SUPERNUS PHARMACEUTICALS INC
Form 10-Q
August 05, 2016
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

WASHINGTON, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended June 30, 2016

OR

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

For the transition period from to

Commission File Number: 001-35518

SUPERNUS PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**20-2590184**
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification No.)
1550 East Gude Drive, Rockville, MD	**20850**
(Address of principal executive offices)	(Zip Code)

(301) 838-2500

(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. x Yes o No

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Website, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). x Yes o 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 definition of large accelerated filer, accelerated filer, and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

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

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

The number of outstanding shares of the registrant s common stock, par value $0.001 per share, as of the close of business on July 29, 2016 was 49,508,476.

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SUPERNUS PHARMACEUTICALS, INC.

FORM 10-Q QUARTERLY REPORT

FOR THE QUARTERLY PERIOD ENDED JUNE 30, 2016

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PART I FINANCIAL INFORMATION

Supernus Pharmaceuticals, Inc.

Consolidated Balance Sheets

(in thousands, except share amounts)

	June 30, 2016 (unaudited)	December 31, 2015
Assets		
Current assets:		
Cash and cash equivalents	$ 36,156	$ 34,152
Marketable securities	24,058	28,038
Accounts receivable, net	34,281	25,908
Inventories, net	16,373	12,587
Prepaid expenses and other current assets	3,272	5,261
Total current assets	114,140	105,946
Long term marketable securities	67,809	55,009
Property and equipment, net	4,193	3,874
Deferred legal fees	16,386	22,503
Intangible assets, net	15,785	976
Other non-current assets	320	318
Total assets	$ 218,633	$ 188,626
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 2,243	$ 4,314
Accrued sales deductions	35,019	26,794
Accrued expenses	28,102	24,813
Deferred licensing revenue	208	176
Total current liabilities	65,572	56,097
Deferred licensing revenue, net of current portion	1,606	1,390
Convertible notes, net	5,699	7,085
Other non-current liabilities	4,322	4,325
Derivative liabilities	412	854
Total liabilities	77,611	69,751
Stockholders equity:		
Common stock, $0.001 par value, 130,000,000 shares authorized at June 30, 2016 and December 31, 2015; 49,508,476 and 49,004,674 shares issued and outstanding at June 30, 2016 and December 31, 2015, respectively	50	49
Additional paid-in capital	270,059	263,955
Accumulated other comprehensive income (loss)	549	(488)
Accumulated deficit	(129,636)	(144,641)
Total stockholders equity	141,022	118,875
Total liabilities and stockholders equity	$ 218,633	$ 188,626

See accompanying notes.

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Supernus Pharmaceuticals, Inc.

Consolidated Statements of Operations

(in thousands, except share and per share data)

	Three Months ended June 30,		Six Months ended June 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
Revenue				
Net product sales	$ 50,335	$ 34,266	$ 93,360	$ 62,363
Licensing revenue	86	786	135	822
Total revenue	50,421	35,052	93,495	63,185
Costs and expenses				
Cost of product sales	2,751	1,762	4,786	3,380
Research and development	11,109	6,878	21,671	10,561
Selling, general and administrative	26,121	23,336	51,281	42,737
Total costs and expenses	39,981	31,976	77,738	56,678
Operating income	10,440	3,076	15,757	6,507
Other income (expense)				
Interest income	363	137	694	250
Interest expense	(196)	(331)	(375)	(712)
Changes in fair value of derivative liabilities	123	1	224	(48)
Loss on extinguishment of debt		(241)	(382)	(2,375)
Other income (expense)	2	25	(1)	25
Total other income (expense)	292	(409)	160	(2,860)
Earnings before income taxes	10,732	2,667	15,917	3,647
Income tax expense	714	662	912	724
Net income	$ 10,018	$ 2,005	$ 15,005	$ 2,923
Income per common share:				
Basic	$ 0.20	$ 0.04	$ 0.30	$ 0.06
Diluted	$ 0.18	$ 0.03	$ 0.28	$ 0.06
Weighted-average number of common shares outstanding:				
Basic	49,427,825	47,911,932	49,333,962	46,246,866
Diluted	51,745,342	52,273,549	51,484,686	47,687,992

See accompanying notes.

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Supernus Pharmaceuticals, Inc.

Consolidated Statements of Comprehensive Income (Loss)

(in thousands)

	Three Months ended June 30,		Six Months ended June 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
Net income	$ 10,018	$ 2,005	$ 15,005	$ 2,923
Other comprehensive income:				
Unrealized net gain (loss) on marketable securities	381	(86)	1,037	3
Other comprehensive income (loss):	381	(86)	1,037	3
Comprehensive income	$ 10,399	$ 1,919	$ 16,042	$ 2,926

See accompanying notes.

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Supernus Pharmaceuticals, Inc.

Consolidated Statements of Cash Flows

(in thousands)

	Six Months ended June 30,	
	2016	**2015**
	(unaudited)	
Cash flows from operating activities		
Net income	$ 15,005	$ 2,923
Adjustments to reconcile net income to net cash provided by operating activities:		
Loss on extinguishment of debt	382	2,375
Change in fair value of derivative liability	(224)	48
Depreciation and amortization	1,117	431
Non-cash interest expense, net/ interest income, net	405	524
Share-based compensation expense	2,971	2,020
Changes in operating assets and liabilities:		
Accounts receivable	(8,373)	(630)
Inventories	(3,786)	(151)
Prepaid expenses and other assets	1,989	(738)
Accounts payable	(2,071)	2,655
Accrued sales deduction	8,225	7,527
Accrued expenses	(2,249)	(1,261)
Deferred licensing revenue	248	(72)
Other non-current liabilities	(4)	(482)
Net cash provided by operating activities	13,635	15,169
Cash flows from investing activities		
Purchases of marketable securities	(23,693)	(34,274)
Sales and maturities of marketable securities	15,658	21,865
Purchases of property and equipment	(903)	(777)
Deferred legal fees	(3,688)	(6,278)
Net cash used in investing activities	(12,626)	(19,464)
Cash flows from financing activities		
Proceeds from issuance of common stock	995	1,009
Net cash provided by financing activities	995	1,009
Net change in cash and cash equivalents	2,004	(3,286)
Cash and cash equivalents at beginning of period	34,152	36,396
Cash and cash equivalents at end of period	$ 36,156	$ 33,110
Supplemental cash flow information:		
Cash paid for interest	$ 247	$ 504
Non-cash financial activity:		
Conversion of convertible notes and interest make-whole	$ 2,138	$ 25,056
Deferred legal fees included in accounts payable and accrued expenses	$ 5,537	$

See accompanying notes.

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Supernus Pharmaceuticals, Inc.

Notes to Consolidated Financial Statements

For the Six Months ended June 30, 2016 and 2015

(unaudited)

1. Organization and Business

Supernus Pharmaceuticals, Inc. (the Company) was incorporated in Delaware on March 30, 2005, and commenced operations on December 22, 2005. The Company is a specialty pharmaceutical company focused on developing and commercializing products for the treatment of central nervous system (CNS) diseases, including neurological and psychiatric disorders. The Company markets two epilepsy products, Oxtellar XR and Trokendi XR, and has several proprietary product candidates in clinical development that address the psychiatry market.

The Company commenced the commercialization of Oxtellar XR and Trokendi XR in 2013.

2. Summary of Significant Accounting Policies

Basis of Presentation

The Company s consolidated financial statements include the accounts of Supernus Pharmaceuticals, Inc. and Supernus Europe Ltd., collectively referred to herein as Supernus or the Company. All significant intercompany transactions and balances have been eliminated in consolidation. The Company s unaudited consolidated financial statements have been prepared in accordance with the requirements of the U.S. Securities and Exchange Commission (SEC) for interim financial information.

As permitted under Generally Accepted Accounting Principles in the United States (U.S. GAAP), certain notes and other information have been omitted from the interim unaudited consolidated financial statements presented in this Quarterly Report on Form 10-Q. Therefore, these financial statements should be read in conjunction with the Company s Annual Report on Form 10-K for the year ended December 31, 2015 filed with the SEC.

In the opinion of management, the consolidated financial statements reflect all adjustments necessary to fairly present the Company s financial position, results of operations, and cash flows for the periods presented. These adjustments are of a normal recurring nature. The Company currently operates in one business segment.

The results of operations for the three and six months ended June 30, 2016 are not necessarily indicative of the Company s future financial results.

Marketable Securities

Marketable securities consist of investments in U.S. Treasuries, various U.S. governmental agency debt securities, corporate bonds and other fixed income securities. The Company s investments are classified as available for sale. Such securities are carried at estimated fair value, with any unrealized holding gains or losses reported, net of any tax effects reported, as accumulated other comprehensive income, which is a separate component of stockholders equity. Realized gains and losses, and declines in value judged to be other-than-temporary, if any, are included in consolidated results of operations. A decline in the market value of any available for sale security below cost that is deemed to be other-than-temporary results in a reduction in fair value, which is charged to earnings in that period, and a new cost basis for the security is established. Dividend and interest income is recognized when earned. The cost of securities sold is calculated using the specific identification method. The Company places all investments with government, industrial, or financial institutions whose debt is rated as investment grade. The Company classifies all available-for-sale marketable securities with maturities greater than one year from the balance sheet date as non-current assets.

The Company established the Supernus Supplemental Executive Retirement Plan (SERP) for the sole purpose of receiving funds for executives from a previous SERP and providing a continuing deferral program under the Supernus SERP. As of June 30, 2016 and December 31, 2015, the fair value of the SERP was $266,000 and $263,000, respectively. The SERP assets were held in mutual fund investments. The fair value of these assets is included within other non-current assets on the consolidated balance sheets. A corresponding noncurrent liability is also included in the consolidated balance sheets to reflect the Company s obligation for the SERP. The Company has not made, and has no plans to make, contributions to the SERP. The securities are restricted in nature and can only be used for purposes of paying benefits under the SERP.

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Accounts Receivable, net

Accounts receivable are reported on the consolidated balance sheets at outstanding amounts, less an allowance for doubtful accounts and discounts. The Company extends credit without requiring collateral. The Company writes off uncollectible receivables when the likelihood of collection is remote. The Company evaluates the collectability of accounts receivable on a regular basis. An allowance, when needed, is based upon various factors including the financial condition and payment history of customers, an overall review of collections experience on other accounts, and economic factors or events expected to affect future collections experience. The Company recorded an allowance of approximately $0.1 million as of June 30, 2016 and no accounts were written off as of December 31, 2015. The Company recorded an allowance of approximately $4.8 million and $3.8 million for expected sales discounts as of June 30, 2016 and December 31, 2015, respectively.

Deferred Financing Costs

Deferred financing costs consist of financing costs incurred by the Company in connection with the closing of the Company s 7.50% Convertible Senior Secured Notes due 2019 (the Notes) (see Note 8). The Company amortizes deferred financing costs over the term of the related debt using the effective interest method. When extinguishing debt, the related deferred financing costs are written off.

Revenue Recognition

Revenue from product sales is recognized when persuasive evidence of an arrangement exists; delivery has occurred and title to the product and associated risk of loss has passed to the customer; the price is fixed or determinable; collection from the customer has been reasonably assured; all performance obligations have been met; and returns and allowances can be reasonably estimated. Product sales are recorded net of estimated rebates, chargebacks, discounts, co-pay assistance and other deductions as well as estimated product returns (collectively, sales deductions).

Our products are distributed through wholesalers and pharmaceutical distributors. Each of these wholesalers and distributors will take title and ownership to the product upon physical receipt of the product and then distribute our products to pharmacies.

Sales Deductions

Allowances for estimated sales deductions are provided for the following:

- Rebates. Rebates include mandated discounts under the Medicaid Drug Rebate Program, the Medicare coverage gap program, as well as negotiated discounts with commercial healthcare providers. Rebates are amounts owed after the final dispensing of products to a benefit plan participant and are based upon contractual agreements or legal requirements with the public sector (e.g. Medicaid) and with private sector benefit providers. The allowance for

rebates is based on statutory and contractual discount rates and expected claimed rebates paid based on a plan provider s utilization. Rebates are generally invoiced and paid quarterly in arrears so that the accrual balance consists of an estimate of the amount expected to be incurred for the current quarter s activity, plus an accrual balance for known or estimated prior quarters unpaid rebates. If actual future rebates vary from estimates, we may need to adjust balances of such rebates to reflect the actual expenditures of the Company with respect to these programs, which would affect revenue in the period of adjustment.

- Chargebacks. Chargebacks are discounts that occur when contracted customers purchase directly from an intermediary distributor or wholesaler. Contracted customers, which currently consist primarily of Public Health Service institutions and federal government entities purchasing via the Federal Supply Schedule, generally purchase the product at a discounted price. The distributor or wholesaler, in turn, charges back the difference between the price initially paid by the distributor or wholesaler and the discounted price paid to the distributor or wholesaler by the customer. The allowance for distributor/wholesaler chargebacks is based on known sales to contracted customers.

- Distributor/Wholesaler deductions and discounts. U.S. specialty distributors and wholesalers are offered various forms of consideration including allowances, service fees and prompt payment discounts for distributing our products. Distributor allowances and service fees arise from contractual agreements with distributors and are generally a percentage of the purchase price paid by the distributors and wholesalers. Wholesale customers are offered a prompt pay discount for payment within a specified period.

- Co-pay assistance. Patients who pay in cash or have commercial insurance and meet certain eligibility requirements may receive co-pay assistance from the Company. The intent of this program is to reduce the patient s out of pocket costs. Liabilities for co-pay assistance are based on actual program participation and estimates of program redemption using data provided by third-party administrators.

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- Returns. Sales of our products are not subject to a general right of return; however, the Company will accept product that is damaged or defective when shipped directly from our warehouse. The Company will accept expired product six months prior and up to 12 months subsequent to its expiry date. Product that has been used to fill patient prescriptions is no longer subject to any right of return.

Milestone Payments

Milestone payments on licensing agreements are recognized as revenue when the collaborative partner acknowledges completion of the milestone and substantive effort (i.e., effort consistent with amount of the milestone) that was necessary to achieve the milestone. Management may recognize revenue contingent upon the achievement of a milestone in its entirety in the period in which the milestone is achieved only if the milestone meets all the criteria to be considered substantive. The Company recorded no milestone revenue during the three months and six months ended June 30, 2016 and $750,000 of milestone revenue during the three and six months ended June 30, 2015.

Cost of Product Sales

The cost of product sales consists primarily of materials, third-party manufacturing costs, freight and distribution costs, allocation of labor, quality control and assurance, and other manufacturing overhead costs.

Income Taxes

The Company utilizes the asset and liability method of accounting for income taxes. Under this method, deferred tax assets and liabilities are determined based on differences between financial reporting and tax reporting bases of assets and liabilities and are measured using enacted tax rates and laws that are expected to be in effect when the differences are expected to reverse. Valuation allowances are established to reduce deferred tax assets to the amounts expected to be realized.

The Company accounts for uncertain tax positions in its consolidated financial statements when it is more-likely-than-not that the position will be sustained upon examination by the tax authorities. Such tax positions must initially and subsequently be measured as the largest amount of tax benefit that has a greater than 50% likelihood of being realized upon ultimate settlement with the tax authority assuming full knowledge of the position and relevant facts. The Company s policy is to recognize any interest and penalties related to income taxes in income tax expense.

Recently Issued Accounting Pronouncements

In March 2016, the Financial Accounting Standards Board (FASB) issued Accounting Standards Update (ASU) No. 2016-09, Compensation-Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting. The standard is intended to simplify several areas of accounting for share-based compensation arrangements, including the income tax impact, classification on the statement of cash flows and forfeitures. ASU 2016-09 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2016, and early adoption is permitted. We are currently evaluating the impact that the standard will have on our consolidated financial statements.

In February 2016, FASB issued ASU No. 2016-02, Leases (Topic 842). The standard requires a lessee to recognize assets and liabilities on the balance sheet for leases with lease terms greater than 12 months. ASU 2016-02 is effective for fiscal years, and interim periods within those years, beginning after December 15, 2018, and early adoption is permitted. We are currently evaluating the impact that the standard will have on our consolidated financial statements.

In April 2015, FASB issued ASU No. 2015-03, Simplifying the Presentation of Debt Issuance Costs. This ASU more closely aligns the treatment of debt issuance costs with debt discounts and premiums and requires debt issuance costs to be presented as a direct deduction from the carrying amount of the related debt. The amendments in this ASU are effective for financial statements issued for fiscal years beginning after December 15, 2015 and interim periods within those fiscal years. This guidance was applied on a retrospective basis and the Company was required to comply with the applicable disclosures for a change in accounting principle. The adoption of ASU 2015-03 resulted in a reclassification of deferred financing costs of $104,000 from asset to liability classification on the Company s consolidated December 31, 2015 financial statements.

In May 2014, the FASB issued ASU No. 2014-09, Revenue from Contracts with Customers . ASU 2014-09 will eliminate transaction-and industry-specific revenue recognition guidance under current U.S. GAAP and replace it with a principles-based approach for determining revenue recognition. ASU 2014-09 will require that companies recognize revenue based on the value of transferred goods or services as they occur in the contract. The ASU also will require additional disclosure about the nature, amount, timing and uncertainty of revenue and cash flows arising from customer contracts, including significant judgments and changes in judgments and assets recognized from costs incurred to obtain or fulfill a contract. ASU 2014-09 is effective for annual reporting periods beginning after December 15, 2016. The FASB has voted to approve a one-year deferral, changing the effective date to annual reporting periods beginning after December 15, 2017, with early adoption being permitted for periods ending after December 15, 2016. Entities can transition to the standard either retrospectively or as a cumulative effect adjustment as of the date of adoption. Presently, the Company is assessing what effect the adoption of ASU 2014-09 will have on our consolidated financial statements and accompanying notes and has not yet selected a method of adoption.

3. Fair Value of Financial Instruments

The fair value of an asset or liability should represent the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants. Such transactions to sell an asset or transfer a liability are assumed to occur in the principal or most advantageous market for the asset or liability. Accordingly, fair value is determined based on a hypothetical

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transaction at the measurement date, considered from the perspective of a market participant rather than from a reporting entity s perspective.

The Company reports assets and liabilities that are measured at fair value using a three tier or level fair value hierarchy that prioritizes the inputs used to measure fair value. This hierarchy maximizes the use of observable inputs and minimizes the use of unobservable inputs. The three levels of inputs used to measure fair value are as follows:

- Level 1 Inputs are unadjusted quoted prices in active markets for identical assets that the Company has the ability to access at the measurement date.

- Level 2 Inputs are quoted prices for similar assets and liabilities in active markets, quoted prices for identical or similar assets or liabilities in markets that are not active, inputs other than quoted prices that are observable for the asset or liability (interest rates, yield curves, etc.) and inputs that are derived principally from or corroborated by observable market data by correlation or other means (market corroborated inputs).

- Level 3 Unobservable inputs that reflect the Company s own assumptions, based on the best information available, including the Company s own data.

In accordance with the fair value hierarchy described above, the following tables show the fair value of the Company s financial assets and liabilities that are required to be measured at fair value, in thousands:

		Fair Value Measurements at June 30, 2016 (unaudited)		
	Total Carrying Value at June 30, 2016	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents	$ 36,156	$ 36,156	$	$
Marketable securities	24,058		24,058	
Long term marketable securities	67,809		67,809	
Marketable securities - restricted (SERP)	266		266	
Total assets at fair value	$ 128,289	$ 36,156	$ 92,133	$
Liabilities:				
Derivative liabilities	$ 412	$	$	$ 412

		Fair Value Measurements at December 31, 2015		
	Total Carrying Value at December 31, 2015	Quoted Prices in Active Markets (Level 1)	Significant Other Observable Inputs (Level 2)	Significant Unobservable Inputs (Level 3)
Assets:				
Cash and cash equivalents	$ 34,152	$ 34,152	$	$
Marketable securities	28,038		28,038	
Long term marketable securities	55,009		55,009	
Marketable securities - restricted (SERP)	263		263	
Total assets at fair value	$ 117,462	$ 34,152	$ 83,310	$
Liabilities:				
Derivative liabilities	$ 854	$	$	$ 854

The fair value of the restricted marketable securities is included within other non-current assets in the consolidated balance sheets.

The Company s Level 1 assets include cash held with banks and money market funds.

Level 2 assets include the SERP assets, commercial paper and investment grade corporate bonds and other fixed income securities. Level 2 securities are valued using third-party pricing sources that apply applicable inputs and other relevant data into their models to estimate fair value.

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Level 3 liabilities include the estimated fair value of the interest make-whole liability associated with the Company s Notes, which are recorded as derivative liabilities.

The fair value of the interest make-whole liability of the Notes was calculated using a binomial-lattice model with the following key assumptions as of June 30, 2016, unaudited:

Volatility	45%
Stock Price as of June 30, 2016	$20.37 per share
Credit Spread	900 bps
Term	10 months
Dividend Yield	0.0%

Significant changes to these assumptions could result in increases/decreases to the fair value of the derivative liabilities.

Changes in the fair value of the interest make-whole liability are recognized as a component of other income (expense) in the Consolidated Statements of Operations. The following table presents information about the Company s Level 3 liabilities as of December 31, 2015 and June 30, 2016 that are included in the non-current liabilities section of the consolidated balance sheets, in thousands:

		Six Months ended June 30, 2016 (unaudited)
Balance at December 31, 2015	$	854
Changes in fair value of derivative liabilities included in earnings		(224)
Reduction due to conversion of debt to equity		(218)
Balance at June 30, 2016	$	412

The carrying value, face value and estimated fair value of the Notes was approximately $5.7 million, $6.6 million and $25.8 million, respectively, as of June 30, 2016. The fair value was estimated based on actual trade information as well as quoted prices provided by bond traders, which would be characterized within Level 2 of the fair value hierarchy. This fair value amount gives recognition to the value of the interest make-whole liability and the value of the conversion option. Upon issuance, these were accounted for as derivative liabilities and additional paid-in-capital, respectively.

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The carrying amounts of other financial instruments, including accounts receivable, accounts payable and accrued expenses, approximate fair value due to their short-term maturities. Unrestricted marketable securities held by the Company were as follows, in thousands:

At June 30, 2016 (unaudited):

Available for Sale	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate debt securities	$ 91,318	597	(48)	$ 91,867

At December 31, 2015:

Available for Sale	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Corporate debt securities	$ 83,535	5	(493)	$ 83,047

The contractual maturities of the unrestricted available for sale marketable securities held by the Company were as follows, in thousands:

	June 30, 2016 (unaudited)
Less Than 1 Year	$ 24,058
1-5 years	67,809
Greater Than 5 Years	
Total	$ 91,867

The Company has not experienced any other-than-temporary losses on its marketable securities and restricted marketable securities. The cost of securities sold is calculated using the specific identification method.

4. Inventories

Inventories consist of the following, in thousands:

	June 30, 2016 (unaudited)	December 31, 2015
Raw materials	$ 2,935	$ 2,887

Work in process	6,238	3,946
Finished goods	7,200	5,754
	$ 16,373	$ 12,587

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5. Property and Equipment

Property and equipment consist of the following, in thousands:

	June 30, 2016 (unaudited)	December 31, 2015
Computer equipment	$ 1,152	$ 1,112
Software	1,611	307
Lab equipment and furniture	6,333	5,667
Leasehold improvements	2,642	2,642
Construction in progress	8	1,114
	11,746	10,842
Less accumulated depreciation and amortization	(7,553)	(6,968)
	$ 4,193	$ 3,874

Depreciation and amortization expense on property and equipment was approximately $298,000 and $585,000 for the three and six months ended June 30, 2016, and $160,000 and $317,000 for the three and six months ended June 30, 2015, respectively.

6. Deferred Legal Fees and Intangible Assets

Deferred legal fees have been incurred in connection with patent litigation for Oxtellar XR and Trokendi XR. As of June 30, 2016 and December 31, 2015, the Company had deferred legal fees of $16.4 million and $22.5 million, respectively.

The following sets forth the gross carrying amount and related accumulated amortization of the intangible asset, in thousands:

		June 30, 2016 (unaudited)		December 31, 2015	
	Average Life	Gross Carrying Amount	Accumulated Amortization	Gross Carrying Amount	Accumulated Amortization
Capitalized patent defense costs	9.5 - 11 years	$ 16,318	$ 533	$ 994	$ 18

The Company prevailed in a lawsuit related to Oxtellar XR in February 2016, at which time the Company began amortizing the costs associated with that litigation.

The net book value of intangible assets was $15.8 million as of June 30, 2016 and was $1.0 million as of December 31, 2015. The increase in intangible assets reflects the successful outcome of the lawsuit related to Oxtellar XR in February 2016. There is an offsetting reduction in the amount carried as deferred legal fees, as described above. Amortization expense on intangible assets was approximately $0.4 million and $0.5 million for the three and six months ended June 30, 2016 and was approximately $57,000 and $115,000 for the three and six months ended June 30, 2015.

There were no indicators of impairment identified at June 30, 2016 or December 31, 2015.

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7. Accrued Expenses

Accrued expenses are comprised of the following, in thousands:

	June 30, 2016 (unaudited)	December 31, 2015
Accrued professional fees	$ 12,051	$ 10,057
Accrued compensation	6,507	7,519
Accrued clinical trial and clinical supply costs	3,225	3,677
Accrued product costs	923	113
Accrued sales and marketing expenses	575	434
Accrued interest expense	270	295
Other accrued expenses	4,551	2,718
	$ 28,102	$ 24,813

8. Convertible Senior Secured Notes

The table below summarizes activity related to the Notes from issuance on May 3, 2013 through June 30, 2016, in thousands:

Gross proceeds	$ 90,000
Initial value of interest make-whole derivative reported as debt discount	(9,270)
Conversion option reported as debt discount and APIC	(22,336)
Conversion of debt to equity - principal	(81,463)
Conversion of debt to equity - accretion of debt discount and deferred financing costs	25,003
Accretion of debt discount and deferred financing costs	5,151
December 31, 2015 carrying value	7,085
Conversion of debt to equity - principal	(1,962)
Conversion of debt to equity - accretion of debt discount and deferred financing costs	424
Accretion of debt discount and deferred financing costs	152
June 30, 2016 carrying value, unaudited	$ 5,699

During the six month period ended June 30, 2016, approximately $2.0 million of the Notes were presented to the Company for conversion. Accordingly, the Company issued approximately 0.4 million shares of common stock in conversion of the principal amount of the Notes. As a result of the conversions, the Company incurred a loss of approximately $0.4 million on extinguishment of debt during the six months ended June 30, 2016, which is included as a separate component of other income (expense) on the Consolidated Statement of Operations. During the six month period ended June 30, 2015, as a result of approximately $25.3 million in note conversions, the Company incurred a loss of approximately $2.4 million on extinguishment of debt.

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9. Summary Stockholders Equity

The following summary table provides details related to the activity in certain captions within Stockholders Equity for the six month period ended June 30, 2016, in thousands:

	Common Stock	Additional Paid-in Capital
	(unaudited)	
Balance, December 31, 2015	$ 49	$ 263,955
Share-based compensation		2,971
Exercise of stock options	1	995
Equity issued on note conversion		2,138
Balance, June 30, 2016	$ 50	$ 270,059

10. Share-Based Payments

The Company has adopted the Supernus Pharmaceuticals, Inc. 2012 Equity Incentive Plan (the 2012 Plan), which is stockholder approved, and provides for the grant of stock options and certain other awards, including stock appreciation rights (SAR), restricted and unrestricted stock, stock units, performance awards, cash awards and other awards that are convertible into or otherwise based on the Company s common stock, to the Company s key employees, directors, and consultants and advisors. The 2012 Plan is administered by the Company s Board of Directors and provides for the issuance of up to 8,000,000 shares of the Company s common stock upon the exercise of stock awards. Option awards are granted with an exercise price equal to the estimated fair value of the Company s common stock at the grant date. Those option awards generally vest in four annual installments, starting on the first anniversary of the date of grant and have ten year contractual terms. Share-based compensation recognized related to the grant of employee and non-employee stock options, SAR, potential Employee Stock Purchase Plan (ESPP) awards and non-vested stock was as follows, in thousands:

	Three Months ended June 30,		Six Months ended June 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
Research and development	$ 340	$ 206	$ 628	$ 410
Selling, general and administrative	1,272	912	2,343	1,610
Total	$ 1,612	$ 1,118	$ 2,971	$ 2,020

The following table summarizes stock option and SAR activity:

	Number of Options	Weighted-Average Exercise Price	Weighted-Average Remaining Contractual

				Term (in years)
Outstanding, December 31, 2015	2,699,007	$	8.94	7.92
Granted (unaudited)	1,024,150		13.01	
Exercised (unaudited)	(44,057)		4.69	
Forfeited or expired (unaudited)	(6,750)		11.47	
Outstanding, June 30, 2016 (unaudited)	3,672,350	$	10.12	8.07
As of December 31, 2015:				
Vested and expected to vest	2,654,381	$	8.93	7.90
Exercisable	901,672	$	7.95	6.86
As of June 30, 2016:				
Vested and expected to vest (unaudited)	3,599,518	$	10.09	8.05
Exercisable (unaudited)	1,475,322	$	8.41	7.00

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11. Earnings per Share

Basic income per common share is determined by dividing income attributable to common stockholders by the weighted-average number of common shares outstanding during the period, without consideration of common stock equivalents. Diluted income per share is computed by dividing the income attributable to common stockholders by the weighted-average number of common share equivalents outstanding for the period. The treasury stock method is used to determine the dilutive effect of the Company s stock option grants, SARs, and potential ESPP awards, and the if-converted method is used to determine the dilutive effect of the Company s Notes.

The following common stock equivalents were excluded in the calculation of diluted income per share because their effect would be anti-dilutive as applied to the income from continuing operations applicable to common stockholders for the three and six months ended June 30, 2016 and 2015:

	Three Months ended June 30,		Six Months ended June 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
Shares underlying Convertible Senior Secured Notes				2,791,624
Warrants to purchase common stock		28,613		25,950
Stock options, stock appreciation rights, and non-vested stock options	1,124,100		1,159,100	

The following table sets forth the computation of basic and diluted net income per share for the three and six months ended June 30, 2016 and 2015, in thousands, except share and per share amounts:

	Three Months ended June 30,		Six Months ended June 30,	
	2016	2015	2016	2015
	(unaudited)		(unaudited)	
Numerator, in thousands:				
Net income used for calculation of basic EPS	$ 10,018	$ 2,005	$ 15,005	$ 2,923
Interest expense on convertible debt	196	331	375	
Changes in fair value of derivative liabilities	(123)	(195)	(224)	
Loss on extinguishment of debt		241	382	
Loss on extinguishment of outstanding debt, as if converted	(849)	(553)	(1,183)	
Total adjustments	(776)	(176)	(650)	
Net income used for calculation of diluted EPS	$ 9,242	$ 1,829	$ 14,355	$ 2,923
Denominator:				
Weighted average shares outstanding, basic	49,427,825	47,911,932	49,333,962	46,246,866
Effect of dilutive potential common shares:				
Shares underlying Convertible Senior Secured Notes	1,240,814	2,417,586	1,301,885	
Shares issuable to settle interest make-whole derivatives	52,563	246,105	71,537	

Stock options, stock appreciation rights, and non-vested stock options	1,024,140	1,697,926	777,302	1,441,126
Total potential dilutive common shares	2,317,517	4,361,617	2,150,724	1,441,126
Weighted average shares outstanding, diluted	51,745,342	52,273,549	51,484,686	47,687,992
Net income per share, basic	$ 0.20	$ 0.04	$ 0.30	$ 0.06
Net income per share, diluted	$ 0.18	$ 0.03	$ 0.28	$ 0.06

12. Income Taxes

During the three and six months ended June 30, 2016, the Company had pre-tax income of $10.7 million and $15.9 million, respectively. The provision for Federal and state income taxes related to the pre-tax income has been largely offset by the utilization of available net operating loss carryforwards (NOLs). Accordingly, the Company reduced its valuation allowance against its deferred tax assets and recognized an income tax expense for the jurisdictions that did not have sufficient NOLs to offset the expected tax expense.

During the three and six months ended June 30, 2016, the Company recorded $0.7 million and $0.9 million of current tax expense, respectively, primarily related to an increase in our reserve for an uncertain tax position related to the Alternative Minimum Tax.

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13. Commitments and Contingencies

The Company has concurrent leases for office and lab space that extend through April 2020. The Company may elect to extend the term of the leases for an additional five-year term. The leases provide for a tenant improvement allowance of approximately $2.1 million in aggregate. During the three and six months ended June 30, 2016, none of the allowance was utilized. During the three and six months ended June 30, 2015, $0.2 million of the allowance was utilized and is included in fixed assets and deferred rent. As of June 30, 2016, $0.5 million remains available for tenant improvements. Rent expense for the leased facilities and leased vehicles for the Company s sales representatives for the three and six months ended June 30, 2016 was approximately $0.7 million and $1.3 million, respectively. Rent expense for the leased facilities and leased vehicles for the three and six months ended June 30, 2015 was approximately $0.6 million and $1.2 million, respectively.

Future minimum lease payments under non-cancelable operating leases as of June 30, 2016 are as follows, in thousands, unaudited:

Year ending December 31:		
2016 (remaining)	$	681
2017		1,312
2018		1,314
2019		1,341
Thereafter		454
	$	5,102

The Company has obtained exclusive licenses from third parties for proprietary rights to support the product candidates in the Company s psychiatry portfolio. Under license agreements with Afecta Pharmaceuticals, Inc. (Afecta), the Company has obtained exclusive worldwide rights to selected product candidates, including an exclusive license to SPN-810 (molindone hydrochloride). The Company does not owe any future milestone payments for SPN-810. The Company is obligated to pay royalties in the low-single digits to Afecta based on worldwide net sales of each of these products.

The Company has also entered into a purchase and sale agreement with Rune Healthcare Limited (Rune), where the Company obtained the exclusive worldwide rights to a product concept from Rune. There are no future milestone payments due to Rune under this agreement. If the Company receives approval to market and sell any products based on the Rune product concept for SPN-809 (viloxazine hydrochloride), the Company is obligated to pay royalties to Rune based on net sales worldwide in the low-single digits.

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

Management s Discussion and Analysis of Financial Condition and Results of Operations is intended to help the reader understand the results of operations and the financial condition of the Company. The interim financial statements included in this report and this Management s Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with our audited consolidated financial statements and notes thereto for the year ended December 31, 2015 and the related Management s Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in our Annual Report on Form 10-K filed with the Securities and Exchange Commission on March 9, 2016.

In addition to historical information, 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, and Section 21E of the Securities Exchange Act of 1934, as amended, which are intended to be covered by the safe harbors created thereby. These forward-looking statements may include declarations regarding the Company s belief or current expectations of management, such as statements including the words budgeted, anticipate, project, estimate, expect, may, believe, potential, and similar statements or expressions, which are intended to be among the statements that are forward-looking statements, as such statements reflect the reality of risk and uncertainty that is inherent in the Company s business. Actual results may differ materially from those expressed or implied by such forward-looking statements. Readers are cautioned not to place undue reliance on these forward-looking statements, which are made as of the date this report was filed with the Securities and Exchange Commission. Our actual results and the timing of events could differ materially from those discussed in our forward-looking statements as a result of many factors, including those set forth under the Risk Factors section of our Annual Report on Form 10-K and elsewhere in this report as well as in other reports and documents we file with the Securities and Exchange Commission from time to time. Except as required by law, we undertake no obligation to update any forward-looking statements to reflect events or circumstances occurring after the date of this Quarterly Report on Form 10-Q.

Solely for convenience, in this Quarterly Report on Form 10-Q the trade names are referred to without the TM symbols and the trademark registrations are referred to without the circled R, but such references should not be construed as any indicator that the Company will not assert, to the fullest extent under applicable law, our rights thereto.

Overview

We are a specialty pharmaceutical company focused on developing and commercializing products for the treatment of central nervous system (CNS) diseases.

Oxtellar XR and Trokendi XR are the first once-daily extended release oxcarbazepine and topiramate products indicated for patients with epilepsy in the U.S. market. These products differ from immediate release products by offering once-daily dosing and unique pharmacokinetic characteristics which we believe can have very positive clinical effects for some patients. We believe a once-daily dosing regimen improves adherence, making it more probable that patients maintain sufficient levels of medication in their bloodstream to protect against seizures. In addition, the unique smooth and steady pharmacokinetic profiles of our once-daily formulations reduce the peak to trough fluctuation in blood level that are typically associated with immediate release products, which we believe may result in increased adverse events (AEs), more symptomatic side effects and decreased efficacy.

In addition, we are developing multiple product candidates in psychiatry to address large unmet medical needs and market opportunities. With SPN-810 (molindone hydrochloride), we are developing a product candidate to treat impulsive aggression (IA) in patients who have attention deficit hyperactivity disorder (ADHD). There are currently no approved products indicated for the treatment of IA. We subsequently plan to develop SPN-810 for treatment of IA in other CNS diseases, such as autism, bipolar disorder, schizophrenia, and some forms of dementia. With SPN-812 (viloxazine hydrochloride), we are developing this product candidate to treat patients who have ADHD.

The table below summarizes our current pipeline of novel products and product candidates.

Product	Indication	Status
Oxtellar XR	Epilepsy	Launched
Trokendi XR	Epilepsy*	Launched
SPN-810	Impulsive Aggression**	Phase III
SPN-812	ADHD	Phase IIb
SPN-809	Depression	Phase II ready

* Supplemental New Drug Application (sNDA) submitted in August 2015 for treatment in adults for prophylaxis of migraine headache.

** Initial program is in patients with ADHD, with a plan to follow on in other indications, such as IA in patients with autism, bipolar disorder, schizophrenia, and some forms of dementia.

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We are continuing to expand our intellectual property portfolio to provide additional protection for our technologies, products, and product candidates. We currently have seven U.S. patents issued covering Oxtellar XR and six U.S. patents issued covering Trokendi XR, providing patent protection expiring no earlier than 2027 for each product.

Commercial Products

Trokendi XR

Trokendi XR, the first once-daily extended release topiramate product indicated for patients with epilepsy in the U.S. market, is designed to improve patient adherence over immediate release products, which must be taken multiple times per day.

We remain in discussions with the United States Food and Drug Administration (FDA) regarding the sNDA on migraine headache. The FDA requested that the Company resubmit the Trokendi XR product label with migraine as an indication in a different format prior to completing its review. No additional new data, studies or analyses for efficacy or safety were required by the FDA. We have submitted the revised label, and a targeted PDUFA date has been set for the third quarter of 2016.

Oxtellar XR

Oxtellar XR is the only once-daily extended release oxcarbazepine product indicated for the treatment of patients with epilepsy in the U.S. as adjunctive therapy.

In a retrospective medical chart review of 200 patients treated with immediate release oxcarbazepine or Oxtellar XR, Oxtellar XR was associated with a significantly lower rate of inpatient hospitalization stays, lower rate of emergency department visits, and a higher rate of compliance. The patient charts were obtained from 17 geographically and clinically diverse sites across the U.S. and included non-academic and academic affiliated practices, general neurology, pediatric neurology, and epilepsy centers.

We expect the number of prescriptions filled for Oxtellar XR and Trokendi XR to continue to increase through the end of 2016 and in subsequent years. Data from Intercontinental Marketing Services (IMS) shows 238,531 prescriptions filled for both drugs during the six months ended June 30, 2016, representing a growth of 43.9% as compared to the 165,776 prescriptions reported for the six months ended June 30, 2015. For the three months ended June 30, 2016, data from IMS shows 123,758 prescriptions filled for both drugs, representing a growth of 38.9% as compared to the 89,086 prescriptions reported for the three months ended June 30, 2015.

We have received Paragraph IV Notice Letters concerning Oxtellar XR and Trokendi XR from various third-parties. In response to these Paragraph IV notice letters, we have initiated litigation against these third parties alleging infringement of our intellectual property rights. We

intend to vigorously defend our intellectual property rights in each of these cases. We anticipate continuing to incur increasing amounts of legal fees and related expenses for these cases as they progress. On February 8, 2016, the Company announced a court ruling that three patents covering Oxtellar XR were valid and that Actavis, plc infringed two of these three patents by submitting an abbreviated new drug application (ANDA) to the FDA. (See Part II, Item 1 Legal Proceedings in this Quarterly Report on Form 10-Q for additional information).

Product Candidates

SPN-810

We are developing SPN-810 as a novel treatment for IA in patients who have ADHD. Our Phase III clinical trial (P301) is being conducted under a Special Protocol Assessment (SPA). SPN-810 has been granted fast-track designation by the FDA. We initiated two Phase III clinical trials in 2015 (P301 and P302) and began dosing patients during the first quarter of 2016. We expect patient enrollment to continue through the end of 2016 and into 2017. We continue to expect launching SPN-810, if approved by the FDA, according to the current timeline in 2019.

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SPN-812

SPN-812 is being developed as a novel non-stimulant treatment for ADHD. We initiated a Phase IIb dose ranging trial during 2015 and began dosing patients during the first quarter of 2016. Patient enrollment has been completed, and last visit for the last patient occurred during the third quarter. We continue to project that we will have data from this Phase IIb trial available by early 2017. In April 2016, we initiated an open-label trial in which 84% of the patients completing the Phase IIb trial have been enrolled.

We expect to incur significant research and development expenses related to the continued development of each of our product candidates, with a total cost of approximately $100 million for each of the two programs through FDA approval.

Collaboration Update

Recently, Shire announced positive results of SHP465 Safety and Efficacy Study in Children and Adolescents with ADHD. The study addresses a key FDA requirement, keeping SHP465 on track for resubmission in the fourth quarter of 2016 and potential launch in second half of 2017, if it is approved by the FDA. SHP465 was originally developed by Shire Laboratories, the former division of Shire that subsequently became Supernus Pharmaceuticals. Based on the agreement between Supernus and Shire, Shire will pay to Supernus a single digit percentage royalty on net sales of the product.

Critical Accounting Policies and the Use of Estimates

The significant accounting policies and bases of presentation for our consolidated financial statements are described in Note 2 Summary of Significant Accounting Policies. The preparation of our financial statements in accordance with Generally Accepted Accounting Principles (GAAP), requires us to make estimates and assumptions that affect the reported amounts of assets, liabilities, revenues, expenses and the disclosure of contingent assets and liabilities. Actual results could differ from those estimates.

We believe the following accounting policies and estimates to be critical:

Revenue Recognition

Revenue from product sales is recognized when: persuasive evidence of an arrangement exists; delivery has occurred and title to the product and associated risk of loss has passed to the customer; the price is fixed or determinable; collection from the customer has been reasonably assured; all performance obligations have been met; and returns and allowances can be reasonably estimated. Product sales are recorded net of estimated rebates, chargebacks, discounts, co-pay assistance and other deductions as well as estimated product returns (collectively, sales deductions).

We derive our estimated sales deductions from an analysis of historical levels of deductions specific to each product. In addition, we also consider the impact of anticipated changes in product price, sales trends and changes in managed care coverage and co-pay assistance.

Deferred Legal Fees

Deferred legal fees are comprised of costs incurred in connection with the defense of patents for Oxtellar XR and Trokendi XR. Amortization of the deferred legal fees will begin upon successful outcome of the on-going litigation. Deferred legal fees will be charged to expense in the event of an unsuccessful outcome of the on-going litigation.

Research and Development Expenses

Research and development (R&D) expenditures are expensed as incurred. Research and development costs consist primarily of employee-related expenses, including salaries and benefits; share-based compensation expense; expenses incurred under agreements with clinical research organizations (CROs), investigative sites, consultants and other vendors that conduct the Company s clinical trials; the cost of acquiring and manufacturing clinical trial materials; the cost of manufacturing materials used in process validation, to the extent that those materials are manufactured prior to receiving regulatory approval for those products and are not expected to be sold commercially; facilities costs that do not have an alternative future use; related depreciation and other allocated expenses; license fees for and milestone payments related to in-licensed products and technologies; and costs associated with animal testing activities and regulatory approvals.

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Accrued Clinical Expenses

Clinical trials are inherently complex, often involving multiple service providers, and can include payments made to investigator physicians at study sites. Because billing for services often lags by a substantial amount of time, we often are required to estimate a significant portion of our accrued clinical expenses. This process involves reviewing open contracts and communicating with our subject matter expert personnel and the appropriate service provider personnel to identify services that have been performed on our behalf. We accrue for the estimated but unbilled services performed and the associated costs incurred.

Payments to service providers can either be based on hourly rates for services or based on performance driven milestones. When accruing clinical expenses, we estimate the time period over which services will be performed during the life of the entire clinical program, the total cost of the program, and the level of effort to be expended in each intervening period. To the maximum extent possible, we work with each service provider to provide an estimate for unbilled services as of the end of the calendar quarter. This includes estimates for payments to site investigators. We work diligently to minimize estimates based solely on company generated calculations. If the service provider underestimates or overestimates the cost associated with a trial or service at any given point in time, adjustments to research and development expenses may be necessary in future periods. Historically, our estimated accrued clinical expenses have closely approximated actual expenses incurred.

Results of Operations

Comparison of the three months ended June 30, 2016 and June 30, 2015

	Three Months ended June 30,		Increase/ (decrease)
	2016	2015	
	(unaudited, in thousands)		
Revenue			
Net product sales	$ 50,335	$ 34,266	16,069
Licensing revenue	86	786	(700)
Total revenues	50,421	35,052	
Costs and expenses			
Cost of product sales	2,751	1,762	989
Research and development	11,109	6,878	4,231
Selling, general and administrative	26,121	23,336	2,785
Total costs and expenses	39,981	31,976	
Operating income	10,440	3,076	
Other income (expense)			
Interest income	363	137	226
Interest expense	(196)	(331)	135
Changes in fair value of derivative liabilities	123	1	122
Loss on extinguishment of debt		(241)	241
Other income	2	25	(23)
Total other income (expenses)	292	(409)	