SEATTLE GENETICS INC /WA
Form 10-Q
August 01, 2017
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 June 30, 2017

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 0-32405

SEATTLE GENETICS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**91-1874389**
(State or other jurisdiction of	**(I.R.S. Employer**
incorporation or organization)	**Identification No.)**

21823 30th Drive SE

Bothell, Washington 98021

(Address of principal executive offices, including zip code)

(Registrant s telephone number, including area code): (425) 527-4000

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 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, smaller reporting company, or an emerging growth company. See the definitions of large accelerated filer, accelerated filer, smaller reporting company, and emerging growth company in Rule 12b-2 of the Exchange Act.

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

Emerging growth company

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

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

As of July 26, 2017, there were 143,027,210 shares of the registrant s common stock outstanding.

Table of Contents

Seattle Genetics, Inc. Quarterly

Report on Form 10-Q

For the Quarter Ended June 30, 2017

INDEX

Table of Contents

PART I. FINANCIAL INFORMATION

Item 1. Condensed Consolidated Financial Statements

Seattle Genetics, Inc.

Condensed Consolidated Balance Sheets

(Unaudited)

(In thousands, except par value)

	June 30, 2017	December 31, 2016
Assets		
Current assets		
Cash and cash equivalents	$ 197,104	$ 108,673
Short-term investments	255,307	480,313
Accounts receivable, net	71,940	61,928
Inventories	69,247	68,124
Prepaid expenses and other current assets	22,411	15,610
Total current assets	616,009	734,648
Property and equipment, net	85,170	62,870
Long-term investments	20,572	29,988
Other non-current assets	35,720	10,890
Total assets	$ 757,471	$ 838,396
Liabilities and Stockholders Equity		
Current liabilities		
Accounts payable and accrued liabilities	$ 106,665	$ 120,669
Current portion of deferred revenue	31,114	27,847
Total current liabilities	137,779	148,516
Long-term liabilities		
Deferred revenue, less current portion	43,559	53,006
Deferred rent and other long-term liabilities	2,601	2,787
Total long-term liabilities	46,160	55,793
Commitments and contingencies		
Stockholders equity		
Preferred stock, $0.001 par value, 5,000 shares authorized; none issued	0	0

Common stock, $0.001 par value, 250,000 shares authorized; 142,981 shares issued and outstanding at June 30, 2017 and 142,193 shares issued and outstanding at December 31, 2016	143	142
Additional paid-in capital	1,748,423	1,701,048
Accumulated other comprehensive income (loss)	8,356	(63)
Accumulated deficit	(1,183,390)	(1,067,040)
Total stockholders equity	573,532	634,087
Total liabilities and stockholders equity	$ 757,471	$ 838,396

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

Table of Contents

Seattle Genetics, Inc.

Condensed Consolidated Statements of Comprehensive Loss

(Unaudited)

(In thousands, except per share amounts)

	Three months ended June 30,		Six months ended June 30,	
	2017	2016	2017	2016
Revenues				
Net product sales	$ 74,343	$ 66,216	$ 144,664	$ 124,864
Collaboration and license agreement revenues	21,505	19,998	43,335	40,174
Royalty revenues	12,375	9,188	29,355	41,519
Total revenues	108,223	95,402	217,354	206,557
Costs and expenses				
Cost of sales	8,055	6,901	15,536	12,845
Cost of royalty revenues	4,324	3,107	8,704	6,722
Research and development	114,406	85,554	232,590	178,425
Selling, general and administrative	40,712	33,282	79,116	63,029
Total costs and expenses	167,497	128,844	335,946	261,021
Loss from operations	(59,274)	(33,442)	(118,592)	(54,464)
Investment and other income, net	2,914	699	2,242	1,243
Net loss	$ (56,360)	$ (32,743)	$ (116,350)	$ (53,221)
Net loss per share basic and diluted	$ (0.39)	$ (0.23)	$ (0.82)	$ (0.38)
Shares used in computation of net loss per share basic and diluted	142,802	140,283	142,631	140,086
Comprehensive loss:				
Net loss	$ (56,360)	$ (32,743)	$ (116,350)	$ (53,221)
Other comprehensive income:				
Unrealized gain on securities available-for-sale, net of tax	4,435	252	8,417	1,037
Foreign currency translation gain	4	6	2	14
Comprehensive loss	$ (51,921)	$ (32,485)	$ (107,931)	$ (52,170)

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

Table of Contents

Seattle Genetics, Inc.

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

	Six months ended June 30,	
	2017	**2016**
Operating activities		
Net loss	$ (116,350)	$ (53,221)
Adjustments to reconcile net loss to net cash used in operating activities		
Share-based compensation	31,993	24,285
Depreciation and amortization	10,215	8,646
Amortization of premiums, accretion of discounts and (gain) loss on investments	(35)	3,747
Deferred rent and other long-term liabilities	(186)	(459)
Changes in operating assets and liabilities		
Accounts receivable, net	(10,012)	(4,812)
Inventories	(1,123)	(14,712)
Prepaid expenses and other assets	(5,519)	(807)
Accounts payable and accrued liabilities	(11,078)	6,511
Deferred revenue	(6,180)	(19,506)
Net cash used in operating activities	(108,275)	(50,328)
Investing activities		
Purchases of securities available-for-sale	(253,877)	(329,153)
Proceeds from maturities of securities available-for-sale	412,700	469,500
Proceeds from sales of securities available-for-sale	60,056	0
Purchases of property and equipment	(37,556)	(10,684)
Net cash provided by investing activities	181,323	129,663
Financing activities		
Proceeds from exercise of stock options and employee stock purchase plan	15,383	10,498
Net cash provided by financing activities	15,383	10,498
Net increase in cash and cash equivalents	88,431	89,833
Cash and cash equivalents at beginning of period	108,673	102,255
Cash and cash equivalents at end of period	$ 197,104	$ 192,088

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

Table of Contents

Seattle Genetics, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Summary of significant accounting policies

Basis of presentation

The accompanying unaudited condensed consolidated financial statements reflect the accounts of Seattle Genetics, Inc. and its wholly-owned subsidiaries (collectively Seattle Genetics or the Company). All intercompany transactions and balances have been eliminated. Management has determined that the Company operates in one segment: the development and sale of pharmaceutical products on its own behalf or in collaboration with others. Substantially all of the Company s assets and revenues are related to operations in the United States; however, the Company also has subsidiaries in Canada, Switzerland and the United Kingdom.

The condensed consolidated balance sheet data as of December 31, 2016 were derived from audited financial statements not included in this quarterly report on Form 10-Q. The accompanying unaudited condensed consolidated financial statements have been prepared in accordance with the rules and regulations of the Securities and Exchange Commission, or SEC, and generally accepted accounting principles in the United States of America, or GAAP, for unaudited condensed consolidated financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. The accompanying unaudited condensed consolidated financial statements reflect all adjustments consisting of normal recurring adjustments which, in the opinion of management, are necessary for a fair statement of the Company s financial position and results of its operations, as of and for the periods presented.

Unless indicated otherwise, all amounts presented in financial tables are presented in thousands, except for per share and par value amounts.

These unaudited condensed consolidated financial statements should be read in conjunction with the audited consolidated financial statements and accompanying notes included in the Company s Annual Report on Form 10-K for the year ended December 31, 2016, as filed with the SEC.

The preparation of financial statements in conformity with GAAP requires management to make estimates and assumptions that affect the amounts reported in the condensed consolidated financial statements and accompanying notes. Actual results could differ from those estimates. The results of the Company s operations for the three and six month periods ended June 30, 2017 are not necessarily indicative of the results to be expected for the full year.

Non-cash investing activities

The Company had $2.7 million and $8.1 million of accrued capital expenditures as of June 30, 2017 and December 31, 2016, respectively. Accrued capital expenditures have been treated as a non-cash investing activity and, accordingly, have not been included in the statement of cash flows until such amounts have been paid in cash.

Investments

The Company invests cash resources primarily in debt securities. In addition, as of June 30, 2017, the Company held an equity investment in the common stock of Immunomedics, Inc., or Immunomedics, as further described in Note 6. These debt and equity securities are classified as available-for-sale, which are reported at estimated fair value with unrealized gains and losses included in accumulated other comprehensive income (loss) in stockholders equity. Realized gains, realized losses and declines in the value of securities judged to be other-than-temporary, are included in investment and other income, net. The cost of investments for purposes of computing realized and unrealized gains and losses is based on the specific identification method. Amortization of premiums and accretion of discounts on debt securities are included in investment and other income, net. Interest and dividends earned on all securities are included in investment and other income, net. The Company classifies investments in debt securities maturing within one year of the reporting date, or where management s intent is to use the investments to fund current operations or to make them available for current operations, as short-term investments. The Company classifies its equity investment in Immunomedics in other non-current assets.

If the estimated fair value of a security is below its carrying value, the Company evaluates whether it is more likely than not that it will sell the security before its anticipated recovery in market value and whether evidence indicating that the cost of the investment is recoverable within a reasonable period of time outweighs evidence to the contrary. The Company also evaluates whether or not it intends to sell the investment. If the impairment is considered to be other-than-temporary, the security is written down to its estimated fair value. In addition, the Company considers whether credit losses exist for any securities. A credit loss exists if the present value of cash flows expected to be collected is less than the amortized cost basis of the security. Other-than-temporary declines in estimated fair value and credit losses are charged against investment and other income, net.

Table of Contents

Other non-current assets

In addition to the equity investment in Immunomedics, other non-current assets included a $5.0 million non-controlling investment in a privately-held company that is accounted for under the cost method of accounting. The Company periodically evaluates the carrying value of the investment if significant adverse events or circumstances indicate an impairment in value. As of June 30, 2017, no impairment in value had been observed.

Long-term incentive plans

The Company has established Long-Term Incentive Plans, or LTIPs. The LTIPs provide eligible employees with the opportunity to receive performance-based incentives, which may be comprised of a cash payment, stock options, and restricted stock units. As of June 30, 2017, the estimated unrecognized compensation expense related to the LTIPs was $36.3 million. The total estimate of unrecognized compensation expense is expected to change in the future for several reasons, including the addition of more eligible employees, or the termination or modification of a plan.

Revenue recognition

The Company s revenues are comprised of ADCETRIS® net product sales, amounts earned under its collaboration and licensing agreements and royalties. Revenue recognition is predicated upon persuasive evidence of an agreement existing, delivery of products or services being rendered, amounts payable being fixed or determinable, and collectibility being reasonably assured.

Net product sales

The Company sells ADCETRIS through a limited number of pharmaceutical distributors in the U.S. and Canada. Customers order ADCETRIS through these distributors and the Company typically ships product directly to the customer. The Company records product sales when title and risk of loss pass, which generally occurs upon delivery of the product to the customer. Product sales are recorded net of estimated government-mandated rebates and chargebacks, distribution fees, estimated product returns and other deductions. Accruals are established for these deductions and actual amounts incurred are offset against applicable accruals. The Company reflects these accruals as either a reduction in the related account receivable from the distributor, or as an accrued liability depending on the nature of the sales deduction. Sales deductions are based on management s estimates that consider payer mix in target markets and experience to date. These estimates involve a substantial degree of judgment.

Government-mandated rebates and chargebacks: The Company has entered into a Medicaid Drug Rebate Agreement, or MDRA, with the Centers for Medicare & Medicaid Services. This agreement provides for a rebate based on covered purchases of ADCETRIS. Medicaid rebates are invoiced to the Company by the various state Medicaid programs. The Company estimates Medicaid rebates based on a variety of factors, including its experience to date. The Company has also completed a Federal Supply Schedule, or FSS, agreement under which certain U.S. government purchasers receive a discount on eligible purchases of ADCETRIS. The Company has entered into a Pharmaceutical Pricing Agreement with the Secretary of Health and Human Services, which enables certain entities that qualify for government pricing under the Public Health Services Act, or PHS, to receive discounts on their qualified purchases of ADCETRIS. Under these agreements, distributors process a chargeback to the Company for the difference between wholesale acquisition cost and the applicable discounted price. As a result of the Company s direct-ship distribution model, it can determine the entities purchasing ADCETRIS and this information enables the Company to estimate expected chargebacks for FSS and PHS purchases based on each entity s eligibility for the FSS and PHS programs. The Company also reviews historical rebate and chargeback information to further refine these estimates.

Distribution fees, product returns and other deductions: The Company s distributors charge a volume-based fee for distribution services that they perform for the Company. The Company allows for the return of product that is within 30 days of its expiration date or that is damaged. The Company estimates product returns based on its experience to date. In addition, the Company considers its direct-ship distribution model, its belief that product is not typically held in the distribution channel, and the expected rapid use of the product by healthcare providers. The Company provides financial assistance to qualifying patients that are underinsured or cannot cover the cost of commercial coinsurance amounts through SeaGen Secure. SeaGen Secure is available to patients in the U.S. and its territories who meet various financial and treatment need criteria. Estimated contributions for commercial coinsurance under SeaGen Secure are deducted from gross sales and are based on an analysis of expected plan utilization. These estimates are adjusted as necessary to reflect the Company s actual experience.

Table of Contents

Collaboration and license agreement revenues

The Company has developed a proprietary technology for linking cytotoxic agents to monoclonal antibodies called antibody-drug conjugates, or ADCs. This proprietary technology is the basis of ADC collaborations that the Company has entered into in the ordinary course of its business with a number of biotechnology and pharmaceutical companies. Under these ADC collaboration agreements, the Company grants its collaborators research and commercial licenses to the Company s technology and provides technology transfer services, technical advice, supplies and services for a period of time.

If there are continuing performance obligations, the Company uses a time-based proportional performance model to recognize revenue over the Company s performance period for the related agreement. Collaboration and license agreements are evaluated to determine whether the multiple elements and associated deliverables can be considered separate units of accounting. To date, the pre-commercial deliverables under the Company s collaboration and license agreements have not qualified as separate units of accounting. The assessment of multiple element arrangements requires judgment in order to determine the appropriate point in time, or period of time, that revenue should be recognized. The Company believes that the development period in each agreement is a reasonable estimate of the performance obligation period of such agreement. Accordingly, all amounts received or due, including any upfront payments, maintenance fees, development and regulatory milestone payments and reimbursement payments, are recognized as revenue over the performance obligation periods of each agreement. These performance obligation periods typically range from one to three years. The agreements with Takeda Pharmaceutical Company Limited, or Takeda, and Genentech, Inc., a member of the Roche Group, or Genentech, have performance obligation periods of ten and seventeen years, respectively. All of the remaining performance obligation periods for active collaborations are currently expected to be completed in three years or less. When no performance obligations are required of the Company, or following the completion of the performance obligation period, such amounts are recognized as revenue when collectibility is reasonably assured. Generally, all amounts received or due other than sales-based milestones and royalties are classified as collaboration and license agreement revenues as they are earned. Sales-based milestones and royalties are recognized as royalty revenue as they are reported to the Company.

The Company s collaboration and license agreements include contractual milestones. Generally, the milestone events contained in the Company s collaboration and license agreements coincide with the progression of the collaborators product candidates from development, to regulatory approval and then to commercialization and fall into the following categories.

Development milestones in the Company s collaborations may include the following types of events:

Designation of a product candidate or initiation of preclinical studies. The Company s collaborators must undertake significant preclinical research and studies to make a determination of the suitability of a product candidate and the time from those studies or designation to initiation of a clinical trial may take several years.

Initiation of a phase 1 clinical trial. Generally, phase 1 clinical trials may take one to two years to complete.

Initiation of a phase 2 clinical trial. Generally, phase 2 clinical trials may take one to three years to complete.

Initiation of a phase 3 clinical trial. Generally, phase 3 clinical trials may take two to six years to complete.

Regulatory milestones in the Company s collaborations may include the following types of events:

Filing of regulatory applications for marketing approval such as a Biologics License Application in the United States or a Marketing Authorization Application in Europe. Generally, it may take up to twelve months to prepare and submit regulatory filings.

Receiving marketing approval in a major market, such as in the United States, Europe, Japan or other significant countries. Generally, it may take up to three years after a marketing application is submitted to obtain approval for marketing and pricing from the applicable regulatory agency.

Commercialization milestones in the Company s collaborations may include the following types of events:

First commercial sale in a particular market, such as in the United States, Europe, Japan or other significant countries.

Product sales in excess of a pre-specified threshold. The amount of time to achieve this type of milestone depends on several factors, including, but not limited to, the dollar amount of the threshold, the pricing of the product, market penetration of the product and the rate at which customers begin using the product.

The Company s ADC collaborators are solely responsible for the development of their product candidates and the achievement of milestones in any of the categories identified above is based solely on the collaborators efforts.

Table of Contents

In the case of the Company s ADCETRIS collaboration with Takeda, the Company may be involved in certain development activities; however, the achievement of milestone events under the agreement is primarily based on activities undertaken by Takeda.

The process of successfully developing a product candidate, obtaining regulatory approval and ultimately commercializing a product candidate is highly uncertain and the attainment of any milestones is therefore uncertain and difficult to predict. In addition, since the Company does not take a substantive role or control the research, development or commercialization of any products generated by its ADC collaborators, the Company is not able to reasonably estimate when, if at all, any milestone payments or royalties may be payable to the Company by its ADC collaborators. As such, the milestone payments associated with its ADC collaborations involve a substantial degree of uncertainty and risk that they may never be received. Similarly, even in those collaborations where the Company may have an active role in the development of the product candidate, such as the Company s ADCETRIS collaboration with Takeda, the attainment of a milestone is based on the collaborator s activities and is generally outside the direction and control of the Company.

The Company generally invoices its collaborators and licensees on a monthly or quarterly basis, or upon the completion of the effort or achievement of a milestone, based on the terms of each agreement. Deferred revenue arises from amounts received in advance of the culmination of the earnings process and is recognized as revenue in future periods when the applicable revenue recognition criteria have been met. Deferred revenue expected to be recognized within the next twelve months is classified as a current liability.

Royalty revenues and cost of royalty revenues

Royalty revenues primarily reflect amounts earned under the ADCETRIS collaboration with Takeda. These royalties include sales royalties, which are based on a percentage of Takeda s net sales at rates that range from the mid-teens to the mid-twenties based on sales volume, and commercial sales-based milestones. Takeda bears a portion of third-party royalty costs owed on its sales of ADCETRIS. This amount is included in royalty revenue in the Company s consolidated financial statements. Cost of royalty revenues reflects amounts owed to the Company s third party licensors related to Takeda s sales of ADCETRIS. These amounts are recognized in the quarter in which Takeda reports its sales activity to the Company, which is the quarter following the related sales. Royalty revenues also include amounts earned in connection with the Company s ADC collaborations.

Recent accounting pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued an Accounting Standards Update entitled ASU 2014-09, Revenue from Contracts with Customers. The standard requires entities to recognize revenue through an evaluation that includes identification of the contract, identification of the performance obligations, determination of the transaction price, allocation of the transaction price to the performance obligations, and recognition of revenue as the entity satisfies the performance obligations. In August 2015, FASB issued an Accounting Standards Update entitled ASU 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date , which defers the effective date of ASU 2014-09 to the Company s fiscal year beginning January 1, 2018. The FASB has continued to issue accounting standards updates to clarify and provide implementation guidance related to Revenue from Contracts with Customers, including ASU 2016-08, Revenue from Contract with Customers: Principal versus Agent Considerations , ASU 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing , ASU 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients and ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers. The Company s preliminary assessment of this new standard is that it will generally not change the way in which the Company recognizes product revenue from sales of ADCETRIS. However, the Company expects that

sales-based royalties and commercial sales-based milestones will be recorded in the period of the related sale based on estimates, rather than recording them as reported by the customer. In addition, the Company expects that the achievement of development milestones under the Company s collaborations will be recorded in the period their achievement becomes probable, which may result in their recognition earlier than under current accounting principles. The new standard also requires more extensive disclosures related to revenue recognition, particularly in quarterly financial statements. The Company will adopt the standard on January 1, 2018 and intends to use the modified retrospective method of adoption. The Company is continuing to evaluate the impact of the standard on all of its revenues, including those mentioned above, and its assessments may change in the future based on its ongoing evaluation.

In January 2016, FASB issued an Accounting Standards Update entitled ASU 2016-01, Financial Instruments: Overall. The standard addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. The Company will adopt the standard on January 1, 2018 using a modified retrospective approach. The standard will require that the Company record changes in the fair value of equity securities in net income or loss. The implementation of this standard is expected to increase the volatility of net income or loss to the extent that the Company continues to hold equity securities.

Table of Contents

In February 2016, FASB issued an Accounting Standards Update entitled ASU 2016-02, Leases. The standard requires entities to recognize in the consolidated balance sheet a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term. The standard will become effective for the Company beginning January 1, 2019, with early adoption permitted. The Company is currently evaluating the guidance to determine the potential impact on its financial condition, results of operations and cash flows, and financial statement disclosures, and expects that the adoption of the standard will increase assets and liabilities related to the Company s operating leases in the consolidated balance sheets.

In March 2016, FASB issued an Accounting Standard Update entitled ASU 2016-09, Compensation Stock Compensation. The standard is intended to simplify certain elements of accounting for share-based payment transactions, including the income tax impact, classification of awards as either equity or liabilities, and classification on the statement of cash flows. In addition, the standard allows an entity-wide accounting policy election to either estimate the number of awards that are expected to vest, as currently required, or account for forfeitures when they occur. The Company has elected to continue estimating the number of awards that are expected to vest. The Company adopted the standard as of January 1, 2017. Since the Company has incurred net losses since its inception and maintains a full valuation allowance on its net deferred tax assets, the adoption did not have a material impact on the Company s financial condition, results of operations and cash flows.

In October 2016, FASB issued an Accounting Standard Update entitled ASU 2016-16, Accounting for Income Taxes: Intra-Entity Asset Transfers of Assets Other than Inventory. The standard is intended to simplify the accounting for intercompany sales of assets other than inventory. Under current GAAP, the tax effects of intra-entity asset transfers are deferred until the transferred asset is sold to a third party or otherwise recovered through use. Under the new guidance, a reporting entity would recognize the tax expense from the sale of the asset in the seller s jurisdiction when the transfer occurs, even though the pre-tax effects of that transaction are eliminated in consolidation. Any deferred tax asset that arises in the buyer s jurisdiction would also be recognized at the time of the transfer. The standard will become effective for the Company beginning on January 1, 2018. The Company is currently evaluating the new standard; however, since the Company has incurred net losses since its inception and maintains a full valuation allowance on its net deferred tax assets, the adoption is not expected to have a material impact on the Company s financial condition, results of operations and cash flows, or financial statement disclosures.

In June 2016, FASB issued an Accounting Standard Update entitled ASU 2016-13, Financial Instruments: Credit Losses. The objective of the standard is to provide information about expected credit losses on financial instruments at each reporting date, and to change how other than temporary impairments on investments securities are recorded. The standard will become effective for the Company beginning on January 1, 2020 with early adoption permitted. The Company is currently evaluating the guidance to determine the potential impact on its financial condition, results of operations and cash flows, and financial statement disclosures.

In January 2017, FASB issued an Accounting Standard Update entitled, ASU 2017-01, Business Combinations: Clarifying the Definition of a Business. The objective of the standard is to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions of assets or businesses. The Company adopted this standard on a prospective basis as of January 1, 2017. The adoption of this standard did not have a material impact on the Company s financial condition, results of operations and cash flows, or financial statement disclosures.

In May 2017, FASB issued an Accounting Standard Update entitled, ASU 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. The objective of the standard is to provide guidance about which changes to the terms or conditions of a share-based payment award require an entity to apply modification accounting in Topic 718. The standard should be applied prospectively to awards modified on or after

the adoption date. The Company early adopted this standard on April 1, 2017. The adoption did not have a material impact on the Company s financial condition, results of operations and cash flows.

2. Net loss per share

Basic and diluted net loss per share is computed by dividing net loss by the weighted average number of common shares outstanding during the period. The Company excluded all restricted stock units and options to purchase common stock from the calculation of basic and diluted net loss per share as such securities are anti-dilutive for all periods presented. The weighted-average number of restricted stock units and options to purchase common stock that have been excluded from the number of shares used to calculate basic and diluted net loss per share totaled 13,057,000 and 12,548,000 for the three months ended June 30, 2017 and 2016, respectively, and 13,188,000 and 12,432,000 for the six months ended June 30, 2017 and 2016, respectively.

Table of Contents

3. Investments

Investments consisted of available-for-sale securities as follows (in thousands):

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
June 30, 2017				
U.S. Treasury securities	$ 276,159	$ 0	$ (280)	$ 275,879
Common stock investment in Immunomedics	12,677	13,813	0	26,490
Total	$ 288,836	$ 13,813	$ (280)	$ 302,369
Contractual Maturities (at date of purchase)				
Due in one year or less	$ 145,445			$ 145,377
Due in one to two years	130,714			130,502
Total	$ 276,159			$ 275,879

	Amortized cost	Gross unrealized gains	Gross unrealized losses	Fair value
December 31, 2016				
U.S. Treasury securities	$ 510,356	$ 68	$ (123)	$ 510,301
Contractual Maturities (at date of purchase)				
Due in one year or less	$ 229,856			$ 229,864
Due in one to two years	280,500			280,437
Total	$ 510,356			$ 510,301

Investments classified as available-for-sale securities are presented in the accompanying consolidated balance sheets as follows (in thousands):

	June 30, 2017	December 31, 2016
Short-term investments	$ 255,307	$ 480,313
Long-term investments	20,572	29,988
Other non-current assets Common stock investment in Immunomedics	26,490	0
Total	$ 302,369	$ 510,301

The aggregate estimated fair value of the Company s investments with unrealized losses was as follows (in thousands):

	Period of continuous unrealized loss			
	12 Months or less		Greater than 12 months	
	Fair value	Gross unrealized losses	Fair value	Gross unrealized losses
June 30, 2017				
U.S. Treasury securities	$ 275,879	$ (280)	$ NA	$ NA
December 31, 2016				
U.S. Treasury securities	$ 200,327	$ (123)	$ NA	$ NA

Table of Contents

4. Fair value

The Company holds short-term and long-term available-for-sale securities that are measured at fair value, which is determined on a recurring basis according to a fair value hierarchy that prioritizes the inputs and assumptions used, and the valuation techniques used to measure fair value. The hierarchy gives the highest priority to unadjusted quoted prices in active markets for identical assets or liabilities (Level 1 measurements) and the lowest priority to unobservable inputs (Level 3 measurements). The three levels of the fair value hierarchy are described as follows:

Level 1: Unadjusted quoted prices in active markets that are accessible at the measurement date for identical, unrestricted assets or liabilities.

Level 2: Quoted prices in markets that are not active or financial instruments for which all significant inputs are observable, either directly or indirectly.

Level 3: Prices or valuations that require inputs that are both significant to the fair value measurement and unobservable.

The determination of a financial instrument s level within the fair value hierarchy is based on an assessment of the lowest level of any input that is significant to the fair value measurement. The Company considers observable data to be market data which is readily available, regularly distributed or updated, reliable and verifiable, not proprietary, and provided by independent sources that are actively involved in the relevant market.

Level 1 investments are valued based on quoted market prices in active markets. The Company did not hold any Level 2 or 3 investments as of June 30, 2017 or December 31, 2016 and did not transfer any investments between Levels 1, 2 and 3 during the six months ended June 30, 2017.

The following table presents the Company s available-for-sale securities by level within the fair value hierarchy for the periods presented (in thousands):

	Fair value measurement using:			
	Quoted prices in active markets for identical assets (Level 1)	**Other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**Total**
As of June 30, 2017				
Short-term investments U.S. Treasury securities	$ 255,307	$ 0	$ 0	$ 255,307
Long-term investments U.S. Treasury securities	20,572	0	0	20,572
Other non-current assets Common stock investment in Immunomedics	26,490	0	0	26,490
Total	$ 302,369	$ 0	$ 0	$ 302,369

	Fair value measurement using:			
	Quoted prices in active markets for identical assets (Level 1)	**Other observable inputs (Level 2)**	**Significant unobservable inputs (Level 3)**	**Total**
As of December 31, 2016				
Short-term investments U.S. Treasury securities	$ 480,313	$ 0	$ 0	$ 480,313
Long-term investments U.S. Treasury securities	29,988	0	0	29,988
Total	$ 510,301	$ 0	$ 0	$ 510,301

Table of Contents

5. Inventories

The following table presents the Company s inventories of ADCETRIS (in thousands):

	June 30, 2017	December 31, 2016
Raw materials	$ 59,559	$ 62,516
Work in process	2,191	8
Finished goods	7,497	5,600
Total	$ 69,247	$ 68,124

The Company capitalizes ADCETRIS inventory costs. ADCETRIS inventory that is deployed into clinical, research or development use is charged to research and development expense when it is no longer available for use in commercial sales. The Company does not capitalize manufacturing costs for any of its product candidates.

6. Immunomedics, Inc. stock purchase agreement

In February 2017, the Company entered into a stock purchase agreement, or the Stock Purchase Agreement, with Immunomedics in connection with its entry into a development and license agreement, or the Immunomedics License, with Immunomedics. The Company paid Immunomedics $14.7 million as consideration for 3.0 million shares of Immunomedics common stock and a warrant to purchase an additional 8.7 million shares of common stock at an exercise price $4.90 per share. The consideration was allocated between the common stock and the warrant based on the relative fair values as of the purchase date, or $12.7 million and $2.0 million, respectively. The shares of common stock were classified as available-for-sale securities and carried at estimated fair value with unrealized gains and losses included in accumulated other comprehensive income (loss) in stockholders equity. The common stock investment was included in other non-current assets as of June 30, 2017. Based on management s assessment, the value of the warrant was determined to be substantially impaired as of March 31, 2017, and charged to investment and other income, net, for the six months ended June 30, 2017. In May 2017, the Company and Immunomedics agreed to terminate the Immunomedics License and to amend the term of the warrant to be exercisable by the Company only until December 31, 2017.

7. Legal matters

On January 10, 2017, the Company became a named defendant in a securities class action complaint seeking compensatory damages of an undisclosed amount. On March 29, 2017, a stockholder derivative lawsuit was filed in Washington Superior Court for the County of Snohomish, naming as defendants certain of the Company s current and former executive officers and members of its board of directors. The Company is named as a nominal defendant. The Company does not believe it is feasible to predict or determine the outcome or resolution of these proceedings, or to estimate the amount of, or potential range of, loss with respect to these proceedings. In addition, the timing of the final resolution of these proceedings is uncertain. As a result of these lawsuits, the Company will incur litigation expenses and may incur indemnification expenses, and potential resolutions of the lawsuits could include settlements requiring payments. Those expenses could have a material impact on the Company s financial position, results of operations, and cash flows.

On February 13, 2017, the Company was named a co-defendant in a lawsuit filed by venBio Select Advisors LLC, or venBio, in the Delaware Chancery Court, or the Court, against the members of the board of directors of Immunomedics. On May 4, 2017, the Company and Immunomedics agreed to terminate the Immunomedics License and to amend the term of the Warrant to be exercisable by the Company only until December 31, 2017, and in connection therewith, Immunomedics and venBio agreed to fully settle, resolve and release the Company, and the Company agreed to fully settle, resolve and release Immunomedics and venBio, from all disputes, claims and liabilities arising from the Immunomedics License and the transactions contemplated thereby, subject to the terms of the related termination agreement and settlement agreement. The termination agreement between Immunomedics and the Company and the settlement of the venBio lawsuit will be effective thirty days following the entry on July 25, 2017 of a final judgment by the Court approving the dismissal of the Company from the venBio lawsuit. The timing of the final resolution of this lawsuit is uncertain and until the termination agreement and related settlement agreement are effective, the Company may continue to incur litigation expenses and may incur indemnification expenses.

8. Subsequent event

On July 30 and July 31, 2017, the Company entered into certain agreements to acquire a biologics manufacturing facility located in Bothell, Washington. As part of the transaction, the Company and Bristol Myers Squibb Company, or BMS, through BMS or its

Table of Contents

wholly-owned subsidiary, entered into an assignment and assumption agreement, or the Assignment Agreement, an asset purchase agreement, or the Asset Purchase Agreement, and agreed to enter into certain ancillary transitional service agreements effective upon the closing of the transactions contemplated by the Asset Purchase Agreement.

Under the Assignment Agreement, on July 30, 2017, BMS assigned to the Company all of its rights and obligations under a purchase agreement, or the Purchase Agreement, pursuant to which BMS agreed to purchase the manufacturing facility site location, which includes the underlying real estate and the manufacturing building, from BMR-3450 Monte Villa Parkway LLC, or BMR. The purchase price was $17.8 million, which the Company previously remitted to BMS to fund the purchase price payable to BMR under the Purchase Agreement, and recorded in property, plant and equipment as of June 30, 2017. On July 31, 2017, the Company completed the acquisition of the manufacturing facility site location from BMR pursuant to the assigned Purchase Agreement. Under the terms of the Purchase Agreement, the Company assumed BMR s obligations under a lease between BMS and BMR, or the Lease, under which BMS currently occupies the manufacturing facility site location. Upon the closing of the transactions contemplated by the Asset Purchase Agreement, which is expected to occur in the second half of 2017, the Lease will terminate.

Under the Asset Purchase Agreement, which was entered into between the Company and BMS on July 31, 2017, or the Asset Purchase Agreement, the Company would acquire certain plant equipment and improvements from BMS upon closing of the transactions contemplated by the Asset Purchase Agreement in exchange for a payment of approximately $25.5 million. The closing of the transactions contemplated by the Asset Purchase Agreement is subject to customary closing conditions, and the execution of a clinical manufacturing services agreement and certain additional ancillary agreements. Under the clinical manufacturing services agreement, the Company will agree to manufacture certain BMS clinical product candidates in accordance with prescribed production schedules and quantities through the later of December 31, 2018 or when certain technical transfer activities have been completed, and to maintain personnel, equipment and expertise sufficient to perform the agreed upon services. BMS will compensate the Company for services rendered under the clinical manufacturing services agreement based on an agreed upon rate for use of the facility and employees, which will be subject to reconciliation based on actual costs incurred. Under the terms of the Asset Purchase Agreement, the Company has agreed to hire the employees who are currently employed by BMS at the manufacturing facility site location.

Table of Contents

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

Forward-Looking Statements

The following discussion of our financial condition and results of operations contains forward-looking statements within the meaning of Section 27A of the Securities Act of 1933 and Section 21E of the Securities Exchange Act of 1934. Forward-looking statements are based on our management s beliefs and assumptions and on information currently available to our management. All statements other than statements of historical facts are forward-looking statements for purposes of these provisions, including those relating to future events or our future financial performance and financial guidance. In some cases, you can identify forward-looking statements by terminology such as may, might, will, should, expect, plan, anticipate, project, believe, estimate, predict, potential, intend or continue, the negative of terms like these or other comparable terminology, and other words or terms of similar meaning in connection with any discussion of future operating or financial performance. These statements are only predictions. All forward-looking statements included in this Quarterly Report on Form 10-Q are based on information available to us on the date hereof, and we assume no obligation to update any such forward-looking statements except as required by law. Any or all of our forward-looking statements in this document may turn out to be incorrect. Actual events or results may differ materially. Our forward-looking statements can be affected by inaccurate assumptions we might make or by known or unknown risks, uncertainties and other factors. We discuss many of these risks, uncertainties and other factors in this Quarterly Report on Form 10-Q in greater detail under the heading Item 1A Risk Factors. We caution investors that our business and financial performance are subject to substantial risks and uncertainties.

Overview

Seattle Genetics is a biotechnology company focused on the development and commercialization of targeted therapies for the treatment of cancer. Our marketed product ADCETRIS®, or brentuximab vedotin, is approved by the United States Food and Drug Administration, or FDA, and the European Commission for three indications, encompassing several settings for the treatment of relapsed Hodgkin lymphoma and relapsed systemic anaplastic large cell lymphoma, or sALCL. ADCETRIS is commercially available in 67 countries around the world, including in the United States, Canada, members of the European Union and Japan. We are collaborating with Takeda Pharmaceutical Company Limited, or Takeda, to develop and commercialize ADCETRIS on a global basis. Under this collaboration, Seattle Genetics retains commercial rights for ADCETRIS in the United States and its territories and in Canada, and Takeda has commercial rights in the rest of the world.

Beyond our current labeled indications, we have a broad development strategy for ADCETRIS evaluating its therapeutic potential in earlier lines of therapy for patients with Hodgkin lymphoma, mature T-cell lymphoma, or MTCL, also known as peripheral T-cell lymphoma, or PTCL, including sALCL, as well as in combination with checkpoint inhibitors. We and our partners are currently conducting four phase 3 clinical trials of ADCETRIS as described below:

ALCANZA: In 2016, we and Takeda reported that the ALCANZA phase 3 trial met its primary endpoint. We submitted a supplemental Biologics License Application, or sBLA, to the FDA in June 2017 to seek approval for a new indication in cutaneous T-cell lymphoma, or CTCL, patients who require systemic therapy, based in part on data from the ALCANZA trial.

ECHELON-1: In June 2017, we and Takeda announced positive top line data from the ECHELON-1 trial, a randomized, open-label, phase 3 trial investigating ADCETRIS plus AVD (adriamycin, vinblastine, dacarbazine) versus ABVD (adriamycin, bleomycin, vinblastine, dacarbazine) as frontline combination therapy in patients with previously untreated advanced classical Hodgkin lymphoma. The ECHELON-1 trial met its primary endpoint, demonstrating that treatment with ADCETRIS plus AVD resulted in a statistically significant improvement in modified progression-free survival, or PFS, versus the control arm as assessed by an independent review facility (hazard ratio=0.770; p-value=0.035). The two-year modified PFS rate for patients in the ADCETRIS plus AVD arm was 82.1 percent compared to 77.2 percent in the control arm. Interim analysis of overall survival, the key secondary endpoint, also trended in favor of the ADCETRIS plus AVD arm. The safety profile of ADCETRIS plus AVD in the ECHELON-1 trial was consistent with that known for the single-agent components of the regimen. There was an increased incidence of febrile neutropenia and peripheral neuropathy in the ADCETRIS plus AVD arm. Febrile neutropenia was reduced through the use of prophylactic growth factors in a subset of patients, and peripheral neuropathy was managed through dose modifications. The control arm had an increased rate and severity of pulmonary toxicity as compared to the ADCETRIS plus AVD arm. Based upon the positive PFS outcome of the ECHELON-1 trial, we plan to submit an sBLA to the FDA by the end of 2017 to seek approval of ADCETRIS as part of a frontline combination chemotherapy regimen in patients with previously untreated advanced classical Hodgkin lymphoma.

ECHELON-2: In November 2016, we and Takeda completed enrollment of 452 patients in our ECHELON-2 trial for frontline MTCL. Based on our most recent review of pooled, blinded data, we have observed a lower rate of reported PFS events than anticipated. We plan to discuss with the FDA the potential to unblind the trial prior to achieving the target number of PFS events specified in our Special Protocol Assessment, or SPA, agreement with the FDA. Based on the length of follow-up, we believe the primary endpoint data will be mature in 2018, and continue to expect to report top-line data next year.

Table of Contents

CHECKMATE 812: In June 2017, we and Bristol-Myers Squibb Company, or BMS, announced a collaboration to evaluate the combination of BMS s immunotherapy Opdivo (nivolumab) with ADCETRIS for the treatment of relapsed/refractory or transplant-ineligible advanced classical Hodgkin lymphoma in a pivotal phase 3 clinical trial, or the CHECKMATE 812 trial.

The ALCANZA, ECHELON-1 and ECHELON-2 trials are each being conducted under SPA agreements with the FDA and pursuant to scientific advice from the European Medicines Agency, or EMA. An SPA is an agreement with the FDA regarding the design of the clinical trial, including size and clinical endpoints, to support an efficacy claim in a new drug application or a BLA submission to the FDA if the trial achieves its primary endpoint.

In collaboration with Astellas Pharma, Inc., or Astellas, we are developing ASG-22ME, or enfortumab vedotin. Based on recent discussions with the FDA, in the second half of 2017 we and Astellas plan to initiate a pivotal phase 2 clinical trial for metastatic urothelial cancer patients who have been previously treated with a checkpoint inhibitor therapy. We and Astellas also plan to initiate a phase 1b trial of enfortumab vedotin in combination with checkpoint inhibitors to begin late in 2017 for patients with metastatic urothelial cancer.

Our clinical-stage pipeline also includes seven other antibody-drug conjugate, or ADC, programs consisting of SGN-CD33A, or vadastuximab talirine, SGN-LIV1A, SGN-CD19A, or denintuzumab mafodotin, SGN-CD19B, SGN-CD123A, SGN-CD352A, and ASG-15ME, as well as two immuno-oncology agents, SEA-CD40, which is based on our sugar-engineered antibody, or SEA, technology, and SGN-2FF, which is a novel small molecule. In addition, we have multiple preclinical and research-stage programs that employ our proprietary technologies, including SGN-CD48A.

On June 19, 2017, we announced that we were discontinuing the phase 3 CASCADE clinical trial of SGN-CD33A in frontline older acute myeloid leukemia, or AML, patients and suspending patient enrollment and treatment in all other SGN-CD33A trials, including the ongoing phase 1/2 trial in frontline high-risk myelodysplastic syndrome, or MDS. We took this action following consultation with the Independent Data Monitoring Committee, or IDMC, and after reviewing unblinded data on June 16, 2017 from the CASCADE trial. The unblinded CASCADE data indicated a higher rate of deaths, including fatal infections, in the SGN-CD33A-containing arm versus the control arm of the trial. On June 21, 2017, the FDA notified us that the Investigational New Drug application, or IND, for SGN-CD33A had been placed on hold, and that no clinical trials may resume under the IND until the FDA lifts the clinical hold. We are reviewing the data and evaluating future plans for the SGN-CD33A development program.

We have collaborations for our ADC technology with a number of biotechnology and pharmaceutical companies, including AbbVie Biotechnology Ltd., or AbbVie; Bayer Pharma AG, or Bayer; Celldex Therapeutics, Inc., or Celldex; Genentech, Inc., a member of the Roche Group, or Genentech; GlaxoSmithKline LLC, or GSK; Pfizer, Inc., or Pfizer; and PSMA Development Company LLC, a subsidiary of Progenics Pharmaceuticals Inc., or Progenics. In addition, we have entered into a 50/50 co-development agreement with Agensys, Inc., an affiliate of Astellas, for the development of ADCs, including enfortumab vedotin. We also have an option for an ADC co-development agreement with Genmab A/S, or Genmab, and a collaboration with Unum Therapeutics, Inc., or Unum, to develop and commercialize novel antibody-coupled T-cell receptor, or ACTR, therapies incorporating our antibodies for the treatment of cancer.

Our ongoing research, development, manufacturing and commercial activities will require substantial amounts of capital and may not ultimately be successful. Over the next several years, we expect that we will incur substantial expenses, primarily as a result of activities related to the commercialization of ADCETRIS, and the continued development of ADCETRIS and enfortumab vedotin. Our product candidates are in relatively early stages of development and will require significant further development, financial resources and personnel to pursue and obtain regulatory approval and develop into commercially viable products, if at all. In addition, SGN-CD33A was our only

product candidate in late stage development and if we determine to discontinue development of SGN-CD33A, we will not have the anticipated revenues from SGN-CD33A to fund our operations, and we may not receive any return on our investment in SGN-CD33A. Our commitment of resources to the continuing development, regulatory and commercialization activities for ADCETRIS, the research, continued development and manufacturing of our product candidates and expansion of our pipeline will likely require us to raise substantial amounts of additional capital and our operating expenses may fluctuate as a result of such activities. In addition, we may incur significant milestone payment obligations to certain of our licensors as our product candidates progress through clinical trials towards potential commercialization.

We recognize revenue from ADCETRIS product sales in the United States and Canada. Our future ADCETRIS product sales are difficult to accurately predict from period to period. In this regard, our product sales have varied, and may continue to vary, significantly from period to period and may be affected by a variety of factors. Such factors include the incidence rate of new patients in ADCETRIS approved indications, customer ordering patterns, the overall level of demand for ADCETRIS, the duration of therapy for patients receiving ADCETRIS, and the extent to which coverage and reimbursement for ADCETRIS is available from government

Table of Contents

and other third-party payers. Obtaining and maintaining appropriate coverage and reimbursement for ADCETRIS is increasingly challenging due to, among other things, the attention being paid to healthcare cost containment and other austerity measures in the U.S. and worldwide, as well as increasing legislative and enforcement interest in the United States with respect to pharmaceutical drug pricing practices. We anticipate that healthcare reform measures that may be adopted in the future may result in more rigorous coverage criteria and an additional downward pressure on the price that we receive for ADCETRIS. We also anticipate that Congress, state legislatures, and third-party payors may continue to review and assess alternative healthcare delivery and payment systems and may in the future propose and adopt legislation or policy changes or implementations effecting additional fundamental changes in the healthcare delivery system, any of which could negatively affect our revenue or sales of ADCETRIS (or any future approved products). In addition, the competition ADCETRIS faces from competing therapies is intensifying, and we anticipate that we will continue to face increasing competition in the future as new companies enter our market and scientific developments surrounding biosimilars and other cancer therapies continue to accelerate. We also believe that the level of our current ADCETRIS sales in the United States has been attributable to the incidence flow of patients eligible for treatment with ADCETRIS, which can vary significantly from period to period. Moreover, we believe that the incidence rate in ADCETRIS approved indications is relatively low, particularly when compared to many other oncology indications. For these and other reasons, we expect that our ability to accelerate ADCETRIS sales growth, if at all, will depend primarily on our ability to continue to expand ADCETRIS labeled indications of use, particularly with respect to the frontline Hodgkin lymphoma and frontline MTCL indications. Our efforts to continue to expand ADCETRIS labeled indications of use will continue to require additional time and investment in clinical trials to complete and may not be successful. Our ability to successfully commercialize ADCETRIS and to continue to expand its labeled indications of use are subject to a number of risks and uncertainties, including those discussed in Part II, Item 1A of this Quarterly Report on Form 10-Q. In particular, although we reported positive top line data in both our ALCANZA and ECHELON-1 trials in August 2016 and June 2017, respectively, there can be no assurance that we will ultimately obtain regulatory approval of ADCETRIS in either of the ALCANZA or ECHELON-1 treatment settings, which would limit our sales of, and the commercial potential of, ADCETRIS. In addition, negative or inconclusive results in our ECHELON-2 trial would negatively impact, or preclude altogether, our ability to obtain regulatory approval in the frontline MTCL indication, which could also limit our sales of, and the commercial potential of, ADCETRIS. We also expect that amounts earned from our collaboration agreements, including royalties, will continue to be an important source of our revenues and cash flows. These revenues will be impacted by future development funding and the achievement of development, clinical and commercial success by our collaborators under our existing collaboration and license agreements, including our ADCETRIS collaboration with Takeda, as well as by entering into potential new collaboration and license agreements. Our results of operations may vary substantially from year to year and from quarter to quarter and, as a result, we believe that period to period comparisons of our operating results may not be meaningful and should not be relied upon as being indicative of our future performance.

Financial summary

For the six months ended June 30, 2017, total revenues increased to $217.4 million, compared to $206.6 million for the same period in 2016. This increase was driven primarily by higher ADCETRIS net product sales, offset in part by a decline in royalty revenues, which included a one-time $20.0 million milestone payment in the first quarter of 2016. Net product sales of ADCETRIS were $144.7 million for the six months ended June 30, 2017, compared to $124.9 million for the same period in 2016. For the six months ended June 30, 2017, total costs and expenses increased to $335.9 million, compared to $261.0 million for the same period in 2016. This primarily reflected increased investment in enfortumab vedotin and SGN-CD33A, as well as investment in our growing pipeline of pre-clinical and clinical-stage programs. As of June 30, 2017, we had $473.0 million in cash, cash equivalents and short- and long-term investments, and $573.5 million in total stockholders equity.

Results of operations

Three and six months ended June 30, 2017 and 2016

Net product sales

We sell ADCETRIS in the U.S. and Canada. Our net product sales were as follows ($ in thousands):

	Three months ended June 30,			Six months ended June 30,		
	2017	**2016**	**% Change**	**2017**	**2016**	**% Change**
Net product sales	$ 74,343	$ 66,216	12%	$ 144,664	$ 124,864	16%

The increase in net product sales for the three and six months ended June 30, 2017 over the comparable periods in 2016 primarily resulted from an increase in sales volume, and to a lesser extent, from the effect of price increases instituted since the 2016 period. The increase in sales volume was primarily driven by increased use of ADCETRIS across multiple lines of therapy in Hodgkin lymphoma and for the treatment of other CD30-expressing malignancies.

Table of Contents

We expect continued growth in ADCETRIS sales in 2017 as compared to 2016. Our ability to accelerate the rate of ADCETRIS sales growth in future periods, if at all, will be primarily dependent on our ability to continue to expand ADCETRIS labeled indications of use. Our efforts to expand ADCETRIS labeled indications of use will continue to require additional time and investment in clinical trials to complete and may not be successful.

We sell ADCETRIS through a limited number of pharmaceutical distributors. Customers order ADCETRIS through these distributors and we typically ship product directly to the customer. We record product sales when title and risk of loss pass, which generally occurs upon delivery of the product to the customer. Product sales are recorded net of estimated government-mandated rebates and chargebacks, distribution fees, estimated product returns and other deductions. These are generally referred to as gross-to-net deductions. Accruals are established for these deductions and actual amounts incurred are offset against applicable accruals. We reflect these accruals as either a reduction in the related account receivable from the distributor, or as an accrued liability depending on the nature of the sales deduction. Sales deductions are based on our estimates that consider payer mix in target markets and our experience to date. These estimates involve a substantial degree of judgment.

Government-mandated rebates and chargebacks: We have entered into a Medicaid Drug Rebate Agreement with the Centers for Medicare & Medicaid Services. This agreement provides for a rebate to participating states based on covered purchases of ADCETRIS. Medicaid rebates are invoiced to us by the various state Medicaid programs. We estimate Medicaid rebates based on a variety of factors, including our experience to date. We also have completed our Federal Supply Schedule, or FSS, agreement under which certain U.S. government purchasers receive a discount on eligible purchases of ADCETRIS. We have entered into a Pharmaceutical Pricing Agreement with the Secretary of Health and Human Services which enables certain entities that qualify for government pricing under the Public Health Services Act, or PHS, to receive discounts on their qualified purchases of ADCETRIS. Under these agreements, distributors process a chargeback to us for the difference between wholesale acquisition cost and the applicable discounted price. As a result of our direct-ship distribution model, we can identify the entities purchasing ADCETRIS and this information enables us to estimate expected chargebacks for FSS and PHS purchases based on each entity s eligibility for the FSS and PHS programs. We also review actual rebate and chargeback information to further refine these estimates.

Distribution fees, product returns and other deductions: Our distributors charge a volume-based fee for distribution services that they perform for us. We allow for the return of product that is within 30 days of its expiration date or that is damaged. We estimate product returns based on our experience to date. In addition, we consider our direct-ship distribution model, our belief that product is not typically held in the distribution channel, and the expected rapid use of the product by healthcare providers. We provide financial assistance to qualifying patients that are underinsured or cannot cover the cost of commercial coinsurance amounts through SeaGen Secure. SeaGen Secure is available to patients in the U.S. and its territories who meet various financial and treatment need criteria. Estimated contributions for commercial coinsurance under SeaGen Secure are deducted from gross sales and are based on an analysis of expected plan utilization. These estimates are adjusted as necessary to reflect our actual experience.

Gross-to-net deduction accruals, net of related payments and credits, are summarized as follows (in thousands):

	Rebates and chargebacks	Distribution fees, product returns and other	Total
Balance as of December 31, 2016	$ 9,500	$ 3,198	$ 12,698
Provision related to current period sales	46,235	3,627	49,862

Adjustment for prior period sales	614	(196)	418
Payments/credits for current period sales	(38,889)	(2,162)	(41,051)
Payments/credits for prior period sales	(7,736)	(1,220)	(8,956)
Balance as of June 30, 2017	$ 9,724	$ 3,247	$ 12,971

Mandatory government discounts are the most significant component of our total gross-to-net deductions and the discount percentage has been increasing. These discount percentages increased during the three and six months ended June 30, 2017 over the comparable periods in 2016 as a result of price increases we instituted that exceeded the rate of inflation, and to a lesser extent, as a result of an increase in sales eligible for government mandated rebates or chargebacks. Generally, the change in government prices is limited to the rate of inflation. We expect future gross-to-net deductions to fluctuate based on the volume of purchases eligible for government mandated discounts and rebates, as well as changes in the discount percentage, which is impacted by potential future price increases, the rate of inflation, and other factors.

Table of Contents

As a result of price increases and a continued increase in the percentage of our gross sales that are eligible for government mandated rebates and chargebacks, we expect gross-to-net deductions to increase in 2017. In recent months there has been extensive discussion in the United States about expanding government discount programs, including allowing Medicare to negotiate drug prices, and pressure on pharmaceutical drug pricing is expected to increase. If government discounted programs are expanded or discounts increased as a result of changes in regulations in the United States, our gross to net deductions will increase and our net sales will be negatively impacted.

Collaboration and license agreement revenues

Our proprietary ADC technologies are the basis of our ADC collaborations that we have entered into in the ordinary course of business with a number of biotechnology and pharmaceutical companies. Under these ADC collaboration agreements, we grant our collaborators research and commercial licenses to our technology and typically provide technology transfer services, technical advice, supplies and services for a period of time.

If there are continuing performance obligations, we use a time-based proportional performance model to recognize revenue over our performance period for the related agreement. Collaboration and license agreements are evaluated to determine whether the multiple elements and associated deliverables can be considered separate units of accounting. To date, the pre-commercial deliverables under our collaboration and license agreements have not qualified as separate units of accounting. The assessment of multiple element arrangements requires judgment in order to determine the appropriate point in time, or period of time, that revenue should be recognized. We believe that the development period in each agreement is a reasonable estimate of the performance obligation period of such agreement. Accordingly, all amounts received or due, including any upfront payments, maintenance fees, development and regulatory milestone payments and reimbursement payments, are recognized as revenue over the performance obligation periods of each agreement. These performance obligation periods typically range from one to three years. The agreements with Takeda and Genentech have performance obligation periods of ten and seventeen years, respectively. All of the remaining performance obligation periods for our active collaborations are currently expected to be completed in three years or less. When no performance obligations are required of us, or following the completion of the performance obligation period, such amounts are recognized as revenue when collectibility is reasonably assured. Generally, all amounts received or due other than sales-based milestones and royalties are classified as collaboration and license agreement revenues as they are earned. Sales-based milestones and royalties are recognized as royalty revenue as they are reported to us.

Our collaboration and license agreements include contractual milestones. Generally, the milestone events contained in our collaboration and license agreements coincide with the progression of the collaborators product candidates from development to regulatory approval and then to commercialization.

Development milestones in our collaborations may include the following types of events:

Designation of a product candidate or initiation of pre-clinical studies. Our collaborators must undertake significant pre-clinical research and studies to make a determination of the suitability of a product candidate and the time from those studies or designation to initiation of a clinical trial may take several years.

Initiation of a phase 1 clinical trial. Generally, phase 1 clinical trials may take one to two years to complete.

Initiation of a phase 2 clinical trial. Generally, phase 2 clinical trials may take one to three years to complete.

Initiation of a phase 3 clinical trial. Generally, phase 3 clinical trials may take two to six years to complete.

Regulatory milestones in our collaborations may include the following types of events:

Filing of regulatory applications for marketing approval such as a BLA in the United States or a Marketing Authorization Application in Europe. Generally, it may take up to twelve months to prepare and submit regulatory filings.

Receiving marketing approval in a major market, such as in the United States, Europe, Japan or other significant countries. Generally it may take up to three years after a marketing application is submitted to obtain approval for marketing and pricing from the applicable regulatory agency.

Commercialization milestones in our collaborations may include the following types of events:

First commercial sale in a particular market, such as in the United States, Europe, Japan or other significant countries.

Product sales in excess of a pre-specified threshold. The amount of time to achieve this type of milestone depends on several factors, including, but not limited to, the dollar amount of the threshold, the pricing of the product, market penetration of the product and the rate at which customers begin using the product.

Table of Contents

Our ADC collaborators are solely responsible for the development of their product candidates and the achievement of milestones in any of the categories identified above is based solely on the collaborators efforts.

In the case of our ADCETRIS collaboration with Takeda, we may be involved in certain development activities; however, the achievement of development, regulatory and commercial milestone events under the agreement is primarily based on activities undertaken by Takeda.

The process of successfully developing a product candidate, obtaining regulatory approval and ultimately commercializing a product candidate is highly uncertain and the attainment of any milestones is therefore uncertain and difficult to predict. In addition, since we do not take a substantive role or control the research, development or commercialization of any products generated by our ADC collaborators, we are not able to reasonably estimate when, if at all, any milestone payments or royalties may be payable to us by our ADC collaborators. As such, the milestone payments associated with our ADC collaborations involve a substantial degree of uncertainty and risk that they may never be received. Similarly, even in those collaborations where we may have an active role in the development of the product candidate, such as our ADCETRIS collaboration with Takeda, the attainment of a milestone is based on the collaborator s activities and is generally outside our direction and control.

We generally invoice our collaborators and licensees on a monthly or quarterly basis, or upon the completion of the effort or achievement of a milestone, based on the terms of each agreement. Any deferred revenue arising from amounts received in advance of the culmination of the earnings process is recognized as revenue in future periods when the applicable revenue recognition criteria have been met. Deferred revenue expected to be recognized within the next twelve months is classified as a current liability.

Collaboration and license agreement revenues by collaborator are summarized as follows ($ in thousands):

	Three months ended June 30,			Six months ended June 30,		
	2017	2016	% Change	2017	2016	% Change
Takeda	$ 17,227	$ 9,556	80%	$ 37,493	$ 22,442	67%
AbbVie	3,324	6,289	(47)%	4,044	10,494	(61)%
Other	954	4,153	(77)%	1,798	7,238	(75)%
Total	$ 21,505	$ 19,998	8%	$ 43,335	$ 40,174	8%

Collaboration revenues from Takeda fluctuate based on changes in the earned portion of reimbursement funding under the ADCETRIS collaboration, which are influenced by the activities each party is performing under the collaboration agreement at a given time. Collaboration revenues from Takeda increased during the three and six months ended June 30, 2017 from the comparable periods in 2016, primarily driven by an increase in drug product supply activities.

Revenues from AbbVie decreased during the three and six months ended June 30, 2017 from the comparable periods in 2016 primarily due to the completion of the performance obligation period in 2016, over which the upfront payments, maintenance fees, development milestone payments were being amortized, offset partially by maintenance fees earned in 2017.

Changes in revenues recognized from our other collaboration agreements, which include our ADC collaborations and our co-development collaborations, reflect the timing of development milestones and licensing fees.

Our collaboration and license agreement revenues are impacted by the term and duration of our collaboration and license agreements and by progress-dependent milestones, annual maintenance fees and reimbursement of materials and support services. Collaboration and license agreement revenues may vary substantially from year to year and quarter to quarter depending on the progress made by our collaborators with their product candidates, the level of support we provide to our collaborators, specifically to Takeda under our ADCETRIS collaboration, the timing of milestones achieved and our ability to enter into additional collaboration and co-development agreements. We expect our collaboration and license agreement revenues in 2017 to be consistent with 2016. We have a significant balance of deferred revenue, representing prior payments from our collaborators that have not yet been recognized as revenue. This deferred revenue will be recognized as revenue in future periods using a time-based approach as we fulfill our performance obligations.

Table of Contents

Collaboration agreements

Takeda

Our ADCETRIS collaboration with Takeda provides for the global co-development of ADCETRIS by the companies and the commercialization of ADCETRIS by Takeda in its territory. We received an upfront payment and have received and are entitled to receive progress-dependent milestone payments based on Takeda s achievement of significant events under the collaboration, in addition to tiered royalties with percentages starting in the mid-teens and escalating to the mid-twenties based on net sales of ADCETRIS within Takeda s licensed territories. Additionally, the companies equally co-fund the cost of selected development activities conducted under the collaboration. We recognize as collaboration revenue the upfront payment, progress-dependent milestone payments, and net development cost reimbursement payments from Takeda over the ten-year development period of the collaboration, which began in December 2009. When the performance of development activities under the collaboration results in us making a reimbursement payment to Takeda, the effect is to reduce the amount of collaboration revenue that we record. We also receive reimbursement for the cost of drug product supplied to Takeda for its use and, in some cases, pay Takeda for drug product they supply to us. The earned portion of net collaboration payments is reflected as a component of collaboration and license agreement revenues.

As of June 30, 2017, total future potential milestone payments to us under the ADCETRIS collaboration could total approximately $165 million. Of the remaining amount, up to approximately $7 million relates to the achievement of development milestones, up to approximately $118 million relates to the achievement of regulatory milestones and up to approximately $40 million relates to the achievement of commercial milestones. As of June 30, 2017, $70 million in milestones had been achieved as a result of regulatory and commercial progress by Takeda.

Astellas

We entered into an agreement with Agensys, subsequently acquired by Astellas, to jointly research, develop and commercialize ADCs for the treatment of several types of cancer. The collaboration encompasses combinations of our ADC technology with fully-human antibodies developed by Astellas to proprietary cancer targets.

Under the collaboration agreement, we and Astellas are co-funding all development and commercialization costs for enfortumab vedotin and ASG-15ME, and will share in any profits that may come from these product candidates if successfully commercialized on a 50/50 basis. Costs associated with co-development activities are included in research and development expense.

Astellas is developing another ADC product candidate on its own, subject to paying us annual maintenance fees, milestones, royalties and support fees for research and development services and material provided under the collaboration agreement. Amounts received for this product candidate being developed solely by Astellas are recognized as revenue.

Unum Therapeutics

We have a strategic collaboration and license agreement with Unum to develop and commercialize novel ACTR therapies incorporating our antibodies for cancer. We and Unum are developing two ACTR product candidates that combine Unum s ACTR technology with our antibodies. Unum is obligated to conduct preclinical research and clinical development activities through phase 1 clinical trials and we are obligated to provide funding for these activities. The agreement calls for us to work together to co-develop and jointly fund programs after phase 1 clinical trials unless either company opts out. Costs associated with co-development activities are included in research and development

expense.

We and Unum would co-commercialize any successfully developed product candidates and share any profits 50/50 on any co- developed programs in the United States. We retain exclusive commercial rights outside of the United States, paying Unum a royalty that is a high single digit to mid-teens percentage of ex-U.S. sales, if any. The potential future licensing and progress-dependent milestone payments to Unum under the collaboration may total up to $400 million between the two ACTR programs, payment of which is triggered by the achievement of development, regulatory and commercial milestones.

ADC Collaboration Agreements

We have other active collaborations with a number of companies to allow them to use our proprietary ADC technology. Under our ADC collaborations, which we have entered into in the ordinary course of business, we typically receive or are entitled to receive upfront cash payments, progress-dependent milestones and royalties on net sales of products incorporating our ADC technology, as well as annual maintenance fees and support fees for research and development services and materials provided under the agreements. These amounts are recognized as revenue as they are realized, or over the performance obligation period of the agreements during which we provide limited support to the collaborator. Our ADC collaborators are responsible for development, manufacturing and commercialization of any ADC product candidates that result from the collaborations and are solely responsible for the achievement of the potential milestones under these collaborations.

Table of Contents

As of June 30, 2017, our ADC collaborations and co-development agreements had generated cash of more than $350 million, primarily in the form of upfront payments. Total milestone payments to us under our current ADC collaboration and co-development agreements could total up to approximately $3.0 billion if all potential product candidates achieved all of their milestone events. Of this amount, approximately $0.5 billion relates to the achievement of development milestones, approximately $1.1 billion relates to the achievement of regulatory milestones and approximately $1.4 billion relates to the achievement of commercial milestones. Since we do not control the research, development or commercialization of any of the products that would generate these milestones, we are not able to reasonably estimate when, if at all, any milestone payments or royalties may be payable by our collaborators. Successfully developing a product candidate, obtaining regulatory approval and ultimately commercializing it is a significantly lengthy and highly uncertain process which entails a significant risk of failure. In addition, business combinations, changes in a collaborator s business strategy and financial difficulties or other factors could result and have resulted in a collaborator abandoning or delaying development of its product candidates. As such, the milestone payments associated with our ADC collaborations and co-development agreements involve a substantial degree of risk and may never be received. Accordingly, we do not expect, and investors should not assume, that we will receive all of the potential milestone payments described above and it is possible that we may never receive any significant milestone payments under these agreements.

Royalty revenues and cost of royalty revenues

Royalty revenues primarily reflect royalties paid to us by Takeda under the ADCETRIS collaboration. These royalties include commercial sales-based milestones and sales royalties. The royalty rate paid by Takeda is calculated as a percentage of Takeda s net sales of ADCETRIS, ranges from the mid-teens to the mid-twenties depending on sales volumes, and resets annually. Takeda bears a portion of third-party royalty costs owed on sales of ADCETRIS in its territory. This amount is included in our royalty revenues. Cost of royalty revenues reflect amounts owed to our third-party licensors related to the sale of ADCETRIS in Takeda s territory.

Our royalty revenues and cost of royalty revenues were as follows ($ in thousands):

	Three months ended June 30,			Six months ended June 30,		
	2017	2016	% Change	2017	2016	% Change
Royalty revenues	$ 12,375	$ 9,188	35%	$ 29,355	$ 41,519	(29)%
Cost of royalty revenues	$ 4,324	$ 3,107	39%	$ 8,704	$ 6,722	29%

Royalty revenues increased for the three months ended June 30, 2017 as compared to 2016, driven by higher sales volumes by Takeda in its territories. Royalty revenues for the six months ended June 30, 2017 decreased from the comparable period in 2016 as the six months ended June 30, 2016 included a one-time $20.0 million milestone payment triggered by Takeda s exceeding $200 million in annual sales for the first time. The decrease driven by the milestone payment in the 2016 period was partially offset by increases in sales volume in the 2017 period.

Cost of royalty revenues fluctuates based on the amount of net sales of ADCETRIS by Takeda in its territories.

We expect that royalty revenues will decrease in 2017 as compared to 2016 primarily as a result of the 2016 royalty revenues including the one-time $20 million sales milestone payment. We expect cost of royalty revenues to increase in 2017 primarily due to anticipated increases in sales volumes in Takeda s territories, and to a lesser extent, increases

in the applicable royalty rates.

Cost of sales

ADCETRIS cost of sales includes manufacturing costs of product sold, third-party royalty costs, amortization of technology license costs, and distribution and other costs. Our cost of sales was as follows ($ in thousands):

	Three months ended June 30,			Six months ended June 30,		
	2017	**2016**	**% Change**	**2017**	**2016**	**% Change**
Cost of sales	$ 8,055	$ 6,901	17%	$ 15,536	$ 12,845	21%

Table of Contents

Cost of sales increased during the three and six months ended June 30, 2017 as compared to 2016 primarily due to increased sales volumes. We expect cost of sales to increase in 2017, primarily due to anticipated increases in sales volumes.

Research and development

Our research and development expenses are summarized as follows ($ in thousands):

	Three months ended June 30,			Six months ended June 30,		
	2017	**2016**	**% Change**	**2017**	**2016**	**% Change**
Research	$ 17,848	$ 15,619	14%	$ 34,603	$ 30,859	12%
Development and contract manufacturing	43,516	31,608	38%	92,426	66,966	38%
Clinical	53,042	38,327	38%	105,561	80,600	31%
Total research and development expenses	$ 114,406	$ 85,554	34%	$ 232,590	$ 178,425	30%

Research expenses include, among other things, personnel, occupancy and laboratory expenses, technology access fees associated with the discovery and identification of new monoclonal antibodies and related technologies, and the development of novel classes of stable linkers and cell-killing agents for our ADC technology. Research expenses also include research activities associated with our product candidates, such as preclinical translational biology and *in vitro* and *in vivo* studies, and IND-enabling pharmacology and toxicology studies. The increase in research expenses during the three and six months ended June 30, 2017 as compared to the same periods in 2016 primarily reflects increases in staffing and related occupancy costs.

Development and contract manufacturing expenses include personnel and occupancy expenses, external contract manufacturing costs for the scale up and pre-approval manufacturing of drug product used in research and our clinical trials, and costs for drug product supplied to our collaborators. Development and contract manufacturing expenses also include quality control and assurance activities, and storage and shipment of our product candidates. The increase in development and contract manufacturing expenses during the three and six months ended June 30, 2017 as compared to the same periods in 2016 primarily reflects increased drug product supplied to Takeda, and to a lesser extent, increases in staffing and other costs to support our growing pipeline of product candidates.

Clinical expenses include personnel, travel, occupancy costs, and external clinical trial costs including costs for clinical sites, clinical research organizations, contractors and regulatory activities associated with conducting human clinical trials. The increase in clinical expenses during the three and six months ended June 30, 2017 as compared to the same periods in 2016 reflects increased clinical trial activity related to our product candidates, primarily SGN-CD33A and enfortumab vedotin, and related increases in staffing.

We utilize our employee and infrastructure resources across multiple development projects as well as our discovery and research programs directed towards identifying monoclonal antibodies and new classes of stable linkers and cell-killing agents for our ADC program. We track human resource efforts expended on many of our programs for purposes of billing our collaborators for time incurred at agreed upon rates and for resource planning. We do not account for actual costs on a project-by-project basis as it relates to our infrastructure, facility, employee and other indirect costs. We do, however, separately track significant third-party costs including clinical trial costs, manufacturing costs and other contracted service costs on a project-by-project basis.

The following table shows expenses incurred for research, contract manufacturing of our product candidates and clinical and regulatory services provided by third parties as well as pre-commercial milestone payments for in-licensed technology for ADCETRIS and each of our clinical-stage product candidates. The table also presents other third-party costs and overhead consisting of personnel, facilities and other indirect costs not directly charged to these development programs.

Table of Contents

Development program ($ in thousands)	Three months ended June 30, 2017	Three months ended June 30, 2016	Six months ended June 30, 2017	Six months ended June 30, 2016	Five years ended June 30, 2017
ADCETRIS (brentuximab vedotin)	$ 18,191	$ 14,613	$ 41,928	$ 36,778	$ 312,195
SGN-CD33A (vadastuximab talirine)	13,075	10,926	29,563	22,006	113,561
ASG-22ME (enfortumab vedotin)	3,754	1,728	11,696	2,292	26,169
Other clinical stage programs	8,373	7,770	16,610	14,766	117,243
Total third-party costs	43,393	35,037	99,797	75,842	569,168
Other costs and overhead	71,013	50,517	132,793	102,583	875,684
Total research and development	$ 114,406	$ 85,554	$ 232,590	$ 178,425	$ 1,444,852

Third-party costs for ADCETRIS increased during the three and six months ended June 30, 2017 from the comparable periods in 2016, primarily due to an increase in drug product supplied to Takeda, offset partially by a decrease in clinical trial activities. The cost of drug product supplied to Takeda is charged to research and development expense. We are reimbursed for the drug product, which is included as a component of collaboration revenue.

Third-party costs for SGN-CD33A increased during the three and six months ended June 30, 2017 from the comparable periods in 2016 primarily due to an increase in clinical trial costs related to the phase 3 CASCADE clinical trial.

Third-party costs for enfortumab vedotin increased during the three and six months ended June 30, 2017 from the comparable periods in 2016 primarily due to an increase in drug supply activities and, to a lesser extent, clinical trial costs as we prepare to initiate additional clinical trials in 2017.

Other costs and overhead include third-party costs of our other preclinical programs, including our strategic collaboration with Unum, and costs associated with personnel and facilities. These costs increased during the three and six months ended June 30, 2017 from the comparable periods in 2016 due to development activities to expand our product pipeline, including increases in staffing levels and the expansion of our facilities to accommodate our growth.

Our expenditures on our ADCETRIS clinical development program and on our current and future preclinical and clinical development programs are subject to numerous uncertainties in timing and cost to completion. In order to advance our product candidates toward commercialization, the product candidates are tested in numerous preclinical safety, toxicology and efficacy studies. We then conduct clinical trials for those product candidates that take several years or more to complete. The length of time varies substantially based upon the type, complexity, novelty and intended use of a product candidate. Likewise, in order to expand ADCETRIS labeled indications of use, we are required to conduct additional extensive clinical trials. The cost of clinical trials may vary significantly over the life of a project as a result of a variety of factors, including:

- the number of patients required in our clinical trials;
- the length of time required to enroll trial participants;

the number and location of sites included in the trials;

the costs of producing supplies of the product candidates needed for clinical trials and regulatory submissions;

the safety and efficacy profile of the product candidate;

the use of clinical research organizations to assist with the management of the trials; and

the costs and timing of, and the ability to secure, regulatory approvals.

We anticipate that our total research and development expenses in 2017 will increase compared to 2016 due to an increase in ADCETRIS costs related to drug product supplied to Takeda, as well as increased costs for the development of our product candidates, primarily enfortumab vedotin and SGN-LIV1A, and the purchase of the BMS manufacturing facility. Certain ADCETRIS development activities, including some clinical studies, will be conducted by Takeda, the costs of which are not reflected in our research and development expenses. Because of these and other factors, expenses will fluctuate based upon many factors, including the degree of collaborative activities, timing of manufacturing campaigns, numbers of patients enrolled in our clinical trials and the outcome of each clinical trial event.

The risks and uncertainties associated with our research and development projects are discussed more fully in Part II, Item 1A Risk Factors. As a result of the uncertainties discussed above, we are unable to determine with any degree of certainty the duration and completion costs of our research and development projects, anticipated completion dates or when and to what extent we will receive cash inflows from the commercialization and sale of ADCETRIS in any additional approved indications or of any of our product candidates.

Table of Contents

Selling, general and administrative

Selling, general and administrative ($ in thousands)	Three months ended June 30, 2017	2016	% Change	Six months ended June 30, 2017	2016	% Change
Selling, general and administrative	$ 40,712	$ 33,282	22%	$ 79,116	$ 63,029	26%

Selling, general and administrative expenses increased during the three and six months ended June 30, 2017 from the comparable periods in 2016 primarily due to increases in staffing to support our continued growth, and to a lesser extent, increases in expenses for legal matters.

We anticipate that selling, general and administrative expenses will increase in 2017 compared to 2016 as we continue our commercial activities in support of the commercialization of ADCETRIS, as well as our support of general operations.

Investment and other income, net

Investment and other income, net ($ in thousands)	Three months ended June 30, 2017	2016	% Change	Six months ended June 30, 2017	2016	% Change
Investment and other income, net	$ 2,914	$ 699	317%	$ 2,242	$ 1,243	80%

Investment and other income, net includes other non-operating income and amounts earned on our investments in U.S. Treasury securities. The increase in investment and other income, net for the three and six month periods ended June 30, 2017 from the comparable periods in 2016 is primarily related to an estimated tax benefit for unrealized gains on our investment in Immunomedics common stock. For the six months ended June 30, 2017 as compared to 2016, the increase is offset partially by the impairment of our investment in the Immunomedics warrant.

Liquidity and capital resources

Selected balance sheet and cash flow data ($ in thousands)	June 30, 2017	December 31, 2016
Cash, cash equivalents, and short- and long-term investments	$ 472,983	$ 618,974
Working capital	478,230	586,132
Stockholders equity	573,532	634,087

	Six months ended June 30, 2017	2016
Cash provided by (used in):		
Operating activities	$ (108,275)	$ (50,328)

Investing activities	181,323	129,663
Financing activities	15,383	10,498

Our combined cash, cash equivalents and investment securities decreased during the six months ended June 30, 2017 from the balance at December 31, 2016, primarily reflecting our net loss for the period, as well as purchases of property and equipment as we expand our facilities to support our growth.

The changes in net cash used in operating activities are primarily related to our net loss, working capital fluctuations and changes in our non-cash expenses, all of which are highly variable. The changes in cash provided by investing activities primarily reflect differences between the proceeds received from sale and maturity of our investments and amounts reinvested, and to a lesser extent, increases in our purchases of property and equipment as we initiated a purchase of a manufacturing facility and continued to expand our facilities to support our growth. Net cash provided by financing activities resulted from the proceeds of stock option exercises and our employee stock purchase plan.

Table of Contents

We have primarily financed our operations through the issuance of equity securities, collections from commercial sales of ADCETRIS, and by amounts received pursuant to product collaborations and our ADC collaborations. To a lesser degree, we have also financed our operations through royalty revenues and interest earned on cash, cash equivalents and investment securities. These financing and revenue sources have historically allowed us to maintain adequate levels of cash and investments.

Our cash, cash equivalents, and investments in debt securities are held in a variety of non-interest bearing bank accounts and interest-bearing instruments subject to investment guidelines allowing for holdings in U.S. government and agency securities, corporate securities, taxable municipal bonds, commercial paper and money market accounts. Our investment portfolio is structured to provide for investment maturities and access to cash to fund our anticipated working capital needs. However, if our liquidity needs should be accelerated for any reason in the near term, or investments do not pay at maturity, we may be required to sell investments in debt securities in our portfolio prior to their scheduled maturities, which may result in a loss. As of June 30, 2017, we had $452.4 million held in cash and cash equivalents, or short-term investments scheduled to mature within the next twelve months.

At our currently planned spending rates we believe that our financial resources, together with product and royalty revenues from sales of ADCETRIS and the fees, milestone payments and reimbursements we expect to receive under our existing collaboration and license agreements, will be sufficient to fund our operations for at least the next twelve months. Changes in our spending rate may occur that would consume available capital resources sooner, such as increased development, manufacturing and clinical trial expenses in connection with our expanding pipeline programs, including several phase 3 trials, or our undertaking of additional programs, business activities, or entry into strategic transactions, including potential additional acquisitions of products, technologies or businesses. Accordingly, we may be required to, or may otherwise determine to, raise additional capital to fund those obligations. Further, in the event of a termination of the ADCETRIS collaboration agreement with Takeda, we would not receive development cost sharing payments or milestone payments or royalties for the development or sale of ADCETRIS in Takeda s territory, and we would be required to fund all ADCETRIS development and commercial activities. Any of these factors could lead to a need for us to raise additional capital.

We expect to make additional capital outlays and to increase operating expenditures over the next several years as we hire additional employees, support our preclinical development, manufacturing and clinical trial activities for ADCETRIS and our other pipeline programs, and expand internationally, as well as commercialize ADCETRIS and position ADCETRIS for potential additional regulatory approvals. Our commitment of resources to the continuing development, regulatory and commercialization activities for ADCETRIS, and the research, continued development and manufacturing of our product candidates will likely require us to raise substantial amounts of additional capital. Further, we actively evaluate various strategic transactions on an ongoing basis, including licensing or otherwise acquiring complementary products, technologies or businesses, and we may require significant additional capital in order to complete or otherwise provide funding for any additional acquisitions. We may seek additional funding through some or all of the following methods: corporate collaborations, licensing arrangements and public or private debt or equity financings. We do not know whether additional capital will be available when needed, or that, if available, we will obtain financing on terms favorable to us or our stockholders. If we are unable to raise additional funds when we need them, we may be required to delay, reduce the scope of, or eliminate one or more of our development programs, which may adversely affect our business and operations.

Commitments

Our future minimum contractual commitments were reported in our Annual Report on Form 10-K for the year ended December 31, 2016, as filed with the SEC. Our future minimum contractual commitments, as reported in our Annual Report on Form 10-K for the year ended December 31, 2016, do not include our commitments under the development

and license agreement, or the Immunomedics License, that we entered into with Immunomedics, Inc., or Immunomedics, in February 2017. In May 2017, we and Immunomedics agreed to terminate the Immunomedics License. Such termination will be effective thirty days following the entry on July 25, 2017 of a final judgment by the Delaware Chancery Court approving our dismissal from the lawsuit filed by venBio Select Advisors LLC, as described in more detail under Part II, Item 1 of this Quarterly Report on Form 10-Q. Accordingly, we do not expect to incur any payment obligations to Immunomedics under the Immunomedics License and there were otherwise no material changes from the contractual commitments previously disclosed in our Annual Report on Form 10-K during the six months ended June 30, 2017.

In July 2017, we entered into certain agreements to acquire a biologics manufacturing facility located in Bothell, Washington, as described in more detail under Part II, Item 5 of this Quarterly Report on Form 10-Q. Under these agreements, we completed the acquisition of the manufacturing facility site location for a purchase price to us of $17.8 million, which was recorded in property, plant and equipment as of June 30, 2017. As part of the transaction, we entered into an asset purchase agreement pursuant to which we agreed to acquire certain plant equipment and improvements upon the closing of the transactions contemplated by the asset purchase agreement in exchange for a payment from us of approximately $25.5 million. The closing of the transactions contemplated by the asset purchase agreement is expected to occur in the second half of 2017.

Recent accounting pronouncements

In May 2014, the Financial Accounting Standards Board, or FASB, issued an Accounting Standards Update entitled ASU 2014-09, Revenue from Contracts with Customers. The standard requires entities to recognize revenue through an evaluation that includes identification of the contract, identification of the performance obligations, determination of the transaction price, allocation of the transaction price to the performance obligations, and recognition of revenue as the entity satisfies the performance obligations. In August 2015, FASB issued an Accounting Standards Update entitled ASU 2015-14, Revenue from Contracts with Customers: Deferral of the Effective Date , which defers the effective date of ASU 2014-09 to our fiscal year beginning January 1, 2018. The FASB has continued to issue accounting standards updates to clarify and provide implementation guidance related to Revenue from Contracts with Customers, including ASU 2016-08, Revenue from Contract with Customers: Principal versus Agent Considerations ,

Table of Contents

ASU 2016-10, Revenue from Contracts with Customers: Identifying Performance Obligations and Licensing , ASU 2016-12, Revenue from Contracts with Customers: Narrow-Scope Improvements and Practical Expedients and ASU 2016-20, Technical Corrections and Improvements to Topic 606, Revenue from Contracts with Customers. Our preliminary assessment of this new standard is that it will generally not change the way in which we recognize product revenue from sales of ADCETRIS. However, we expect that sales-based royalties and commercial sales-based milestones will be recorded in the period of the related sale based on estimates, rather than recording them as reported by the customer. In addition, we expect that the achievement of development milestones under our collaborations will be recorded in the period their achievement becomes probable, which may result in their recognition earlier than under current accounting principles. The new standard also requires more extensive disclosures related to revenue recognition, particularly in quarterly financial statements. We will adopt the standard on January 1, 2018 and intend to use the modified retrospective method of adoption. We are continuing to evaluate the impact of the standard on all of our revenues, including those mentioned above, and our assessments may change in the future based on our ongoing evaluation.

In January 2016, FASB issued an Accounting Standards Update entitled ASU 2016-01, Financial Instruments: Overall. The standard addresses certain aspects of recognition, measurement, presentation and disclosure of financial instruments. We will adopt the standard on January 1, 2018 using a modified retrospective approach. The standard will require us to record changes in the fair value of equity securities in net income or loss. The implementation of this standard is expected to increase the volatility of net income or loss to the extent that we continue to hold equity securities.

In February 2016, FASB issued an Accounting Standards Update entitled ASU 2016-02, Leases. The standard requires entities to recognize in the consolidated balance sheet a liability to make lease payments and a right-of-use asset representing its right to use the underlying asset for the lease term. The standard will become effective for us beginning January 1, 2019, with early adoption permitted. We are currently evaluating the guidance to determine the potential impact on our financial condition, results of operations and cash flows, and financial statement disclosures, and expect that the adoption of the standard will increase assets and liabilities related to our operating leases in our consolidated balance sheets.

In March 2016, FASB issued an Accounting Standard Update entitled ASU 2016-09, Compensation Stock Compensation. The standard is intended to simplify certain elements of accounting for share-based payment transactions, including the income tax impact, classification of awards as either equity or liabilities, and classification on the statement of cash flows. In addition, the standard allows an entity-wide accounting policy election to either estimate the number of awards that are expected to vest, as currently required, or account for forfeitures when they occur. We have elected to continue estimating the number of awards that are expected to vest. We adopted the standard as of January 1, 2017. Since we have incurred net losses since our inception and maintain a full valuation allowance on our net deferred tax assets, the adoption did not have a material impact on our financial condition, results of operations and cash flows.

In October 2016, FASB issued an Accounting Standard Update entitled ASU 2016-16, Accounting for Income Taxes: Intra-Entity Asset Transfers of Assets Other than Inventory. The standard is intended to simplify the accounting for intercompany sales of assets other than inventory. Under current GAAP, the tax effects of intra-entity asset transfers are deferred until the transferred asset is sold to a third party or otherwise recovered through use. Under the new guidance, a reporting entity would recognize the tax expense from the sale of the asset in the seller s jurisdiction when the transfer occurs, even though the pre-tax effects of that transaction are eliminated in consolidation. Any deferred tax asset that arises in the buyer s jurisdiction would also be recognized at the time of the transfer. The standard will become effective for us beginning on January 1, 2018. We are currently evaluating the new standard; however, since we have incurred net losses since our inception and maintain a full valuation allowance on our net deferred tax assets,

the adoption is not expected to have a material impact on our financial condition, results of operations and cash flows, or financial statement disclosures.

In June 2016, FASB issued an Accounting Standard Update entitled ASU 2016-13, Financial Instruments: Credit Losses. The objective of the standard is to provide information about expected credit losses on financial instruments at each reporting date, and to change how other than temporary impairments on investments securities are recorded. The standard will become effective for us beginning on January 1, 2020 with early adoption permitted. We are currently evaluating the guidance to determine the potential impact on our financial condition, results of operations and cash flows, and financial statement disclosures.

In January 2017, FASB issued an Accounting Standard Update entitled, ASU 2017-01, Business Combinations: Clarifying the Definition of a Business. The objective of the standard is to clarify the definition of a business with the objective of adding guidance to assist entities with evaluating whether transactions should be accounted for as acquisitions of assets or businesses. We adopted this standard on a prospective basis as of January 1, 2017. The adoption of this standard did not have a material impact on our financial condition, results of operations and cash flows, or financial statement disclosures.

In May 2017, FASB issued an Accounting Standard Update entitled, ASU 2017-09, Compensation - Stock Compensation (Topic 718): Scope of Modification Accounting. The objective of the standard is to provide guidance about which changes to the

Table of Contents

terms or conditions of