Agreements, GSK is responsible for the development and commercialization of products in the partnered respiratory programs. Through September 30, 2015, sales of both BREO[®] ELLIPTA[®] and especially ANORO[®] ELLIPTA[®] by GSK have been significantly below our expectations which resulted in a decline in our stock price. Although we may receive milestone payments from GSK if certain development milestones are achieved in our MABA program, we believe that royalty revenues from BREO[®] ELLIPTA[®] and ANORO[®] ELLIPTA[®] will represent the majority of our future revenues from GSK. The amount and timing of revenue from such royalties and milestones is unknown and highly uncertain. Our future success depends upon the performance by GSK of its commercial obligations under the GSK Agreements. We have no control over GSK's marketing and sales efforts, and GSK might not be successful, which would harm our business and cause the price of our securities to fall.

The amount of royalties and milestone payments, if any, we receive will depend on many factors, including the following:

- the extent and effectiveness of the sales and marketing and distribution support GSK provides our partnered products;
- market acceptance and demand for our partnered products;
- the competitive landscape of generic and branded products and developing therapies that compete with our partnered products, including other products owned by GSK (such as Advair[®]) but which are not partnered with us and pricing pressure in the respiratory markets targeted by our partnered products;
- the size of the market for our partnered products;

- decisions as to the timing of product launches, pricing and discounts;
- GSK's ability to expand the indications for which our partnered products can be marketed;
- a satisfactory efficacy and safety profile as demonstrated in a broad patient population;
- acceptance of, and ongoing satisfaction with, our partnered products by the medical community, patients receiving therapy and third party payors;
- the ability of patients to be able to afford our partnered products or obtain health care coverage that covers our partnered products;
- safety concerns in the marketplace for respiratory therapies in general and with our partnered products in particular;
- regulatory developments relating to the manufacture or continued use of our partnered products;
- the requirement to conduct additional post-approval studies or trials for our partnered products;
- GSK's ability to successfully achieve development milestones with respect to our partnered MABA program;
- GSK's ability to obtain regulatory approval of our partnered products in additional countries; or
- the unfavorable outcome of any potential litigation relating to our partnered products.

Table of Contents

Reduced prices and reimbursement rates due to the actions of governments, payors, or competition or other healthcare cost containment initiatives such as restrictions on use, may negatively impact royalties generated under the GSK Agreements.

The continuing efforts of governments, pharmaceutical benefit management organizations (PBMs), insurance companies, managed care organizations and other payors of health care costs to contain or reduce costs of health care has adversely affected the price, market access, and total revenues of BREO® ELLIPTA® and ANORO® ELLIPTA® and may continue to adversely affect them in the future. In addition, we have experienced and expect to continue to experience increased competitive activity which has resulted in lower overall prices for our products.

The Patient Protection and Affordable Care Act and other legislative or regulatory requirements or potential legislative or regulatory actions regarding healthcare and insurance matters, along with the trend toward managed healthcare in the United States (U.S.), could adversely influence the purchase of healthcare products and reduce demand and prices for our partnered products. This could harm GSK's ability to market our partnered products and significantly reduce future revenues. For example, when GSK launched BREO® ELLIPTA® for the treatment of COPD in the U.S. in October 2013, GSK experienced significant challenges gaining coverage at some of the largest PBMs, healthcare payors, and providers and lower overall prices than expected. Recent actions by U.S. PBMs in particular have increased discount levels for respiratory products resulting in lower net sales pricing realized for products in our collaboration. Further, if the ongoing Phase 3b studies with FF/VI do not show improved outcomes relative to the standard of care, obtaining payor coverage for RELVAR®/BREO® ELLIPTA® could become more difficult in the future. In addition, in certain foreign markets, the pricing of prescription drugs is subject to government control and reimbursement may in some cases be unavailable. We believe that pricing pressures will continue and may increase. This may make it difficult for GSK to sell our partnered products a price acceptable to us or GSK or to generate revenues in-line with our analysts' or investors' expectations, which may cause the price of our securities to fall.

If the commercialization of RELVAR® /BREO® ELLIPTA® or ANORO® ELLIPTA® in the countries in which they have received regulatory approval encounters any delays or adverse developments, or perceived delays or adverse developments, or if sales or payor coverage do not meet investor, analyst or our expectations, our business will be harmed, and the price of our securities could fall.

Under the GSK Agreements, GSK has full responsibility for commercialization of RELVAR® / BREO® ELLIPTA® and ANORO® ELLIPTA®. GSK has launched RELVAR® / BREO® ELLIPTA® in a number of countries including the United States (U.S.), Canada, Japan, the United Kingdom, and Germany among others. The commercial launch of both products has been below our expectations primarily due to lower overall pricing levels in the U.S. and a longer timeframes to obtain payor coverage. For example, GSK recently stated that it has experienced more restrictive formulary access and lower net pricing in the U.S. respiratory market than it expected, which may indicate broader weakness in the respiratory markets targeted by RELVAR® / BREO® ELLIPTA® and ANORO® ELLIPTA®. As a result, a number of analysts have adjusted their sales forecasts downward from previous projections. Any further delays or adverse developments or perceived additional delays or adverse developments with respect to the commercialization of RELVAR® / BREO® ELLIPTA® and ANORO® ELLIPTA® including if sales or payor coverage do not meet investor, analyst or our expectations, will significantly harm our business and the price of our securities could fall.

If GSK's commercialization efforts to market BREO® ELLIPTA® for asthma encounters any delays or adverse developments, or perceived delays or adverse developments, or if sales or payor coverage do not meet investor, analyst or our expectations, our business will be harmed, and the price of our securities could fall.

Edgar Filing: THERAVANCE INC - Form 10-Q

On April 30, 2015, the U.S. Food and Drug Administration (FDA) approved BREO® ELLIPTA® (FF/VI) as a once-daily inhaled treatment for asthma in patients aged 18 years and older in the U.S. If GSK's commercialization efforts to market BREO® ELLIPTA® for asthma in the U.S. encounters any delays or adverse developments, or perceived delays or adverse developments, or if sales or payor coverage do not meet investor, analyst or our expectations, our business will be harmed, and the price of our securities could fall.

Any adverse change in FDA policy or guidance regarding the use of LABAs to treat asthma may significantly harm our business and the price of our securities could fall.

On February 18, 2010, the FDA announced that LABAs should not be used alone in the treatment of asthma and it will require manufacturers to include this warning in the product labels of these drugs, along with taking other steps to reduce the overall use of these medicines. The FDA now requires that the product labels for LABA medicines reflect, among other things, that the use of LABAs is contraindicated without the use of an asthma controller medication such as an inhaled corticosteroid, that LABAs should only be used long-term in patients whose asthma cannot be adequately controlled on asthma controller medications, and that LABAs should be used for the shortest duration of time required to achieve control of asthma symptoms and discontinued, if possible, once asthma control is achieved. In addition, in March 2010, the FDA held an Advisory Committee to discuss the design of medical

Table of Contents

research studies (known as clinical trial design) to evaluate serious asthma outcomes (such as hospitalizations, a procedure using a breathing tube known as intubation, or death) with the use of LABAs in the treatment of asthma in adults, adolescents, and children. Further, in April 2011, the FDA announced that to further evaluate the safety of LABAs, it is requiring the manufacturers of currently marketed LABAs to conduct additional randomized, double-blind, controlled clinical trials comparing the addition of LABAs to inhaled corticosteroids versus inhaled corticosteroids alone. Results from these post-marketing studies are expected in 2017. It is unknown at this time what, if any, effect these or future FDA actions will have on the prospects for FF/VI. The current uncertainty regarding the FDA's position on LABAs for the treatment of asthma and the lack of consensus expressed at the March 2010 Advisory Committee may result in the FDA requiring additional asthma clinical trials in the U.S. for FF/VI and increase the overall risk of FF/VI for the treatment of asthma in the U.S. We cannot predict the extent to which new FDA policy or guidance might significantly impede the discovery, development, production and marketing of FF/VI. Any adverse change in FDA policy or guidance regarding the use of LABAs to treat asthma may significantly harm our business and the price of our securities could fall.

Any adverse developments to the regulatory status of either RELVAR® /BREO® ELLIPTA® or ANORO® ELLIPTA® in the countries in which they have received regulatory approval including labeling restrictions, safety findings, or any other limitation to usage, will harm our business and may cause the price of our securities to fall.

Although RELVAR®/BREO® ELLIPTA® or ANORO® ELLIPTA® are approved and marketed in a number of countries, it is possible that adverse changes to the regulatory status of these products could occur in the event new safety issues are identified, treatment guidelines are changed, or new studies fail to demonstrate product benefits. A number of notable pharmaceutical products have experienced adverse developments during commercialization that have resulted in the product being withdrawn, approved uses being limited, or new warnings being included. In the event that any adverse regulatory change was to occur to any of our products, our business will be harmed and the price of our securities will fall.

Any adverse developments or results or perceived adverse developments or results with respect to the ongoing studies for FF/VI in asthma or COPD, for UMEC/VI in COPD, or any future studies will significantly harm our business and the price of our securities could fall, and if regulatory authorities in those countries in which approval has not yet been granted determine that the Phase 3 programs for FF/VI in asthma or COPD or the Phase 3 programs for UMEC/VI for COPD do not demonstrate adequate safety and efficacy, the continued development of FF/VI or UMEC/VI or both may be significantly delayed, they may not be approved by these regulatory authorities, and even if approved it may be subject to restrictive labeling, any of which will harm our business, and the price of our securities could fall.

Although we have announced the completion of, and reported certain top-line data from, the Phase 3 registrational program for FF/VI in COPD and asthma, a number of additional studies of FF/VI are underway. For example, in September 2015, GSK and we announced that the Study to Understand Mortality and Morbidity (SUMMIT) did not meet its primary endpoints. Any adverse developments or perceived adverse developments with respect to any prior, current or future studies in these programs will significantly harm our business and the price of our securities could fall.

Although the FDA, the European Medicines Agency, the Japanese Ministry of Health, Labour and Welfare and Health Canada have approved ANORO® ELLIPTA®, it has not yet been approved in other countries.

Any adverse developments or results or perceived adverse developments or results with respect to other pending or future regulatory submissions for the FF/VI program or the UMEC/VI program will significantly harm our business and the price of our securities could fall.

Edgar Filing: THERAVANCE INC - Form 10-Q

Examples of such adverse developments include, but are not limited to:

- not every study, nor every dose in every study, in the Phase 3 programs for FF/VI achieved its primary endpoint and regulatory authorities may determine that additional clinical studies are required;
- safety, efficacy or other concerns arising from clinical or non-clinical studies in these programs having to do with the LABA VI, which is a component of FF/VI and UMEC/VI;
- analysts adjusting their sales forecasts downward from previous projections based on results or interpretations of results of prior, current or future studies;
- safety, efficacy or other concerns arising from clinical or non-clinical studies in these programs;
- regulatory authorities determining that the Phase 3 programs in asthma or in COPD raise safety concerns or do not demonstrate adequate efficacy; or

Table of Contents

- any change in FDA policy or guidance regarding the use of LABAs to treat asthma or the use of LABAs combined with a LAMA to treat COPD.

If the FDA or other applicable regulatory authorities approve generic products, including but not limited generic forms of Advair®, that compete with RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® the royalties payable to us pursuant to the LABA Collaboration Agreement will be less than anticipated, which in turn would harm our business and the price of our securities could fall.

Once an NDA or marketing authorization application outside the United States is approved, the product covered thereby becomes a listed drug that can, in turn, be cited by potential competitors in support of approval of an Abbreviated New Drug Application (ANDA) in the United States. Agency regulations and other applicable regulations and policies provide incentives to manufacturers to create modified, non-infringing versions of a drug to facilitate the approval of an ANDA or other application for generic substitutes in the United States and in nearly every pharmaceutical market around the world. Numerous companies like Mylan N.V. and Teva Pharmaceuticals Industries Ltd. have publicly stated their intentions to bring generic forms of the ICS/LABA drug Advair®, when certain patents covering the Advair® delivery device expire in 2016. Mylan N.V. has recently announced the completion of their Phase III studies for their generic Advair program, and expressed their intention to file their ANDA with the FDA before the end of 2015. These manufacturers might only be required to conduct a relatively inexpensive study to show that their product has the same active ingredient(s), dosage form, strength, route of administration and conditions of use, or labeling, as the branded product and that the generic product is bioequivalent to the branded product, meaning it is absorbed in the body at the same rate and to the same extent. These generic equivalents, which must meet the same quality standards as branded products, may be significantly less costly to bring to market, and companies that produce generic equivalents are generally able to offer their products at lower prices. Thus, after the introduction of a generic competitor, a significant percentage of the sales of any branded product and products that may compete with such branded product is typically lost to the generic product. Accordingly, introduction of generic products that compete against ICS/LABA products, like RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA®, would materially adversely impact our future royalty revenue, profitability and cash flows. We cannot yet ascertain what impact these generic products and any future approved generic products will have on any sales of RELVAR®/BREO® ELLIPTA® or ANORO® ELLIPTA®, if approved.

RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® face substantial competition for their intended uses in the targeted markets from products discovered, developed, launched and commercialized both by GSK and by other pharmaceutical companies, which could cause the royalties payable to us pursuant to the LABA Collaboration Agreement to be less than expected, which in turn would harm our business and the price of our securities could fall.

GSK has responsibility for obtaining regulatory approval, launching and commercializing RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® for their intended uses in the targeted markets around the world. While these products have received regulatory approval and been launched and commercialized in the U.S. and certain other targeted markets, the products face substantial competition from existing products previously developed and commercialized both by GSK and by other competing pharmaceutical companies and can expect to face additional competition from new products that are discovered, developed and commercialized by the same pharmaceutical companies and other competitors going forward. For example, sales of Advair®, GSK's approved medicine for both COPD and asthma, continue to be significantly greater than sales of RELVAR®/BREO® ELLIPTA®, and GSK has indicated publicly that it intends to continue commercializing Advair®.

Many of the pharmaceutical companies competing in respiratory markets are international in scope with substantial financial, technical and personnel resources that permit them to discover, develop, obtain regulatory approval and commercialize new products in a highly efficient and low cost manner at competitive prices to consumers. In addition, many of these competitors have substantial commercial infrastructures that facilitate commercializing their products in a highly efficient and low cost manner at competitive prices to consumers. The market for products developed for the treatment of COPD and asthma continues to experience significant innovation and reduced cost in bringing products to market over time, including generic forms of existing products developed for the treatment of COPD and asthma. As an example, Boehringer Ingelheim recently obtained approval for its LABA/LAMA combination product Spiolto® Respimat®, which was launched in 2015. In September 2015, Boehringer Ingelheim obtained FDA approval for Spiriva for the long-term, once-daily, maintenance treatment of asthma in patients 12 years of age and older. In addition, Novartis obtained FDA approval for a combination COPD treatment, which Novartis plans to launch in the first quarter of 2016 under the tradename Utibron Neohaler. There can be no assurance that RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® will not be replaced by new products that are deemed more effective at lower cost to consumers. The ability of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® to succeed and achieve the anticipated level of sales depends on the commercial and development performance of GSK to achieve and maintain a competitive advantage over other products with the same intended use in the targeted markets.

Table of Contents

If sales of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® are less than anticipated because of existing or future competition in the markets in which they are commercialized, including competition from existing and new products that are perceived as lower cost or more effective, our royalty payments will be less than anticipated, which in turn would harm our business and the price of our securities could fall.

We and GSK are developing UMEC/VI/FF (LAMA/LABA/ICS) and MABA/FF as potential triple combination treatments for COPD and, potentially, asthma. As a result of the Spin-Off, most of our economic rights in these programs were assigned to Theravance Biopharma. If these programs are successful and GSK and the respiratory market in general views triple combination therapy as significantly more beneficial than existing therapies, including RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA®, our business could be harmed, and the price of our securities could fall.

Under our LABA Collaboration Agreement with GSK, we and GSK are exploring various paths to create triple therapy respiratory medications. The use of triple therapy is supported by the GOLD (Global initiative for chronic Obstructive Lung Disease) guidelines in high-risk patients with severe COPD and a high risk of exacerbations. One potential triple therapy path is the combination of UMEC/VI (two separate bronchodilators) and FF (an inhaled corticosteroid), to be administered via the ELLIPTA® dry powder inhaler, referred to as UMEC/VI/FF or the closed triple. Prior to the Spin-Off, we were entitled to receive 100% of any royalties payable under the GSK Agreements arising from sales of UMEC/VI/FF (as well as MABA and MABA/FF) if such products were successfully developed, approved and commercialized. In July 2014, we and GSK announced the initiation of a large, global Phase 3 study for the closed triple in patients with COPD. If this Phase 3 study (or any other closed triple Phase 3 studies that may be initiated in the future) is successful, GSK and the respiratory market in general may view this triple combination therapy as significantly more beneficial than existing therapies, including RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA®. In such event the commercialization of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® could be adversely affected, which in turn could result in lower royalties to us. Furthermore, if the closed triple (or MABA /FF) receives regulatory approval in either the U.S. or the EU, GSK's diligent efforts obligations regarding commercialization matters 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. Since GSK's commercialization efforts following such regulatory approval will be guided by a portfolio approach across products in which we have retained our full interest and also products in which we now have only a small portion of our former interest, GSK's commercialization efforts may have the effect of reducing the overall value of our remaining interests in the GSK Agreements in the future. As a result of the transactions effected by the Spin-Off, however, we are now only entitled to receive 15% of any contingent payments and royalties payable by GSK from sales of FF/UMEC/VI (and MABA, and MABA/FF) while Theravance Biopharma receives 85% of those same payments.

On June 2, 2014, we completed the separation of our businesses into two independent, publicly traded companies by separating our late-stage partnered respiratory assets from our biopharmaceutical operations; the lengthy, complicated process to separate the two businesses has diverted the attention of our management and employees, and has increased our professional services expenses in 2014 and in the early part of 2015.

On April 25, 2013, we announced our intention to separate our businesses into two independent, publicly traded companies. On August 1, 2013, the company to be spun-off, Theravance Biopharma, filed a preliminary Form 10 with the SEC, and subsequent amendments throughout 2013 and the spring of 2014. The Spin-Off was completed on June 2, 2014. Theravance continues to be responsible for all development and commercial activities under the GSK Agreements. Theravance is eligible to receive the associated royalty revenues from FF/VI (RELVAR®/BREO® ELLIPTA®), UMEC/VI (ANORO® ELLIPTA®) and potentially VI monotherapy and 15% of the aggregate potential royalty revenues payable to Theravance Respiratory Company, LLC from UMEC/VI/FF, MABA, and MABA/FF and other products that may be developed under the GSK Agreements. Theravance Biopharma is now a separate and independent publicly traded biopharmaceutical company focusing on the discovery, development and commercialization of small-molecule medicines in areas of significant unmet medical need.

Edgar Filing: THERAVANCE INC - Form 10-Q

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. In the event that Theravance Biopharma defaults on such obligations, our business and results of operations may be materially harmed.

In conjunction with the Spin-Off of Theravance Biopharma, on March 3, 2014, we, Theravance Biopharma and GSK entered into a series of agreements clarifying how the companies would implement the separation and operate following the Spin-Off. We, Theravance Biopharma and GSK entered into a three-way master agreement providing for GSK's consent to the Spin-Off provided certain conditions were met. We and GSK also entered into amendments of the GSK Agreements. The master agreement and the other agreements are all currently effective.

Table of Contents

The amendments to the GSK Agreements do not change the royalty rates or other economic terms. The amendments do provide that GSK's diligent efforts obligations regarding commercialization matters under both agreements will change upon regulatory approval in either the U.S. or the EU of UMEC/VI/FF or a MABA combined with FF. Upon such regulatory approval, 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. Since GSK's commercialization efforts following such regulatory approval will be guided by a portfolio approach across products in which we have retained our full interest and also products in which we now have only a small portion of our former interest, GSK's commercialization efforts may have the effect of reducing the overall value of our remaining interests in the GSK Agreements in the future.

We cannot assure you that we will not undertake additional restructuring activities, that the business separation will succeed in meeting our objectives and increasing stockholder value, or that the actual results will not differ materially from the results that we anticipate.

We have incurred and may continue to incur significant expenditures for professional services in connection with the business separation and our post-separation operations, including financial advisory, accounting and legal fees.

Under the terms of a separation and distribution agreement entered into between us and Theravance Biopharma, Theravance Biopharma will indemnify us from (i) all debts, liabilities and obligations transferred to Theravance Biopharma in connection with the Spin-Off (including its failure to pay, perform or otherwise promptly discharge any such debts, liabilities or obligations after the Spin-Off), (ii) any misstatement or omission of a material fact in its information statement filed with the SEC, resulting in a misleading statement and (iii) any breach by it of certain agreements entered into between the parties in connection with the Spin-Off. Theravance Biopharma's ability to satisfy these indemnities, if called upon to do so, will depend upon its future financial strength and if we are not able to collect on indemnification rights from Theravance Biopharma, our financial condition may be harmed.

We may not be able to utilize all of our net operating loss carryforwards.

We have net operating loss carryforwards and other significant U.S. tax attributes that we believe could offset otherwise taxable income in the U.S. As a part of the overall Spin-Off transaction, the transfer of certain assets by us to Theravance Biopharma and our distribution of Theravance Biopharma ordinary shares resulted in taxable transfers pursuant to applicable provisions of the Internal Revenue Code of 1986, as amended (the Code) and Treasury Regulations. The taxable gain recognized by us attributable to the transfer of certain assets to Theravance Biopharma will generally equal the excess of the fair market value of each asset transferred over our adjusted tax basis in such asset. Although we will not recognize any gain with respect to the cash we transferred to Theravance Biopharma, we may recognize substantial gain based on the fair market value of the other assets (other than cash) transferred to Theravance Biopharma. The determination of the fair market value of these assets is subjective and could be subject to adjustments or future challenge by the Internal Revenue Service (IRS), which could result in an increase in the amount of gain realized by us as a result of the transfer. Our U.S. federal income tax resulting from any gain recognized upon the transfer of our assets to Theravance Biopharma (including any increased U.S. federal income tax that may result from a subsequent determination of higher fair market values for the transferred assets), may be reduced by our net operating loss carryforward. The net operating loss carryforwards available in any year to offset our net taxable income will be reduced following a more than 50% change in ownership during any period of 36 consecutive months (an ownership change) as determined under the Internal Revenue Code of 1986 (the Code). As of December 31, 2014, we have conducted an analysis to determine whether an ownership change had occurred since inception through December 31, 2014, and concluded that we had undergone two ownership changes in prior years. We have approximately \$1.4 billion of net operating loss carryforward available to us as of December 31, 2014. We currently expect our net operating losses to be fully available to offset current year net taxable income after taking into account the taxable nature of the Spin-Off. With respect to our remaining net operating losses of approximately \$1.2 billion as of December 31, 2014, there may be certain annual limitations for utilization based on the above-described ownership change provisions. In addition, we may not be able to have sufficient future taxable income prior to their expiration because net

Edgar Filing: THERAVANCE INC - Form 10-Q

operating losses have carryforward periods. Future changes in federal and state tax laws pertaining to net operating loss carryforwards may also cause limitations or restrictions from us claiming such net operating losses. If the net operating loss carryforwards become unavailable to us or are fully utilized, our future taxable income will not be shielded from federal and state income taxation absent certain U.S. federal and state tax credits, and the funds otherwise available for general corporate purposes would be reduced.

The Spin-Off resulted in substantial changes in our Board, management, and employees. If we fail to hire and effectively integrate new executive officers into our organization, the future development and commercialization of our product candidates may suffer, harming future regulatory approvals, sales of our product candidates or our results of operations.

Since the Spin-Off, substantially all of our directors and senior management team has changed. Our current board and management team has only been working together for a relatively short period of time. In addition, Rick E. Winningham resigned as

Table of Contents

our President and Chief Executive Officer effective as of August 15, 2014 and as Chairman of our Board and as a director effective as of October 30, 2014. Since the Spin-Off, we have appointed Michael W. Aguiar as our Chief Executive Officer and as a member of our Board, appointed Eric d Esparbes as our Chief Financial Officer and appointed Michael E. Faerm as our Chief Business Officer. We expect to continue to expand our management team in the future. Our future performance will depend significantly on our ability to successfully integrate our new directors into our Board and our new Chief Executive Officer, Chief Financial Officer, Chief Business Officer and other recently and subsequently hired executive officers into our management team, and on those individuals' ability to develop and maintain an effective working relationship. Our failure to integrate recently and subsequently appointed directors and executive officers, including our new Chief Executive Officer, Chief Financial Officer and Chief Business Officer, with other members of management could result in inefficiencies in the conduct of our business, which can adversely affect our results of operations.

If any product candidates in any respiratory program partnered with GSK are not approved by regulatory authorities or are determined to be unsafe or ineffective in humans, our business will be adversely affected and the price of our securities could fall.

The FDA must approve any new medicine before it can be marketed and sold in the U.S. Our partner GSK must provide the FDA and similar foreign regulatory authorities with data from preclinical and clinical studies that demonstrate that the product candidates are safe and effective for a defined indication before they can be approved for commercial distribution. GSK will not obtain this approval for a partnered product candidate unless and until the FDA approves a NDA. The processes by which regulatory approvals are obtained from the FDA to market and sell a new product are complex, require a number of years and involve the expenditure of substantial resources. In order to market medicines in foreign countries, separate regulatory approvals must be obtained in each country. The approval procedure varies among countries and can involve additional testing, and the time required to obtain approval may differ from that required to obtain FDA approval. Approval by the FDA does not ensure approval by regulatory authorities in other countries, and approval by one foreign regulatory authority does not ensure approval by regulatory authorities in other foreign countries or by the FDA. Conversely, failure to obtain approval in one or more country may make approval in other countries more difficult.

Clinical studies involving product candidates partnered with GSK may reveal that those candidates are ineffective, inferior to existing approved medicines, unacceptably toxic, or that they have other unacceptable side effects. In addition, the results of preclinical studies do not necessarily predict clinical success, and larger and later-stage clinical studies may not produce the same results as earlier-stage clinical studies.

Frequently, product candidates that have shown promising results in early preclinical or clinical studies have subsequently suffered significant setbacks or failed in later clinical or non-clinical studies. In addition, clinical and non-clinical studies of potential products often reveal that it is not possible or practical to continue development efforts for these product candidates. If these studies are substantially delayed or fail to prove the safety and effectiveness of product candidates in development partnered with GSK, GSK may not receive regulatory approval for such product candidates and our business and financial condition will be materially harmed and the price of our securities may fall.

Several well-publicized Complete Response letters issued by the FDA and safety-related product withdrawals, suspensions, post-approval labeling revisions to include boxed warnings and changes in approved indications over the last several years, as well as growing public and governmental scrutiny of safety issues, have created a conservative regulatory environment. The implementation of new laws and regulations and revisions to FDA clinical trial design guidance have increased uncertainty regarding the approvability of a new drug. Further, there are additional requirements for approval of new drugs, including advisory committee meetings for new chemical entities, and formal risk evaluation and mitigation strategy at the FDA's discretion. These laws, regulations, additional requirements and changes in interpretation could cause non-approval or further delays in the FDA's review and approval of any product candidates in any respiratory program partnered with GSK.

Even if product candidates in any respiratory program partnered with GSK receive regulatory approval, as is the case with RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA®, commercialization of such products may be adversely affected by regulatory actions and oversight.

Even if GSK receives regulatory approval for product candidates in any respiratory program partnered with GSK, this approval may include limitations on the indicated uses for which GSK can market the medicines or the patient population that may utilize the medicines, which may limit the market for the medicines or put GSK at a competitive disadvantage relative to alternative therapies. These restrictions make it more difficult to market the approved products.

For example, at the joint meeting of the Pulmonary-Allergy Drugs Advisory Committee and Drug Safety and Risk Management Advisory Committee of the FDA regarding the sNDA for BREO® ELLIPTA® as a treatment for asthma, the advisory committee recommended that a large LABA safety trial with BREO® ELLIPTA® should be required in adults and in 12-17 year olds, similar to

Table of Contents

the ongoing LABA safety trials being conducted as an FDA Post-Marketing Requirement by each of the manufacturers of LABA containing asthma treatments.

In addition, the manufacturing, labeling, packaging, adverse event reporting, advertising, promotion and recordkeeping for the approved product remain subject to extensive and ongoing regulatory requirements. If we or GSK become aware of previously unknown problems with an approved product in the U.S. or overseas or at contract manufacturers' facilities, a regulatory authority may impose restrictions on the product, the contract manufacturers or on GSK, including requiring it to reformulate the product, conduct additional clinical studies, change the labeling of the product, withdraw the product from the market or require the contract manufacturer to implement changes to its facilities. GSK is also subject to regulation by regional, national, state and local agencies, including the Department of Justice, the Federal Trade Commission, the Office of Inspector General of the U.S. Department of Health and Human Services and other regulatory bodies as well as governmental authorities in those foreign countries in which any of the product candidates in any respiratory program partnered with GSK are approved for commercialization. The Federal Food, Drug, and Cosmetic Act, the Public Health Service Act and other federal and state statutes and regulations govern to varying degrees the research, development, manufacturing and commercial activities relating to prescription pharmaceutical products, including non-clinical and clinical testing, approval, production, labeling, sale, distribution, import, export, post-market surveillance, advertising, dissemination of information and promotion. Any failure to maintain regulatory approval will limit GSK's ability to commercialize the product candidates in any respiratory program partnered with GSK, which would materially and adversely affect our business and financial condition and which may cause the price of our securities to fall.

We have incurred operating losses in each year since our inception and will continue to incur losses until royalties from the sales of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® exceed total expenses, including interest expenses, and our revenues and operating results will likely fluctuate in future periods.

From mid-1997 until the Spin-Off, we were engaged in discovering and developing compounds and product candidates and we never generated sufficient revenue from the sale of medicines or royalties on sales by our partners to achieve sustained profitability. As of September 30, 2015, we had an accumulated deficit of approximately \$1.7 billion. Although we expect to have a substantial reduction in our expenses in future periods as a result of the Spin-Off, we will continue to incur losses until royalties from the sales of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® exceed total expenses, including interest expenses, and our revenues and operating results will likely fluctuate from period to period. We are uncertain when or if we will be able to achieve or sustain profitability. Failure to become and remain profitable would adversely affect the price of our securities, our ability to return capital to stockholders and continue operations.

We may not be successful in our efforts to expand our portfolio of royalty generating products.

In the future, we may choose to acquire rights to one or more additional royalty generating products. However, we may be unable to license or acquire rights to suitable royalty generating products for a number of reasons. In particular, the licensing and acquisition of pharmaceutical product rights is a competitive area. Several more established companies are also pursuing strategies to license or acquire rights to royalty generating products. These established companies may have a competitive advantage over us. Other factors that may prevent us from licensing or otherwise acquiring rights to suitable royalty generating products include the following:

- we may be unable to license or acquire the rights on terms that would allow us to make an appropriate return from the product;

- companies that perceive us to be their competitors may be unwilling to assign or license their product rights to us; or
- we may be unable to identify suitable royalty generating products.

If we are unable to acquire or license rights to suitable royalty generating product candidates, our business may suffer.

We have a significant amount of debt including Convertible Subordinated Notes and Non-Recourse Notes that are senior in capital structure and cash flow, respectively, to our common stockholders. Satisfying the obligations relating to our debt could adversely affect the amount or timing of distributions to our stockholders.

As of September 30, 2015, we had approximately \$744.1 million in total long-term debt outstanding, comprised primarily of \$255.1 million in principal that remains outstanding under our 2.125% Convertible Subordinated Notes due 2023 (the 2023 Notes) and \$489.0 million in principal that remains outstanding under our 9% Fixed Rate Royalty term notes due 2029 (the 2029 Notes and with the 2023 Notes, the Notes). The 2023 Notes are unsecured debt and are not redeemable by us prior to the maturity date. Holders of the Notes may require us to purchase all or any portion of their Notes at 100% of their principal amount, plus any unpaid interest, upon a fundamental change. A fundamental change is generally defined to include a merger involving us, an acquisition of a

Table of Contents

majority of our outstanding common stock, and the change of a majority of our board without the approval of the board. In addition, to the extent we pursue and complete a monetization transaction, the structure of such transaction may qualify as a fundamental change under the Notes, which could trigger the put rights of the holders of the Notes, in which case we would be required to use a portion of the net proceeds from such transaction to repurchase any Notes put to us. Our 2029 Notes have rights to 40% of all royalty payments received from GSK related to RELVAR®/BREO® ELLIPTA®, ANORO® ELLIPTA®, and VI monotherapy until the notes are paid in full.

Satisfying the obligations of this debt could adversely affect the amount or timing of any distributions to our stockholders. We may choose to satisfy repurchase, or refinance this debt through public or private equity or debt financings if we deem such financings available on favorable terms. If any or all of the Convertible Subordinated Notes are not converted into shares of our common stock before the maturity date, we will have to pay the holders the full aggregate principal amount of the Notes then outstanding. If the Fixed Rate Royalty are not refinanced or paid in full, then they will receive 40% of all future economics associated with RELVAR®/BREO® ELLIPTA®, ANORO® ELLIPTA®, and VI monotherapy, until the notes are paid in full. Any of the above payments could have a material adverse effect on our cash position. If we fail to satisfy these obligations, it may result in a default under the indenture, which could result in a default under certain of our other debt instruments, if any. Any such default would harm our business and the price of our securities could fall.

If we lose key management personnel, or if we fail to retain our key employees, our ability to manage our business will be impaired.

Following the Spin-Off, we have a much smaller management team and very few employees. We are highly dependent on principal members of our management team and a small group of key employees to operate our business. Our company is located in northern California, which is headquarters to many other biotechnology and biopharmaceutical companies and many academic and research institutions. As a result, competition for certain skilled personnel in our market remains intense. None of our employees have employment commitments for any fixed period of time and they all may leave our employment at will. If we fail to retain our qualified personnel or replace them when they leave, we may be unable to continue our business operations, which may cause the price of our securities to fall.

We rely and will continue to rely on outsourcing arrangements for many of our activities, including financial reporting and accounting and human resources.

We currently have only thirteen full-time employees and, as a result, we rely, and expect to continue to rely, on outsourcing arrangements for a significant portion of our activities, including financial reporting and accounting and human resources, as well as for certain functions as a public company. We may have limited control over these third parties and we cannot guarantee that they will perform their obligations in an effective and timely manner.

As we continue to develop our business, our mix of assets and our sources of income may require that we register with the SEC as an investment company in accordance with the Investment Company Act of 1940.

We have not been and have no current intention to register as an investment company under the Investment Company Act of 1940, or the 40 Act, because we believe the nature of our assets and the sources of our income currently exclude us from the definition of an investment company pursuant to Sections (3)(a)(1)(A), (3)(a)(1)(C) under the 40 Act and Rule 270.3a-1 of Title 17 of the Code of Federal Regulations. Accordingly, we are not currently subject to the provisions of the 40 Act, such as compliance with the 40 Act's registration and reporting

Edgar Filing: THERAVANCE INC - Form 10-Q

requirements, capital structure requirements, affiliate transaction restrictions, conflict of interest rules, requirements for disinterested directors, and other substantive provisions. Generally, to avoid being a company that is an investment company under the 40 Act, it must both: (a) not be or hold itself out as being engaged primarily in the business of investing, reinvesting or trading in securities, and (b) either (i) not be engaged or propose to engage in the business of investing in securities or own or propose to acquire investment securities having a value exceeding 40% of the value of its total assets (exclusive of U.S. government securities and cash items) on an unconsolidated basis or (ii) not have more than 45% of the value of its total assets (exclusive of Government securities and cash items) consist of or more than 45% of its net income after taxes (for the last four fiscal quarters combined) be derived from securities. In addition, we would not be an investment company if an exception, exemption, or safe harbor under the 40 Act applies.

We monitor our assets and income for compliance with the tests under the 40 Act and seek to conduct our business activities to ensure that we do not fall within its definitions of investment company. If we were to become an investment company and be subject to the strictures of the 40 Act, the restrictions imposed by the 40 Act would likely require changes in the way we do business and add significant administrative burdens to our operations. In order to ensure that we do not fall within the 40 Act, we may need to take various actions which we might otherwise not pursue. These actions may include restructuring the Company and/or modifying our mixture of assets and income.

Specifically, our mixture of debt vs. royalty assets is important to our classification as an investment company or not. In this regard, while we currently believe that none of the definitions of investment company apply to us, we may in the future rely on an

Table of Contents

exception under the 40 Act provided by Section 3(c)(5)(A). To qualify for Section 3(c)(5)(A), as interpreted by the staff of the SEC, we would be required to have at least 55% of our total assets in notes, drafts, acceptances, open accounts receivable, and other obligations representing part or all of the sales price of merchandise, insurance, and services (or Qualifying Assets). In a no-action letter issued to Royalty Pharma on August 13, 2010, the staff stated that royalty interests are Qualifying Assets under this exception. If the SEC or its staff in the future adopts a contrary interpretation or otherwise restricts the conclusions in the staff's no-action letter such that our royalty interests are no longer Qualifying Assets for purposes of Section 3(c)(5)(A), we could be required to register under the 40 Act.

The rules and interpretations of the SEC and the courts, relating to the definition of investment company are highly complex in numerous respects. While we currently intend to conduct our operations so that we will not be deemed an investment company, we can give no assurances that we will not determine it to be in the Company's and our stockholders' interest to register as an investment company, not be deemed an investment company and not be required to register under the 40 Act.

Risks Related to our Alliance with GSK

Because all our current and projected revenues are derived from products under the GSK Agreements, disputes with GSK could harm our business and cause the price of our securities to fall.

All of our current and projected revenues are derived from products under the GSK Agreements. Any action or inaction by either GSK or us that results in a material dispute, allegation of breach, litigation, arbitration, or significant disagreement between the parties may be interpreted negatively by the market or by our investors, could harm our business and cause the price of our securities to fall. Examples of these kinds of issues include but are not limited to non-performance of contractual obligations and allegations of non-performance, disagreements over the relative marketing and sales efforts for our partnered products and other GSK respiratory products, disputes over public statements, and similar matters. In addition, while we obtained GSK's consent to the Spin-Off as structured, GSK could decide to challenge various aspects of our post-Spin-Off operation of Theravance Respiratory Company, LLC (TRC), the limited liability company jointly owned by us and Theravance Biopharma as violating or allowing it to terminate the GSK Agreements. Although we believe our operation of TRC fully complies with the GSK Agreements and applicable law, there can be no assurance that we would prevail against any such claims by GSK. Moreover, regardless of the merit of any claims by GSK, we may incur significant cost and diversion of resources in defending them. In addition, any market or investor uncertainty about the respiratory programs partnered with GSK or the enforceability of the GSK Agreements could result in significant reduction in the market price of our securities and other material harm to our business.

Because GSK is a strategic partner as well as a significant stockholder, it may take actions that in certain cases are materially harmful to both our business or to our other stockholders.

Although GSK beneficially owns approximately 27% of our outstanding capital stock as of October 30, 2015, it is also a strategic partner with rights and obligations under the GSK Agreements that cause its interests to differ from the interests of us and our other stockholders. In particular, GSK has a substantial respiratory product portfolio in addition to the partnered products that are covered by the GSK Agreements. GSK may make respiratory product portfolio decisions or statements about its portfolio which may be, or may be perceived to be, harmful to the respiratory products partnered with us. For example, GSK could promote its non-GSK/Theravance respiratory products, delay or terminate the development or commercialization of the respiratory programs covered by the GSK Agreements, or take other actions, such as making public statements, that have a negative effect on our stock price. In this regard and by way of example, sales of Advair®, GSK's approved medicine for both COPD and asthma, continue to be significantly greater than sales of RELVAR®/BREO® ELLIPTA®, and GSK has indicated publicly that it intends to continue commercializing Advair®. Also, given the potential future royalty payments GSK may be obligated to pay under the GSK

Edgar Filing: THERAVANCE INC - Form 10-Q

Agreements, GSK may seek to acquire us to reduce those payment obligations. The timing of when GSK may seek to acquire us could potentially be when it possesses information regarding the status of drug programs covered by the GSK Agreements that has not been publicly disclosed and is not otherwise known to us. As a result of these differing interests, GSK may take actions that it believes are in its best interest but which might not be in the best interests of either us or our other stockholders. In addition, upon regulatory approval of UMEC/VI/FF or a MABA/ICS in either the U.S. or the EU, 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. Since GSK's commercialization efforts following such regulatory approval will be guided by a portfolio approach across products in which we have retained our full interest and also products in which we now have only a portion of our former interest, GSK's commercialization efforts may have the effect of reducing the overall value of our remaining interests in the products covered by the GSK Agreements in the future. In addition, following the expiration of our governance agreement with GSK in September 2015, GSK is no longer subject to the restrictions thereunder regarding the voting of the shares of our capital stock owned by it.

Table of Contents

GSK has also indicated to us that it believes its consent may be required before we can engage in certain royalty monetization transactions with third parties, which may inhibit our ability to engage in these transactions.

In the course of our discussions with GSK concerning the Spin-Off of Theravance Biopharma, GSK indicated to us that it believes that its consent may be required before we can engage in certain transactions designed to monetize the future value of royalties that may be payable to us from GSK under the GSK Agreements. GSK has informed us that it believes that there may be certain covenants included in these types of transactions that might violate certain provisions of the GSK Agreements. Although we believe that we can structure royalty monetization transactions in a manner that fully complies with the requirements of the GSK Agreements without GSK's consent, a third party in a proposed monetization transaction may nonetheless insist that we obtain GSK's consent for the transaction or re-structure the transaction on less favorable terms. We have obtained GSK's agreement that (i) we may grant certain pre-agreed covenants in connection with monetization of our interests in RELVAR®/BREO® ELLIPTA®, ANORO® ELLIPTA® and vilanterol monotherapy and portions of our interests in TRC, and (ii) it will not unreasonably withhold its consent to our requests to grant other covenants, provided, among other conditions, that in each case, the covenants are not granted in favor of pharmaceutical or biotechnology company with a product either being developed or commercialized for the treatment of respiratory disease. If we seek GSK's consent to grant covenants other than pre-agreed covenants, we may not be able to obtain GSK's consent on reasonable terms, or at all. If we proceed with a royalty monetization transaction that is not otherwise covered by the GSK Agreement without GSK's consent, GSK could request that its consent be obtained or seek to enjoin or otherwise challenge the transaction as violating or allowing it to terminate the GSK Agreements. Regardless of the merit of any claims by GSK, we would incur significant cost and diversion of resources in defending against GSK's claims or asserting our own claims and GSK may seek concessions from us in order to provide its consent. Any uncertainty about whether or when we could engage in a royalty monetization transaction, the potential impact on the enforceability of the GSK Agreements or the loss of potential royalties from the respiratory programs partnered with GSK, could impair our ability to pursue a return of capital strategy for our stockholders ahead of our receipt of significant royalties from GSK, result in significant reduction in the market price of our securities and cause other material harm to our business.

GSK's ownership of a significant percentage of our stock and its ability to acquire additional shares of our stock may create conflicts of interest, and may inhibit our management's ability to continue to operate our business in the manner in which it is currently being operated.

As of October 31, 2015, GSK beneficially owned approximately 27% of our outstanding capital stock. As such, GSK could have substantial influence in the election of our directors, delay or prevent a transaction in which stockholders might receive a premium over the prevailing market price for their shares and have significant control over certain changes in our business. Moreover, if GSK does not participate in the tender offer we commenced on October 30, 2015, it will further concentrate its ownership of Theravance.

The procedures previously governing and restricting GSK offers to our stockholders to acquire outstanding voting stock and the restrictions regarding the voting of shares of our capital stock owned by it terminated upon the expiration of the governance agreement on September 1, 2015.

Further, pursuant to our Certificate of Incorporation, we renounce our interest in and waive any claim that a corporate or business opportunity taken by GSK constitutes a corporate opportunity of ours unless such corporate or business opportunity is expressly offered to one of our directors who is a director, officer or employee of GSK, primarily in his or her capacity as one of our directors.

GSK's significant ownership position may deter or prevent efforts by other companies to acquire us, which could prevent our stockholders from realizing a control premium.

As of October 31, 2015, GSK beneficially owned approximately 27% of our outstanding capital stock. As a result of GSK's significant ownership, other companies may be less inclined to pursue an acquisition of us and therefore we may not have the opportunity to be acquired in a transaction that stockholders might otherwise deem favorable, including transactions in which our stockholders might realize a substantial premium for their shares. If GSK does not participate in the tender offer we commenced on October 30, 2015, it will further concentrate its ownership of Theravance.

GSK could sell or transfer a substantial number of shares of our common stock, which could depress the price of our securities or result in a change in control of our company.

GSK is not subject to any contractual restrictions with us on its ability to sell or transfer our common stock on the open market, in privately negotiated transactions or otherwise, and these sales or transfers could create substantial declines in the price of our

Table of Contents

securities or, if these sales or transfers were made to a single buyer or group of buyers, could contribute to a transfer of control of our company to a third party. Sales by GSK of a substantial number of shares, or the expectation of such sales, could cause a significant reduction in the market price of our common stock.

Risks Related to Legal and Regulatory Uncertainty

If the efforts of our partner, GSK, to protect the proprietary nature of the intellectual property related to products in any respiratory program partnered with GSK are not adequate, the future commercialization of any such product could be delayed, limited or prevented, which would materially harm our business and the price of our securities could fall.

To the extent the intellectual property protection of products in any respiratory program partnered with GSK are successfully challenged or encounter problems with the U.S. Patent and Trademark Office or other comparable agencies throughout the world, the commercialization of these products could be delayed, limited or prevented. Any challenge to the intellectual property protection of a late-stage development asset or approved product arising from any respiratory program partnered with GSK could harm our business and cause the price of our securities to fall.

Our commercial success depends in part on products in any respiratory program partnered with GSK not infringing the patents and proprietary rights of third parties. Third parties may assert that these products are using their proprietary rights without authorization. In addition, third parties may obtain patents in the future and claim that use of GSK's technologies infringes upon these patents. Furthermore, parties making claims against GSK may obtain injunctive or other equitable relief, which could effectively block GSK's ability to further develop or commercialize one or more of the product candidates or products in any respiratory program partnered with GSK.

In the event of a successful claim of infringement against GSK, it may have to pay substantial damages, obtain one or more licenses from third parties or pay royalties. In addition, even in the absence of litigation, GSK may need to obtain licenses from third parties to advance its research or allow commercialization of the products. GSK may fail to obtain any of these licenses at a reasonable cost or on reasonable terms, if at all. In that event, GSK would be unable to further develop and commercialize one or more of the products, which could harm our business significantly. In addition, in the future GSK could be required to initiate litigation to enforce its proprietary rights against infringement by third parties. Prosecution of these claims to enforce its rights against others would involve substantial litigation expenses. If GSK fails to effectively enforce its proprietary rights related to our partnered respiratory programs against others, our business will be harmed, and the price of our securities could fall.

Risks Related to Ownership of our Common Stock

The price of our securities has been extremely volatile and may continue to be so, and purchasers of our securities could incur substantial losses.

The price of our securities has been extremely volatile and may continue to be so. Between January 1, 2015 and September 30, 2015, the high and low sales prices of our common stock as reported on The NASDAQ Global Select Market varied between \$6.36 and \$21.16 per share. The

stock market in general and the market for biotechnology and biopharmaceutical companies in particular have experienced extreme volatility that has often been unrelated to the companies' operating performance, in particular during the last several years. The following factors, in addition to the other risk factors described in this section, may also have a significant impact on the market price of our securities:

- any adverse developments or results or perceived adverse developments or results with respect to the commercialization of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® with GSK, including, without limitation, if payor coverage is lower than anticipated or if sales of RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA® are less than anticipated because of pricing pressure in the respiratory markets targeted by our partnered products or existing or future competition in the markets in which they are commercialized, including competition from existing and new products that are perceived as lower cost or more effective, and our royalty payments are less than anticipated;

- any positive developments or results or perceived positive developments or results with respect to the development of UMEC/VI/FF with GSK, including, without limitation if the new Phase 3 study (or any other closed triple Phase 3 studies that may be initiated in the future) is successful and GSK and the respiratory market in general view this triple combination therapy as significantly more beneficial than existing therapies, including RELVAR®/BREO® ELLIPTA® and ANORO® ELLIPTA®;

- any adverse developments or results or perceived adverse developments or results with respect to the on-going development of FF/VI with GSK, including, without limitation, any difficulties or delays encountered with the regulatory path for

Table of Contents

FF/VI or any indication from clinical or non-clinical studies, including the large Phase 3b program, that FF/VI is not safe or efficacious or does not sufficiently differentiate itself from alternative therapies;

- any adverse developments or results or perceived adverse developments or results with respect to the on-going development of UMEC/VI with GSK, including, without limitation, any difficulties or delays encountered with regard to the regulatory path for UMEC/VI, any indication from clinical or non-clinical studies that UMEC/VI is not safe or efficacious;

- any adverse developments or perceived adverse developments in the field of LABAs, including any change in FDA policy or guidance (such as the pronouncement in February 2010 warning that LABAs should not be used alone in the treatment of asthma and related labeling requirements, the impact of the March 2010 FDA Advisory Committee discussing LABA clinical trial design to evaluate serious asthma outcomes or the FDA's April 2011 announcement that manufacturers of currently marketed LABAs conduct additional clinical studies comparing the addition of LABAs to inhaled corticosteroids versus inhaled corticosteroids alone);

- the occurrence of a fundamental change triggering a put right of the holders of the Notes or our inability, or perceived inability, to satisfy the obligations under the Notes when they become due;

- our incurrence of expenses in any particular quarter that are different than market expectations;

- the extent to which GSK advances (or does not advance) FF/VI, UMEC/VI, UMEC/VI/FF, VI monotherapy and the MABA program through development into commercialization in all indications in all major markets;

- any adverse developments or perceived adverse developments with respect to our relationship with GSK, including, without limitation, disagreements that may arise between us and GSK;

- announcements regarding GSK generally;

- announcements of patent issuances or denials, technological innovations or new commercial products by GSK;

- publicity regarding actual or potential study results or the outcome of regulatory review relating to products under development by GSK;
- regulatory developments in the U.S. and foreign countries;
- economic and other external factors beyond our control;
- sales of stock by us or by our stockholders, including sales by certain of our employees and directors whether or not pursuant to selling plans under Rule 10b5-1 of the Securities Exchange Act of 1934;
- relative illiquidity in the public market for our common stock (our three largest stockholders other than GSK collectively owned approximately 27% of our outstanding capital stock as of October 30, 2015 based on our review of publicly available filings); and
- potential sales or purchases of our capital stock by GSK.

We may be unable to or elect not to continue returning capital to our stockholders.

We have a corporate goal of returning capital to stockholders and have paid quarterly dividends during the 3rd and 4th quarters of 2014 and during the first three quarters of 2015. On October 28, 2015, we announced the acceleration of our capital return plan with a \$150 million share repurchase program approved by our Board of Directors, replacing our quarterly dividend. We currently intend to repurchase our shares through the end of 2016 through a combination of the tender offer which commenced on October 30, 2015 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

Table of Contents

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.

The payment of, or continuation of, capital returns to stockholders is at the discretion of our board of directors and is dependent upon our financial condition, results of operations, capital requirements, general business conditions, tax treatment of capital returns, potential future contractual restrictions contained in credit agreements and other agreements and other factors deemed relevant by our board of directors. Future capital returns may also be affected by, among other factors: our views on potential future capital requirements for investments in acquisitions and our working capital and debt maintenance requirements; legal risks; stock repurchase programs; changes in federal and state income tax laws or corporate laws; and changes to our business model. Our capital returns may change from time to time, and we cannot provide assurance that we will continue to provide any particular amounts. A reduction, change or suspension in our capital returns programs could have a negative effect on our stock price.

Concentration of ownership will limit your ability to influence corporate matters.

As of October 30, 2015, GSK beneficially owned approximately 27% of our outstanding capital stock and our directors, executive officers and investors affiliated with these individuals beneficially owned approximately 1% of our outstanding capital stock. Based on our review of publicly available filings as of October 30, 2015, our three largest stockholders other than GSK collectively owned approximately 42% of our outstanding capital stock. These stockholders could control the outcome of actions taken by us that require stockholder approval, including a transaction in which stockholders might receive a premium over the prevailing market price for their shares. If certain of our large stockholders do not participate in the tender offer we commenced on October 30, 2015, it will further concentrate their ownership of Theravance. In addition, following the expiration of the governance agreement in September 2015, GSK is no longer subject to the restrictions thereunder regarding the voting of the shares of our capital stock owned by it.

Anti-takeover provisions in our charter and bylaws and in Delaware law could prevent or delay a change in control of our company.

Provisions of our Certificate of Incorporation and Bylaws may discourage, delay or prevent a merger or acquisition that stockholders may consider favorable, including transactions in which you might otherwise receive a premium for your shares. These provisions include:

- requiring supermajority stockholder voting to effect certain amendments to our Certificate of Incorporation and Bylaws;
- restricting the ability of stockholders to call special meetings of stockholders;
- prohibiting stockholder action by written consent; and

- establishing advance notice requirements for nominations for election to the Board or for proposing matters that can be acted on by stockholders at meetings.

In addition, some provisions of Delaware law may also discourage, delay or prevent someone from acquiring us or merging with us.

Item 2. Unregistered Sales of Equity Securities and Use of Proceeds

On March 5, 2015, May 11, 2015 and August 12, 2015, we completed the sale of 92,674, 85,579 and 245,828 shares of our common stock to Glaxo Group Limited, an affiliate of GSK, at a price of \$18.06, \$16.00 and \$14.18, respectively, per share, resulting in aggregate gross proceeds of \$6.5 million before deducting transaction expenses. Neither we nor the affiliate of GSK engaged any investment advisors with respect to the sale and no underwriting discounts or commissions were paid or will be paid to any party in connection with the sale. We issued and sold the shares in reliance upon an exemption from registration pursuant to Section 4(2) of the Securities Act of 1933, as amended.

Table of Contents**Item 6. Exhibits****(a) Index to Exhibits**

Exhibit Number	Description	Form	Incorporated by Reference Filing Date/Period End Date
3.3	Amended and Restated Certificate of Incorporation	S-1	7/26/04
3.4	Certificate of Amendment of Restated Certificate of Incorporation	10-Q	3/31/07
3.5	Amended and Restated Bylaws (as amended by the board of directors April 25, 2007)	10-Q	9/30/08
3.6	Amended and Restated Bylaws (as amended by the board of directors October 22, 2015)	8-K	10/28/15
4.1	Specimen certificate representing the common stock of the registrant	10-K	12/31/06
4.4	Indenture dated as of January 24, 2013 by and between Theravance, Inc. and The Bank of New York Mellon Trust Company, N.A., as trustee	8-K	1/25/13
4.5	Form of 2.125% Convertible Subordinated Note Due 2023 (included in Exhibit 4.4)		
10.64	First Amendment to 2029 Severance Plan	8-K (filed as Exhibit 10.2)	7/29/15
31.1	Certification of Chief Executive Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated pursuant to the Securities Exchange Act of 1934, as amended		
31.2	Certification of Chief Financial Officer pursuant to Rules 13a-14(a) and 15d-14(a) promulgated pursuant to the Securities Exchange Act of 1934, as amended		
32	Certifications Pursuant to 18 U.S.C. Section 1350		
101	Financial statements from the quarterly report on Form 10-Q of the Company for the three and nine months ended September 30, 2015 (unaudited), formatted in XBRL: (i) the Condensed Consolidated Balance Sheets, (ii) the Condensed Consolidated Statements of Operations, (iii) the Condensed Consolidated Statements of Comprehensive Loss, (iv) the Condensed Consolidated Statements of Cash Flows and (iv) the Notes to the Condensed Consolidated Financial Statements		

Table of Contents

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

Theravance, Inc.

Date: November 5, 2015

/s/ Michael W. Aguiar
Michael W. Aguiar
Chief Executive Officer
(principal executive officer)

Date: November 5, 2015

/s/ Eric d Esparbes
Eric d Esparbes
Senior Vice President, Finance and Chief Financial Officer
(principal financial and principal accounting officer)