EXELIXIS, INC.
Form 10-Q
November 01, 2018
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UNITED STATES
SECURITIES AND EXCHANGE COMMISSION
Washington, D.C. 20549
FORM 10-Q
ý QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
For the quarterly period ended September 28, 2018
or
¨ TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934
Commission File Number: 000-30235
EXELIXIS, INC.
(Exact name of registrant as specified in its charter)

Delaware	04-3257395
(State or other jurisdiction of incorporation or organization)	(I.R.S. Employer Identification Number)

1851 Harbor Bay Parkway
Alameda, CA 94502
(650) 837-7000
(Address, including zip code, and telephone number, including area code, of registrant's principal executive offices)
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 ý No ¨
Indicate by check mark whether the registrant has submitted electronically every Interactive Data File required to be submitted 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 such files). Yes ý No ¨
Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer, a 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	ý	Accelerated filer	¨
Non-accelerated filer	¨	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 Securities Act. ¨
Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No ý
As of October 22, 2018, there were 298,983,135 shares of the registrant's common stock outstanding.

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PART I - FINANCIAL INFORMATION
Item 1. Financial Statements
EXELIXIS, INC.
CONDENSED CONSOLIDATED BALANCE SHEETS
(in thousands, except share and per share data)
(unaudited)

	September 30, 2018	December 31, 2017*
ASSETS		
Current assets:		
Cash and cash equivalents	$ 353,623	$ 183,164
Short-term investments	281,000	204,607
Short-term restricted cash and investments	504	504
Trade and other receivables, net	104,634	81,192
Inventory, net	10,433	6,657
Unbilled collaboration revenue	24,489	—
Prepaid expenses and other current assets	12,279	8,750
Total current assets	786,962	484,874
Long-term investments	114,093	64,255
Long-term restricted cash and investments	1,100	4,646
Property and equipment, net	51,046	25,743
Goodwill	63,684	63,684
Operating lease right-of-use assets	5,989	—
Other long-term assets	1,492	12,092
Total assets	$ 1,024,366	$ 655,294
LIABILITIES AND STOCKHOLDERS' EQUITY		
Current liabilities:		
Accounts payable	$ 8,679	$ 9,575
Accrued compensation and benefits	27,283	21,073
Accrued clinical trial liabilities	18,958	19,849
Rebates and fees due to customers	11,689	7,565
Accrued collaboration liabilities	8,397	8,974
Current portion of deferred revenue	—	31,984
Other current liabilities	15,900	16,150
Total current liabilities	90,906	115,170
Long-term portion of deferred revenue	2,268	238,520
Long-term portion of lease liabilities	12,619	14,530
Other long-term liabilities	2,607	2,113
Total liabilities	108,400	370,333
Commitments		
Stockholders' equity:		
Preferred stock, $0.001 par value, 10,000,000 shares authorized and no shares issued	—	—
Common stock, $0.001 par value; 400,000,000 shares authorized; issued and outstanding: 298,881,884 and 296,209,426 at September 30, 2018 and December 31, 2017, respectively	299	296
Additional paid-in capital	2,156,632	2,114,184
Accumulated other comprehensive loss	(513)	(347)
Accumulated deficit	(1,240,452)	(1,829,172)
Total stockholders' equity	915,966	284,961
Total liabilities and stockholders' equity	$ 1,024,366	$ 655,294

* The Condensed Consolidated Balance Sheet as of December 31, 2017 has been derived from the audited financial statements as of that date.

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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EXELIXIS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS
(in thousands, except per share data)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Revenues:				
Net product revenues	$162,946	$96,416	$443,054	$253,297
Collaboration revenues	62,451	56,094	182,170	79,108
Total revenues	225,397	152,510	625,224	332,405
Operating expenses:				
Cost of goods sold	7,360	4,658	18,996	10,875
Research and development	44,741	28,543	124,986	79,967
Selling, general and administrative	48,120	38,129	153,989	113,084
Total operating expenses	100,221	71,330	297,971	203,926
Income from operations	125,176	81,180	327,253	128,479
Other income (expense), net:				
Interest income	3,507	1,133	8,099	3,497
Interest expense	(1)	—	(1)	(8,679)
Other, net	272	2,275	369	(3,638)
Total other income (expense), net	3,778	3,408	8,467	(8,820)
Income before income taxes	128,954	84,588	335,720	119,659
Provision for income taxes	2,324	3,206	5,739	3,921
Net income	$126,630	$81,382	$329,981	$115,738
Net income per share, basic	$0.42	$0.28	$1.11	$0.39
Net income per share, diluted	$0.41	$0.26	$1.05	$0.37
Shares used in computing net income per share, basic	298,416	294,269	297,700	292,776
Shares used in computing net income per share, diluted	312,346	312,940	313,200	311,555

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

EXELIXIS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF COMPREHENSIVE INCOME
(in thousands)
(unaudited)

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Net income	$126,630	$81,382	$329,981	$115,738
Other comprehensive income (loss) [1]	218	67	(166)	364
Comprehensive income	$126,848	$81,449	$329,815	$116,102

(1) Other comprehensive income (loss) consisted solely of unrealized gains or losses, net, on available-for-sale securities arising during the periods presented. Reclassification adjustments to net income resulting from realized gains or losses on the sale of securities were nominal and there was no income tax expense related to other comprehensive income during those periods.

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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EXELIXIS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS
(in thousands)
(unaudited)

	Nine Months Ended September 30,	
	2018	2017
Net income	$329,981	$115,738
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	2,876	842
Stock-based compensation	28,330	15,029
401(k) matching contributions made in common stock	3,232	1,373
Loss on extinguishment of debt	—	6,239
Amortization of debt discounts and debt issuance costs	—	182
Interest paid in kind	—	(11,825)
Gain on other equity investments	(209)	(2,980)
Other	(1,423)	157
Changes in assets and liabilities:		
Trade and other receivables, net	(15,645)	(49,241)
Inventory, net	(3,776)	(2,468)
Unbilled collaboration revenue	(32,673)	—
Prepaid expenses and other current assets	(3,529)	(2,530)
Operating lease right-of-use assets	2,732	—
Other long-term assets	(542)	689
Accounts payable	(1,248)	(577)
Accrued compensation and benefits	6,210	(420)
Accrued clinical trial liabilities	(891)	2,050
Rebates and fees due customers	4,124	1,723
Accrued collaboration liability	(577)	7,091
Deferred revenue	(1,548)	20,710
Long-term portion of lease liabilities	(974)	—
Other current and long-term liabilities	(3,321)	10,476
Net cash provided by operating activities	311,129	112,258
Cash flows from investing activities:		
Purchases of Property and equipment and other, net	(30,403)	(3,449)
Proceeds from sale of property and equipment	308	14
Purchases of investments	(368,304)	(248,046)
Proceeds from maturities of investments	231,204	266,335
Proceeds from sale of investments	11,935	37,294
Proceeds from other equity investments	209	2,980
Net cash (used in) provided by investing activities	(155,051)	55,128
Cash flows from financing activities:		
Principal repayments of debt	—	(185,788)
Proceeds from exercise of stock options	10,390	16,532
Proceeds from employee stock purchase plan	3,650	3,053
Taxes paid related to net share settlement of equity awards	(3,205)	(3,012)
Net cash provided by (used in) financing activities	10,835	(169,215)
Net increase (decrease) in cash, cash equivalents and restricted cash	166,913	(1,829)
Cash, cash equivalents and restricted cash at beginning of period	188,314	155,836

Cash, cash equivalents and restricted cash at end of period	$355,227	$154,007

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EXELIXIS, INC.
CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS - continued
(in thousands)
(unaudited)

	Nine Months Ended September 30,	
	2018	2017
Supplemental cash flow disclosure - non-cash investing and financing activity:		
Property and equipment deemed to have been acquired under build-to-suit lease	$ —	$ 14,530
Right-of-use assets obtained in exchange for lease obligations (1)	$ 17,180	—
Unpaid liabilities incurred to acquire Property and equipment	$ 1,281	$ 245

(1) Amounts for the nine months ended September 30, 2018 include the transition adjustment for the adoption of Accounting Standards Update ("ASU") No. 2016-02, Leases (Topic 842) ("Topic 842").

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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EXELIXIS, INC.
NOTES TO CONDENSED CONSOLIDATED FINANCIAL STATEMENTS
(unaudited)

NOTE 1. ORGANIZATION AND SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

Organization

Exelixis, Inc. ("Exelixis," "we," "our" or "us") is a biotechnology company committed to the discovery, development and commercialization of new medicines to improve care and outcomes for people with cancer. Since our founding in 1994, three products discovered at Exelixis have progressed through clinical development, received regulatory approval, and entered the marketplace. Two are derived from cabozantinib, an inhibitor of multiple tyrosine kinases including MET, AXL, VEGF receptors, and RET: CABOMETYX® (cabozantinib) tablets approved for advanced renal cell carcinoma ("RCC"); and COMETRIQ® (cabozantinib) capsules approved for progressive, metastatic medullary thyroid cancer. The third product, COTELLIC® (cobimetinib) tablets, is an inhibitor of MEK, marketed under a collaboration agreement with Genentech, Inc. (a member of the Roche Group) ("Genentech"), and is approved as part of a combination regimen to treat advanced melanoma.

Basis of Consolidation

The accompanying Condensed Consolidated Financial Statements include the accounts of Exelixis and those of our wholly-owned subsidiaries. These entities' functional currency is the U.S. dollar. All intercompany balances and transactions have been eliminated.

Basis of Presentation

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with accounting principles generally accepted in the U.S. for interim financial information and pursuant to Form 10-Q and Article 10 of Regulation S-X of the Securities and Exchange Commission ("SEC"). Accordingly, they do not include all of the information and footnotes required by U.S. generally accepted accounting principles for complete financial statements. In our opinion, all adjustments (consisting only of normal recurring adjustments) considered necessary for a fair presentation of the results of operations and cash flows for the periods presented have been included.

We have adopted a 52- or 53-week fiscal year policy that generally ends on the Friday closest to December 31st. Fiscal year 2018 will end on December 28, 2018 and fiscal year 2017 ended on December 29, 2017. For convenience, references in this report as of and for the fiscal periods ended September 28, 2018, June 29, 2018, March 30, 2018 and September 29, 2017, and as of and for the fiscal years ended December 28, 2018 and December 29, 2017, are indicated as being as of and for the periods ended September 30, 2018, June 30, 2018, March 31, 2018 and September 30, 2017, and the years ended December 31, 2018 and December 31, 2017, respectively. Similarly, references in this report to the first day of the fiscal year ended December 28, 2018 are indicated as being as of January 1, 2018.

Operating results for the nine months ended September 30, 2018 are not necessarily indicative of the results that may be expected for the year ending December 31, 2018 or for any future period. The accompanying Condensed Consolidated Financial Statements and Notes thereto should be read in conjunction with our Consolidated Financial Statements and Notes thereto for the year ended December 31, 2017, included in our Annual Report on Form 10-K filed with the SEC on February 26, 2018.

Segment Information

We operate in one business segment that focuses on discovery, development and commercialization of new medicines to improve care and outcomes for people with cancer. Our Chief Executive Officer, as the chief operating decision-maker, manages and allocates resources to our operations on a total consolidated basis. Consistent with this decision-making process, our Chief Executive Officer uses consolidated, single-segment financial information for purposes of evaluating performance, forecasting future period financial results, allocating resources and setting incentive targets.

All of our long-lived assets are located in the U.S. See "Note 2. Revenues" for enterprise-wide disclosures about product sales, revenues from major customers and revenues by geographic region.

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Use of Estimates

The preparation of the accompanying Condensed Consolidated Financial Statements conforms to accounting principles generally accepted in the U.S., which requires management to make judgments, estimates and assumptions that affect the reported amounts of assets, liabilities, equity, revenues and expenses, and related disclosures. On an ongoing basis, management evaluates its estimates including, but not limited to: those related to revenue recognition, including determining the nature and timing of satisfaction of performance obligations, and determining the standalone selling price of performance obligations, and variable consideration such as rebates, chargebacks, sales returns and sales allowances as well as milestones included in collaboration arrangements; the amounts of revenues and expenses under our profit and loss sharing agreement; recoverability of inventory; operating lease assets and liabilities; the accrual for certain liabilities including accrued clinical trial liability; and valuations of equity awards used to determine stock-based compensation. We base our estimates on historical experience and on various other market-specific and other relevant assumptions that we believe to be reasonable under the circumstances, the results of which form the basis for making judgments about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results could differ materially from those estimates.

Reclassifications

Certain prior period amounts in the accompanying Condensed Consolidated Financial Statements have been reclassified to conform to current period presentation.

Recently Adopted Accounting Pronouncements

Restricted Cash

In January 2018, we adopted Accounting Standards Update ASU No. 2016-18, Statement of Cash Flows (Topic 230): Restricted Cash (a consensus of the FASB Emerging Issues Task Force), (“ASU 2016-18”). ASU 2016-18 requires that a statement of cash flows explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Therefore, amounts generally described as restricted cash and restricted cash equivalents are included with cash and cash equivalents when reconciling the beginning-of-period and end-of-period total amounts shown on the statement of cash flows. ASU 2016-18 was adopted using the retrospective transition method in the accompanying Condensed Consolidated Financial Statements. As a result of the adoption of ASU 2016-18, we no longer include purchases of restricted cash and proceeds from maturities of restricted cash in our cash flows from investing activities. Accordingly, the adoption of ASU 2016-18 resulted in a $0.5 million increase in Net cash provided by investing activities for the nine months ended September 30, 2017.

See “Note 4. Cash and Investments - Cash, Cash Equivalents and Restricted Cash” for a reconciliation of cash and cash equivalents presented in our previously published Condensed Consolidated Statement of Cash Flows for the nine months ended September 30, 2017 and Cash, cash equivalents and restricted cash reported in the accompanying Condensed Consolidated Statement of Cash Flows for the same period.

Revenue

On January 1, 2018, we adopted ASU No. 2014-09, Revenue from Contracts with Customers (Topic 606) (“Topic 606”) using the modified retrospective method applied to those contracts that were not completed as of January 1, 2018. Results for the three and nine months ended September 30, 2018 are presented under Topic 606, while prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under previous revenue recognition guidance, Accounting Standards Codification (“ASC”) Topic 605: Revenue Recognition (“Topic 605”).

Leases

On July 1, 2018 we early adopted Topic 842. We adopted Topic 842 using the modified retrospective approach with a cumulative-effect adjustment as of January 1, 2018 in accordance with ASU No. 2018-11, Leases (Topic 842) - Targeted Improvements. Results for the three and nine months ended September 30, 2018 are presented under Topic 842. We have not restated the results for the three and six months ended June 30, 2018 and three months ended March 31, 2018 as the adjustments required to present those periods under Topic 842 were not material. Other prior period amounts are not adjusted and continue to be reported in accordance with our historic accounting under previous lease guidance, ASC Topic 840: Leases (“Topic 840”). We elected the package of practical expedients permitted under the

transition guidance within

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the new standard, which among other things, allowed us to carry forward the historical lease classification of those leases in place as of January 1, 2018.

Impact of Adoption of Topic 606 and Topic 842

We recorded a net reduction of $258.5 million to opening accumulated deficit as of January 1, 2018, due to the cumulative impact of adopting Topic 606, with the impact primarily relating to a change in the recognition of upfront and non-substantive milestone payments received related to our collaboration arrangements with Ipsen Pharma SAS ("Ipsen") and Takeda Pharmaceutical Company Ltd. ("Takeda"). The adoption of Topic 606 did not have an impact on our recognition of revenue from product sales.

We also recorded a net reduction of $0.2 million to opening accumulated deficit as of January 1, 2018, due to the cumulative impact of adopting Topic 842, with the impact relating to a change in the classification of certain of our buildings in our Lease Agreement (the "Lease") with Ascentris 105, LLC ("Ascentris") from a build to suit lease to an operating lease. For a description of the Lease, see "Note 11. Leases."

The impact of the adoption of Topic 606 and Topic 842 on the accompanying Condensed Consolidated Balance Sheet as of January 1, 2018 was as follows (in thousands):

	December 31, 2017	Adjustments Due to the Adoption of Topic 606	Adjustments Due to the Adoption of Topic 842	January 1, 2018
Contract assets: unbilled collaboration revenue, gross:				
Current portion	$—	$9,588	$—	$9,588
Long-term portion	$—	$12,247	$—	$12,247
Trade and other receivables, net	$81,192	$—	$7,743	$88,935
Property and equipment, net	$25,743	$—	$(14,530)	$11,213
Operating lease right-of-use assets	$—	$—	$8,579	$8,579
Contract liabilities: deferred revenue, gross:				
Current portion	$31,984	$(23,591)	$—	$8,393
Long-term portion	$238,520	$(213,079)	$—	$25,441
Operating lease liabilities:				
Other current liabilities[1]	$16,150	$—	$3,173	$19,323
Long-term portion of lease liabilities [2]	$14,530	$—	$(1,206)	$13,324
Other long-term liabilities	$2,113	$—	$(408)	$1,705
Accumulated deficit	$(1,829,172)	$258,505	$233	$(1,570,434)

(1) Includes deferred rent and current portion of operating lease liabilities.

(2) Long-term portion of operating lease liabilities and Financing obligation for build-to-suit lease.

The adjustments due to the adoption of Topic 606 primarily related to a reduction in deferred revenue driven by the allocation of the transaction price to our license performance obligations in the Ipsen and Takeda collaborations, which were determined to be functional intellectual property that was transferred at a point in time and as a result, revenue was recorded at a point in time. Previously under Topic 605, revenue related to the upfront payments and one non-substantive milestone payment earned in 2016 had been deferred over the estimated period of performance pursuant to the terms of the contract. Contract assets as of January 1, 2018 primarily related to estimated revenue for reimbursements for our continuing research and development services and the $10.0 million milestone from Ipsen's filing with the European Medicines Agency ("EMA") for cabozantinib, as a treatment for patients with previously-treated advanced hepatocellular carcinoma ("HCC"), that was deemed probable under Topic 606 prior to January 1, 2018. Deferred revenue as of January 1, 2018 is related to the up-front, nonrefundable, fees and milestones earned that were allocated to our research and development services performance obligation which had not been satisfied as of that date. Contract assets and liabilities are netted by collaboration agreement in our Condensed Consolidated Balance Sheets; however, for illustration purposes the above amounts are shown prior to netting.

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The adjustments due to the adoption of Topic 842 primarily related to the recognition of an operating lease right-of-use asset and operating lease liability for the Lease. In addition, the adoption of Topic 842 resulted in a change in classification of build-to-suit component of the Lease to an operating lease and as a result we derecognized the estimated fair value of the building shells that were included in Property and equipment, net as of December 31, 2017, as we had been deemed to own these buildings under Topic 840. For additional discussion of the build-to-suit property, see “Note 5 Property and Equipment” to our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on February 26, 2018. For a description of the Lease, see “Note 11. Leases” in these Condensed Consolidated Financial Statements.

The impact of the adoption of Topic 606 and Topic 842 on the accompanying Condensed Consolidated Statements of Operations as of and for three and nine months ended September 30, 2018 were as follows (in thousands):

	Three Months Ended September 30, 2018			
	As Reported	Effect of Adoption of Topic 606 Higher / (Lower)	Effect of Adoption of Topic 842 Higher / (Lower)	Balances Without the Adoption of Topic 606 or 842
Collaboration revenues	$62,451	$ 32,558	$ —	$29,893
Total revenues	$225,397	$ 32,558	$ —	$192,839
Selling, general and administrative expenses	$48,120	$ —	$ 936	$47,184
Total operating expenses	$100,221	$ —	$ 936	$99,285
Interest expense	$(1)	$ —	$ (348)	$(349)
Total other income, net	$3,778	$ —	$ 348	$3,430
Income before income taxes	$128,954	$ 32,558	$ (588)	$96,984
Provision for income taxes	$2,324	$ 680	$ (2)	$1,646
Net income	$126,630	$ 31,878	$ (586)	$95,338
Net income per share, basic	$0.42	$ 0.11	$ —	$0.32
Net income per share, diluted	$0.41	$ 0.10	$ —	$0.31

	Nine Months Ended September 30, 2018			
	As Reported	Effect of Adoption of Topic 606 Higher / (Lower)	Effect of Adoption of Topic 842 Higher / (Lower)	Balances Without the Adoption of Topic 606 or 842
Collaboration revenues	$182,170	$ 9,809	$ —	$172,361
Total revenues	$625,224	$ 9,809	$ —	$615,415
Selling, general and administrative expenses	$153,989	$ —	$ 936	$153,053
Total operating expenses	$297,971	$ —	$ 936	$297,035
Interest expense	$(1)	$ —	$ (348)	$(349)
Total other income, net	$8,467	$ —	$ 348	$8,119
Income before income taxes	$335,720	$ 9,809	$ (588)	$326,499
Provision for income taxes	$5,739	$ 566	$ (2)	$5,175
Net income	$329,981	$ 9,243	$ (586)	$321,324
Net income per share, basic	$1.11	$ 0.03	$ —	$1.08
Net income per share, diluted	$1.05	$ 0.03	$ —	$1.03

Collaboration revenues for both the three and nine months ended September 30, 2018 included $36.9 million in revenue recognized in accordance with Topic 606 related to a $40.0 million milestone from Ipsen which we expect to earn in the fourth quarter of 2018 for the approval of CABOMETYX for previously-treated HCC that would not have

been recognized if we had not adopted Topic 606. If we had not adopted Topic 606, we would also have recognized a $10.0 million milestone in the first quarter of 2018 upon the validation of Ipsen's filing with the EMA for cabozantinib as a treatment for patients with previously-treated advanced HCC that was recognized under Topic 606 as part of our adoption transition adjustment on

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January 1, 2018. The adoption of Topic 606 also resulted in a reduction of previously deferred revenue that was recorded as part of our adoption transition adjustment as of January 1, 2018.

Revenue

Topic 606 supersedes all previous revenue recognition requirements in accordance with generally accepted accounting principles. This standard applies to all contracts with customers, except for contracts that are within the scope of other standards, such as leases, insurance, collaboration arrangements and financial instruments. Under Topic 606, an entity recognizes revenue when its customer obtains control of promised goods or services, in an amount that reflects the consideration to which the entity is entitled to in exchange for those goods or services. To determine revenue recognition for arrangements that we determine are within the scope of Topic 606, we perform the following five steps: (i) identify the contract(s) with a customer; (ii) identify the performance obligations in the contract; (iii) determine the transaction price; (iv) allocate the transaction price to the performance obligations in the contract; and (v) recognize revenue when (or as) we satisfy a performance obligation. We only apply the five-step model to contracts when it is probable that we will collect the consideration we are entitled to in exchange for the goods or services we transfer to the customer.

Net Product Revenues

We sell our products principally to specialty distributors and specialty pharmacy providers, or collectively, our Customers. These Customers subsequently resell our products to health care providers and patients. In addition to distribution agreements with Customers, we enter into arrangements with health care providers and payors that provide for government-mandated and/or privately-negotiated rebates, chargebacks and discounts with respect to the purchase of our products. Revenues from product sales are recognized when the Customer obtains control of our product, which occurs at a point in time, typically upon delivery to the Customer.

Product Sales Discounts and Allowances

Revenues from product sales are recorded at the net sales price (transaction price), which includes estimates of variable consideration for which reserves are established and that result from discounts, chargebacks, rebates, co-pay assistance, returns and other allowances that are offered within contracts between us and our Customers, health care providers, payors and other indirect customers relating to the sales of our products. These reserves are based on the amounts earned or to be claimed on the related sales and are classified as reductions of accounts receivable (if the amount is payable to the Customer) or a current liability (if the amount is payable to a party other than a Customer). Where appropriate, these estimates take into consideration a range of possible outcomes that are probability-weighted for relevant factors such as our historical experience, current contractual and statutory requirements, specific known market events and trends, industry data and forecasted Customer buying and payment patterns. Overall, these reserves reflect our best estimates of the amount of consideration to which we are entitled based on the terms of the contract. The amount of variable consideration that is included in the transaction price may be constrained, and is included in the net sales price only to the extent that it is probable that a significant reversal in the amount of the cumulative revenue recognized will not occur in a future period. Actual amounts of consideration ultimately received may differ from our estimates. If actual results in the future vary from our estimates, we will adjust these estimates, which would affect net product revenues and earnings in the period such variances become known.

Chargebacks: Chargebacks are discounts that occur when contracted customers purchase directly from a specialty distributor. Contracted customers, which currently consist primarily of Public Health Service institutions, non-profit clinics, Federal government entities purchasing via the Federal Supply Schedule and Group Purchasing Organizations, and health maintenance organizations, generally purchase the product at a discounted price. The specialty distributor, in turn, charges back to us the difference between the price initially paid by the specialty distributor and the discounted price paid to the specialty distributor by the customer. The allowance for chargebacks is based on an estimate of sales to contracted customers.

Discounts for Prompt Payment: Our Customers in the U.S. receive a discount of 2% for prompt payment. We expect our Customers will earn 100% of their prompt payment discounts and, therefore, we deduct the full amount of these discounts from total product sales when revenues are recognized.

Rebates: Allowances for rebates include mandated discounts under the Medicaid Drug Rebate Program, other government programs and commercial contracts. Rebate amounts owed after the final dispensing of the product to a benefit plan participant are based upon contractual agreements or legal requirements with public sector benefit providers, such as Medicaid. The allowance for rebates is based on statutory or contractual discount rates and expected utilization. Our

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estimates for the expected utilization of rebates are based on customer and payer data received from the specialty pharmacies and distributors and historical utilization rates. Rebates are generally invoiced by the payer and paid in arrears, such that the accrual balance consists of an estimate of the amount expected to be incurred for the current quarter's shipments to our customers, plus an accrual balance for known prior quarters' unpaid rebates. If actual future rebates vary from estimates, we may need to adjust our accruals, which would affect net product revenues in the period of adjustment.

Allowances for rebates also include amounts related to the Medicare Part D Coverage Gap Discount Program. In the U.S., the Medicare Part D prescription drug benefit mandates participating manufacturers to fund 50% of the Medicare Part D insurance coverage gap for prescription drugs sold to eligible patients. Our estimates for expected Medicare Part D coverage gap amounts are based on customer and payer data received from specialty pharmacies and distributors and historical utilization rates. Funding of the coverage gap is invoiced and paid in arrears so that the accrual balance consists of an estimate of the amount expected to be incurred for the current quarter's shipments to patients, plus an accrual balance for known prior quarters' unpaid claims. If actual future funding varies from estimates, we may need to adjust our accruals, which would affect net product revenues in the period of adjustment.

Co-payment Assistance: Patients who have commercial insurance and meet certain eligibility requirements may receive co-payment assistance. We accrue a liability for co-payment assistance based on actual program participation and estimates of program redemption using customer data provided by the specialty distributor that administers the copay program.

Other Customer Credits: We pay fees to our Customers for account management, data management and other administrative services. To the extent the services received are distinct from the sale of products to the Customer, these payments are classified in Selling, general and administrative expenses in our Condensed Consolidated Statements of Operations.

Collaboration Revenues

We enter into collaboration arrangements, under which we license certain rights to our intellectual property to third parties. The terms of these arrangements typically include payment to us for one or more of the following: non-refundable, up-front license fees; development, regulatory and commercial milestone payments; product supply services; development cost reimbursements; profit sharing arrangements; and royalties on net sales of licensed products. Except for profit sharing arrangements and payments for product supply services, each of these payment types are within the scope of Topic 606. As part of the accounting for these arrangements, we must develop assumptions that require judgment to determine the standalone selling price for each performance obligation identified in the contract. These key assumptions may include forecasted revenues, clinical development timelines and costs, reimbursement rates for personnel costs, discount rates and probabilities of technical and regulatory success.

Up-front License Fees: If the license to our intellectual property is determined to be distinct from the other performance obligations identified in the arrangement, we recognize revenues from nonrefundable, up-front fees allocated to the license when the license is transferred to the licensee and the licensee is able to use and benefit from the license. For licenses that are bundled with other promises, we utilize judgment to assess the nature of the combined performance obligation to determine whether the combined performance obligation is satisfied over time or at a point in time and, if over time, the appropriate method of measuring progress for purposes of recognizing revenue from non-refundable, up-front fees. We evaluate the measure of progress each reporting period and, if necessary, adjust the measure of performance and related revenue recognition.

Regulatory and Development Milestone Payments: At the inception of each arrangement that includes development milestone payments, we evaluate whether the milestones are considered probable of being reached and estimate the amount to be included in the transaction price using the most likely amount method. If it is probable that a significant revenue reversal would not occur, the associated milestone value is included in the transaction price. Milestone payments that are not within our or the licensee's control, such as regulatory approvals, are not considered probable of being achieved until uncertainty associated with the approvals has been resolved. The transaction price is then allocated to each performance obligation, on a relative standalone selling price basis, for which we recognize revenue as or when the performance obligations under the contract are satisfied. At the end of each subsequent reporting period, we re-evaluate the probability of achieving such development and regulatory milestones and any related

constraint, and if necessary, adjust our estimate of the overall transaction price. Any such adjustments are recorded on a cumulative catch-up basis, which would affect Collaboration revenues and earnings in the period of adjustment.

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Product Supply Services: Arrangements that include a promise for future supply of drug product for either clinical development or commercial supply at the licensee's discretion are generally considered as options. We assess if these options provide a material right to the licensee and if so, they are accounted for as separate performance obligations.
Development Cost Reimbursements: Our Ipsen and Takeda arrangements include promises of future clinical development and drug safety services, as well as participation on certain joint committees. We have determined that these services collectively are distinct from the licenses provided to Ipsen and Takeda and as such, these promises are accounted for as a separate performance obligation recorded over time. We record revenue for these services as the performance obligations are satisfied, which we estimate using internal development costs incurred and projections through the term of the arrangements.
Profit Sharing Arrangements: Under the terms of our collaboration agreement with Genentech for cobimetinib, we are entitled to a share of U.S. profits and losses received in connection with commercialization of cobimetinib. We are also entitled to low double-digit royalties on ex-U.S. net sales. We account for such arrangements in accordance with ASC Topic 808: Collaborative Arrangements ("Topic 808"). We have determined that we are an agent under the agreement and therefore revenues are recorded net of costs incurred. We record U.S. profits and losses under the collaboration agreement in the period earned based on our estimate of those amounts. We expect to recognize an annual profit under the agreement for the year ending December 31, 2018 and accordingly, those profits are recognized as Collaboration revenues in the accompanying Condensed Consolidated Statements of Operations. Historically, we had not recognized a profit for any annual period from the commercialization of cobimetinib in the U.S. and accordingly, losses for periods prior to 2018 were recognized as Selling, general and administrative expenses in the accompanying Condensed Consolidated Statements of Operations.
Sales-based Milestone Payments and Royalties: For arrangements that include sales-based royalties, including milestone payments based on the volume of sales, the license is deemed to be the predominant item to which the royalties or sales-based milestones relate and we recognize revenue at the later of (i) when the related sales occur, or (ii) when the performance obligation to which some or all of the royalty has been allocated has been satisfied (or partially satisfied).

Leases

We determine if an arrangement is a lease at inception. Operating leases are included in operating lease right-of-use assets, other current liabilities, and operating lease liabilities in our Condensed Consolidated Balance Sheets. Right-of-use assets represent our right to use an underlying asset for the lease term and lease liabilities represent our obligation to make lease payments arising from the lease. Operating lease right-of-use assets and liabilities are recognized at the lease commencement date based on the present value of lease payments over the lease term. In determining the present value of lease payments, we use our incremental borrowing rate based on the information available at the lease commencement date. The operating lease right-of-use assets also include any lease payments made and exclude lease incentives. Our lease terms may include options to extend or terminate the lease when it is reasonably certain that we will exercise any such options. Lease expense is recognized on a straight-line basis over the expected lease term.
For lease agreements entered into after the adoption of Topic 842 that include lease and non-lease components, such components are generally accounted for separately. For our building leases, as a result of us having elected to adopt the package of practical expedients permitted under the Topic 842 transition guidance, we account for the lease and non-lease components, such as common area maintenance charges, as a single lease component.

Recent Accounting Pronouncements

In August 2018, the Financial Accounting Standards Board (the "FASB") issued ASU No. 2018-15, Intangibles—Goodwill and Other—Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract ("ASU 2018-15"). ASU 2018-15 align the requirements for capitalizing implementation costs incurred in a hosting arrangement that is a service contract with the requirements for capitalizing implementation costs incurred to develop or obtain internal-use software (and hosting arrangements that include an internal-use software license). Accordingly, ASU 2018-15 requires an entity (customer) in a hosting arrangement that is a service contract to follow the guidance in Subtopic 350-40 to determine which implementation costs to capitalize as an asset related to the service contract and which costs to expense. ASU

2018-15 also requires us to expense the capitalized implementation costs of a hosting arrangement that is a service contract over the term of the hosting arrangement, which includes reasonably certain renewals. ASU 2018-15 is effective for us for all interim and annual reporting periods beginning after December 15, 2019. Early adoption is permitted. We are in the process of assessing the impact of ASU 2018-15 on our Consolidated Financial Statements.

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NOTE 2. REVENUES

Revenues by disaggregated category were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Product revenues:				
Gross product revenues	$193,356	$111,148	$525,438	$289,365
Discounts and allowances	(30,410)	(14,732)	(82,384)	(36,068)
Net product revenues	162,946	96,416	443,054	253,297
Collaboration revenues:				
License revenues [1]	51,323	54,335	152,261	74,706
Research and development service revenues [2]	10,560	2,316	27,464	5,623
Other collaboration revenues [3]	568	(557)	2,445	(1,221)
Total collaboration revenues	62,451	56,094	182,170	79,108
Total revenues	$225,397	$152,510	$625,224	$332,405

(1) Upon the adoption of Topic 606, the allocation of proceeds from our collaboration partners, including upfront and milestone payments, between intellectual property licenses and research and development services as well as the resulting timing of recognition has changed. License revenues for the three and nine months ended September 30, 2018 included the immediate recognition of the portion of milestones that were allocated to the transfer of intellectual property licenses for those milestones for which it had become probable that a significant revenue reversal would not occur as well as royalty revenues from Ipsen and Genentech. License revenues for the three and nine months ended September 30, 2017 included the full recognition of substantive milestones achieved during the period, recognition of deferred revenues from upfront payments and a non-substantive milestone, which were being amortized over various periods, as well as royalty revenues from Ipsen and Genentech.

(2) Research and development service revenues for the three and nine months ended September 30, 2018 included the recognition of deferred revenue for the portion of the upfront and milestone payments that have been allocated to the research and development service performance obligations which are being amortized through early 2030, as well as development cost reimbursements earned on our collaboration agreements. As described above, we did not allocate any of our upfront payments or milestones to research and development services prior to the adoption of Topic 606; therefore, Research and development service revenues for the three and nine months ended September 30, 2017 included only development cost reimbursements earned on our collaboration agreements.

(3) Other collaboration revenues for the three and nine months ended September 30, 2018 included net losses on product supply services provided to Ipsen and Takeda and the profit on the U.S. commercialization of COTELLIC from Genentech. Other collaboration revenues for the three and nine months ended September 30, 2017 included only net losses on product supply services, since losses on the U.S. commercialization of COTELLIC for the period were instead included in Selling, general and administrative expenses.

During the three and nine months ended September 30, 2018, Net product revenues and License revenues related to goods and intellectual property licenses transferred at a point in time and Research and development services revenues related to services performed over time. License revenues and Research and development services revenues were recorded in accordance with Topic 606 during 2018 and Topic 605 in prior periods. Other collaboration revenues, which included the profit on the U.S. commercialization of COTELLIC and net losses on product supply services, were recorded in accordance with Topic 808 for all periods presented.

Net product revenues disaggregated by product were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
CABOMETYX	$158,262	$90,362	$428,317	$233,582

COMETRIQ	4,684	6,054	14,737	19,715
Net product revenues	$162,946	$96,416	$443,054	$253,297

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Total revenues disaggregated by significant customer were as follows (dollars in thousands):

	Three Months Ended September 30,					
	2018			2017		
	Dollars	Percent of total		Dollars	Percent of total	
Ipsen	$57,186	25	%	$50,680	33	%
Caremark L.L.C.	30,707	14	%	20,272	13	%
Affiliates of McKesson Corporation	26,597	12	%	14,575	10	%
Diplomat Specialty Pharmacy	17,946	8	%	20,460	13	%
Accredo Health, Incorporated	20,677	9	%	13,445	9	%
Others, individually less than 10% of Total revenues for all periods presented	72,284	32	%	33,078	22	%
Total revenues	$225,397	100	%	$152,510	100	%

	Nine Months Ended September 30,					
	2018			2017		
	Dollars	Percent of total		Dollars	Percent of total	
Ipsen	$145,038	23	%	$60,704	18	%
Caremark L.L.C.	83,516	13	%	52,526	16	%
Affiliates of McKesson Corporation	71,249	11	%	38,699	12	%
Diplomat Specialty Pharmacy	56,568	9	%	62,909	19	%
Accredo Health, Incorporated	58,677	9	%	36,504	11	%
Others, individually less than 10% of Total revenues for all periods presented	210,176	35	%	81,063	24	%
Total revenues	$625,224	100	%	$332,405	100	%

Total revenues disaggregated by geographic region were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
U.S.	$166,270	$97,807	$453,342	$260,853
Europe	57,186	50,680	145,038	60,704
Rest of the world	1,941	4,023	26,844	10,848
Total revenues	$225,397	$152,510	$625,224	$332,405

Net product revenues are attributed to regions based on the ship-to location. Collaboration revenues are attributed to regions based on the location of our collaboration partners' headquarters.

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Product Sales Discounts and Allowances

The activities and ending reserve balances for each significant category of discounts and allowances (which constitute variable consideration) were as follows (in thousands):

	Chargebacks and Discounts for Prompt Payment	Other Customer Credits/Fees and Co-pay Assistance	Rebates	Total
Balance at December 31, 2017	$ 1,928	$ 1,795	$5,770	$9,493
Provision related to sales made in:				
Current period	52,296	9,208	21,192	82,696
Prior periods	(520)	156	50	(314)
Payments and customer credits issued	(50,726)	(9,412)	(17,070)	(77,208)
Balance at September 30, 2018	$ 2,978	$ 1,747	$9,942	$14,667

Chargebacks and discounts for prompt payment are recorded as a reduction of trade receivables and the remaining reserve balances are classified as Other current liabilities in the accompanying Condensed Consolidated Balance Sheets.

Contract Assets and Liabilities

We receive payments from our licensees based on billing schedules established in each contract. Amounts are recorded as accounts receivable when our right to consideration is unconditional. Upfront and milestone payments may require deferral of revenue recognition to a future period until we perform our obligations under these arrangements and are recorded as deferred revenue upon receipt or when due. We may also recognize revenue in advance of the contractual billing schedule and such amounts are recorded as unbilled collaboration revenue when recognized. Changes in our contract assets and liabilities under Topic 606 were as follows (in thousands):

	Contract Assets: Unbilled Collaboration Revenue		Contract Liabilities: Deferred Revenue	
	Current Portion	Long-term Portion	Current Portion	Long-term Portion
Balance at December 31, 2017	$—	$ —	$31,984	$238,520
Adoption of Topic 606	9,588	12,247	(23,591)	(213,079)
Balance at January 1, 2018	9,588	12,247	8,393	25,441
Increases as a result of a change in transaction price and recognition of revenues as services are performed	37,744	4,037	—	—
Transfer to receivables from contract assets recognized at the beginning of the period	(9,109)	—	—	—
Increases as a result of the deferral of milestones achieved in period, excluding amounts recognized as revenue	—	—	873	3,712
Revenue recognized that was included in the contract liability balance at the beginning of the period	—	—	(6,114)	—
Other adjustments [1]	(13,734)	(16,284)	(3,152)	(26,885)
Balance at September 30, 2018	$24,489	$ —	$—	$2,268

(1) Includes reclassification of deferred revenue from long-term to current and adjustments made due to netting of contract assets and liabilities by collaboration agreement.

During the three and nine months ended September 30, 2018, we recognized $48.2 million and $151.8 million, respectively, in revenues under Topic 606 for performance obligations satisfied in previous periods. Such revenues primarily related to milestone and royalty payments allocated to our license performance obligations of our

collaborations with Ipsen and Daiichi Sankyo Company, Limited (“Daiichi Sankyo”).

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NOTE 3. COLLABORATION AGREEMENTS

From time to time, we enter into collaborative arrangements for the development, manufacture and/or commercialization of products and/or product candidates. These collaborations generally provide for non-refundable up-front license fees, development and commercial performance milestone payments, payments for product supply services, development cost reimbursements, royalty payments and/or profit sharing. See “Note 2. Revenues” for information on collaboration revenues recognized during the three and nine months ended September 30, 2018 and 2017.

Ipsen Collaboration

In February 2016, we entered into a collaboration and license agreement with Ipsen for the commercialization and further development of cabozantinib. Pursuant to the terms of the collaboration agreement, Ipsen received exclusive commercialization rights for current and potential future cabozantinib indications outside of the U.S., Canada and Japan. The collaboration agreement was subsequently amended in December 2016 to include commercialization rights in Canada. We have also agreed to collaborate with Ipsen on the development of cabozantinib for current and potential future indications. The parties’ efforts are governed through a joint steering committee and appropriate subcommittees established to guide and oversee the collaboration’s operation and strategic direction; provided, however, that we retain final decision-making authority with respect to cabozantinib’s ongoing development.

In consideration for the exclusive license and other rights contained in the collaboration agreement, including commercialization rights in Canada, Ipsen paid us aggregate upfront payments of $210.0 million. As of December 31, 2017 we had achieved various milestones totaling $125.0 million. During the nine months ended September 30, 2018 we achieved an additional $50.0 million milestone upon the EMA’s approval of cabozantinib as a first-line treatment of advanced RCC, a $25.0 million commercial milestone upon Ipsen’s achievement of $100.0 million of net sales cumulatively over four consecutive quarters, a $10.0 million milestone upon Ipsen’s filing with the EMA for cabozantinib as a treatment for patients with previously-treated advanced HCC and a $5.0 million milestone on the approval by Health Canada of cabozantinib for the treatment of adults with advanced RCC. The timing and amount of revenue recognized during the three and nine months ended September 30, 2018 for those milestones is described below.

We are also eligible to receive future development and regulatory milestone payments, totaling up to an additional $194.0 million, including a $40.0 million milestone upon the EMA’s approval of cabozantinib as a treatment for patients with previously-treated advanced HCC, and additional milestone payments for other future indications and/or jurisdictions. The collaboration agreement also provides that we will be eligible to receive contingent payments of up to $520.3 million associated with sales volume milestones. We will also receive royalties on net sales of cabozantinib by Ipsen outside of the U.S. and Japan. We were entitled to receive a tiered royalty of 2% to 12% on the initial $150.0 million of net sales, which was reached in the three months ended June 30, 2018. As of September 30, 2018, we are entitled to receive a tiered royalty of 22% to 26% of annual net sales, with separate tiers for Canada. These tiers reset each calendar year.

We are primarily responsible for funding cabozantinib-related development costs for those trials in existence at the time we entered into the collaboration agreement with Ipsen; global development costs for additional trials are shared between the parties, with Ipsen reimbursing us for 35% of such costs, provided Ipsen chooses to opt into such trials. In accordance with the collaboration agreement, Ipsen has opted into and is co-funding: CheckMate 9ER, the phase 3 pivotal trial evaluating the combination of cabozantinib with nivolumab versus sunitinib in patients with previously-untreated, advanced or metastatic RCC being conducted in collaboration with Bristol-Myers Squibb Company (“BMS”); CheckMate 040, the phase 1/2 study evaluating the combination of cabozantinib with nivolumab in patients with both previously-treated and previously-untreated advanced HCC being conducted in collaboration with BMS (though Ipsen will not be co-funding the triplet arm of the study evaluating cabozantinib with nivolumab and ipilimumab); and eight cohorts of the COSMIC-021 phase 1b trial evaluating cabozantinib in combination with atezolizumab in locally advanced or metastatic solid tumors being conducted in collaboration with the Roche Group.

We remain responsible for the manufacture and supply of cabozantinib for all development and commercialization activities under the collaboration agreement. In connection with the collaboration agreement, we entered into a supply agreement with Ipsen to supply finished, labeled drug product to Ipsen for distribution in the territories outside of the

U.S. and Japan for the term of the collaboration agreement. The product will be supplied at our cost, as defined in the agreement, which excludes the 3% royalty we are required to pay GlaxoSmithKline ("GSK") on Ipsen's net sales of any product incorporating cabozantinib.

Unless terminated earlier, the collaboration agreement has a term that continues, on a product-by-product and country-by-country basis, until the latter of (i) the expiration of patent claims related to cabozantinib, (ii) the expiration of

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regulatory exclusivity covering cabozantinib or (iii) ten years after the first commercial sale of cabozantinib, other than COMETRIQ. The supply agreement will continue in effect until expiration or termination of the collaboration agreement. The collaboration agreement may be terminated for cause by either party based on uncured material breach of either the collaboration agreement or the supply agreement by the other party, bankruptcy of the other party or for safety reasons. We may terminate the collaboration agreement if Ipsen challenges or opposes any patent covered by the collaboration agreement. Ipsen may terminate the collaboration agreement if the U.S. Food and Drug Administration or EMA orders or requires substantially all cabozantinib clinical trials to be terminated. Ipsen also has the right to terminate the collaboration agreement on a region-by-region basis after the first commercial sale of cabozantinib in advanced RCC in the given region. Upon termination by either party, all licenses granted by us to Ipsen will automatically terminate, and, except in the event of a termination by Ipsen for our material breach, the licenses granted by Ipsen to us shall survive such termination and shall automatically become worldwide, or, if Ipsen were to terminate only for a particular region, then for the terminated region. Following termination by us for Ipsen's material breach, or termination by Ipsen without cause or because we undergo a change of control by a party engaged in a competing program, Ipsen is prohibited from competing with us for a period of time.

We identified the following performance obligations under the collaboration agreement with Ipsen: (1) the transfer of an exclusive license for the commercialization and further development of cabozantinib, as described above; and (2) research and development services, which includes certain committed studies for the development of cabozantinib, pharmacovigilance services and participation on the joint steering and development committees (as defined in the collaboration agreement).

We evaluated the collaboration agreement with Ipsen under Topic 606 as of January 1, 2018. Based on the evaluation as of that date, the up-front, nonrefundable fees, the milestones earned and royalties earned as of December 31, 2017, the $10.0 million milestone we expected to achieve during the three months ended March 31, 2018 upon Ipsen's filing with the EMA for cabozantinib as a treatment for patients with previously-treated advanced HCC, and the estimated reimbursements for our research and development services performance obligation constituted the amount of the consideration to be included in the transaction price as of December 31, 2017. The transaction price was allocated to the performance obligations identified based on our best estimate of the relative standalone selling price: for our license, the estimate was determined using a discounted cash flow valuation utilizing forecasted revenues and costs, and a discount rate and for research and development services the estimate was determined using an adjusted market assessment approach that relies on internal and external costs and market factors. Other than the $10.0 million HCC filing milestone discussed above, variable consideration related to regulatory and development milestones not previously recognized was constrained due to the fact that it was not probable that a significant reversal of cumulative revenue would not occur, given the inherent uncertainty of success with these milestones. Any variable consideration related to sales-based milestones and royalties will be recognized when the related sales occur as these amounts have been determined to relate to the license transferred to Ipsen and therefore is recognized at the later of when the performance obligation is satisfied or the related sales occur. We re-evaluate the transaction price in each reporting period and as uncertain events are resolved or other changes in circumstances occur.

Revenues related to our license performance obligation are recorded immediately as our license represents functional intellectual property that was transferred at a point in time, upon execution of the collaboration agreement in February 2016. Revenues for our research and development services performance obligation are being recognized using the inputs method based on our internal development projected cost estimates through the current estimated patent expiration of cabozantinib in the European Union, which is early 2030. As of September 30, 2018, $53.4 million of the transaction price allocated to our research and development services performance obligation had not been satisfied.

Collaboration revenues for both the three and nine months ended September 30, 2018 included $36.9 million in revenue related to a $40.0 million milestone from Ipsen we expect to earn during the three months ending December 31, 2018 for the approval by the European Commission ("EC") of cabozantinib for previously-treated HCC. We determined recognition of the milestone during the three months ended September 30, 2018 was appropriate following Ipsen's receipt of the Committee for Medicinal Products for Human Use's ("CHMP") positive opinion of cabozantinib for previously-treated HCC. The positive CHMP opinion is being reviewed by the EC as part of their approval process. Our determination that we expected to earn the $40.0 million milestone resulted in a change in the overall transaction

price of the collaboration agreement, as it was probable that a significant reversal of cumulative revenue would not occur. The $36.9 million in revenue in the three months ended September 30, 2018 represents the portion of the milestone that was allocated to the previously satisfied performance obligations for the transfer of an intellectual property license and research and development services. The remainder of the milestone was allocated to research and development services which will be recognized in future periods as those services are delivered through early 2030.

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Collaboration revenues for both the three and nine months ended September 30, 2018 also included $5.0 million in revenue for a milestone from Ipsen on the approval by Health Canada of cabozantinib for the treatment of adults with advanced RCC. We have determined the milestone relates entirely to the previously satisfied performance obligations for the transfer of an intellectual property license and therefore recognized the entire milestone in the three months ended September 30, 2018 when the milestone was achieved.

Collaboration revenues for the nine months ended September 30, 2018 included $46.2 million in revenue for a $50.0 million milestone from Ipsen for the approval of cabozantinib for the first-line treatment of advanced RCC by the EC, of which $45.8 million was recognized during the three months ended March 31, 2018. We determined recognition of the milestone during the three months ended March 31, 2018 was appropriate following the CHMP positive opinion of cabozantinib for the first-line treatment of advanced RCC. The $45.8 million in revenue during the three months ended March 31, 2018 represents the portion of the milestone that was allocated to the previously satisfied performance obligations for the transfer of an intellectual property license and research and development services. The remainder of the milestone was allocated to research and development services to be recognized in future periods as those services are delivered through early 2030, which included an additional $0.2 million in revenue recognized during the three months ended September 30, 2018.

Collaboration revenues for the nine months ended September 30, 2018 also included $25.0 million in revenue for a commercial milestone from Ipsen that we earned during the three months ended June 30, 2018 upon Ipsen's achievement of $100.0 million of net sales cumulatively over four consecutive quarters. We have determined that sales-based milestones relate entirely to the previously satisfied performance obligations for the transfer of an intellectual property license and therefore recognized the entire milestone in the quarter the milestone was achieved.

As of September 30, 2018, the net contract asset for the collaboration agreement with Ipsen was $24.5 million, which was included in Unbilled collaboration revenue in the accompanying Condensed Consolidated Balance Sheets.

Collaboration revenues under the collaboration agreement with Ipsen were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Ipsen collaboration revenues	$57,186	$50,679	$145,038	$60,703

Takeda Collaboration

In January 2017, we entered into a collaboration and license agreement with Takeda for the commercialization and further clinical development of cabozantinib in Japan. Pursuant to the terms of the collaboration agreement, Takeda has exclusive commercialization rights for current and potential future cabozantinib indications in Japan. The parties have also agreed to collaborate on the future clinical development of cabozantinib in Japan. The operation and strategic direction of the parties' collaboration is governed through a joint executive committee and appropriate subcommittees.

In consideration for the exclusive license and other rights contained in the collaboration agreement, we received a $50.0 million upfront nonrefundable payment from Takeda.

In May 2018, we amended the collaboration agreement to modify the milestones we are eligible to receive under the agreement. As of September 30, 2018, we were eligible to receive development, regulatory and first-sale milestone payments of up to $100.0 million related to second-line RCC, first-line RCC and second-line HCC, as well as additional development, regulatory and first-sale milestone payments for potential future indications. The collaboration agreement also provides that we are eligible to receive pre-specified payments of up to $83.0 million associated with sales volume milestones. We consider the contingent payments due to us upon the achievement of specified sales volumes to be similar to royalty payments. We will also receive royalties on net sales of cabozantinib in Japan. We are entitled to receive a tiered royalty of 15% to 24% on the initial $300.0 million of net sales, and after the initial $300.0 million of net sales, we are then entitled to receive a tiered royalty of 20% to 30% on annual net sales. These tiers will reset each calendar year.

Takeda is responsible for 20% of the costs associated with the global cabozantinib development plan's current and future trials, provided Takeda opts into such trials, and 100% of costs associated with the cabozantinib development

activities that are exclusively for the benefit of Japan. In accordance with the collaboration agreement, Takeda has opted into and is co-funding CheckMate 9ER.

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Pursuant to the terms of the collaboration agreement, we are responsible for the manufacture and supply of cabozantinib for all development and commercialization activities under the collaboration, and consequently, we entered into a clinical supply agreement covering the supply of cabozantinib to Takeda, as well as a quality agreement setting forth, in detail, the respective responsibilities pertaining to the quality requirements of the aforementioned supply to Takeda. We will record reimbursements for development costs as revenue as the development services represent a part of our ongoing major or central operations.

Unless earlier terminated, the collaboration agreement has a term that continues, on a product-by-product basis, until the earlier of (i) two years after first generic entry with respect to such product in Japan or (ii) the later of (A) the expiration of patent claims related to cabozantinib and (B) the expiration of regulatory exclusivity covering cabozantinib in Japan. The collaboration agreement may be terminated for cause by either party based on uncured material breach by the other party, bankruptcy of the other party or for safety reasons. For clarity, Takeda's failure to achieve specified levels of commercial performance, based upon sales volume and/or promotional effort, during the first six years of the collaboration shall constitute a material breach of the collaboration agreement. We may terminate the agreement if Takeda challenges or opposes any patent covered by the collaboration agreement. At any time prior to August 1, 2023, the parties may mutually agree to terminate the collaboration agreement if Japan's Pharmaceuticals and Medical Devices Agency is unlikely to grant any approval of the marketing authorization application in any cancer indication in Japan. After the commercial launch of cabozantinib in Japan, Takeda may terminate the collaboration agreement upon twelve months' prior written notice following the third anniversary of the first commercial sale of cabozantinib in Japan. Upon termination by either party, all licenses granted by us to Takeda will automatically terminate, and the licenses granted by Takeda to us shall survive such termination and shall automatically become worldwide.

We identified the following performance obligations under the collaboration agreement with Takeda: (1) the transfer of an exclusive license for the commercialization and further development of cabozantinib, as described above; and (2) research and development services, which includes certain committed studies for the development of cabozantinib, pharmacovigilance services and participation on the joint executive and development committees (as defined in the collaboration agreement).

We evaluated the collaboration agreement with Takeda under Topic 606 as of January 1, 2018. Based on the evaluation as of that date, the up-front, nonrefundable fee and the estimated reimbursements for our research and development services performance obligation constituted the amount of the consideration to be included in the transaction price as of December 31, 2017. The transaction price was allocated to the performance obligations identified based on our best estimate of the relative standalone selling price: for our license, the estimate was determined using a discounted cash flow valuation utilizing forecasted revenues and costs, and a discount rate and for research and development services the estimate was determined using an adjusted market assessment approach that relies on internal and external costs and market factors. Variable consideration related to regulatory and development milestones not previously recognized was constrained due to the fact that it was not probable that a significant reversal of cumulative revenue would not occur, given the inherent uncertainty of success with these milestones. Any variable consideration related to sales-based milestones and royalties will be recognized when the related sales occur as these amounts have been determined to relate predominantly to the license transferred to Takeda and therefore is recognized at the later of when the performance obligation is satisfied or the related sales occur. We re-evaluate the transaction price in each reporting period and as uncertain events are resolved or other changes in circumstances occur.

Revenues related to our license performance obligation are recorded immediately as our license represents functional intellectual property that was transferred at a point in time, upon execution of the collaboration agreement in January 2017. Revenues for our research and development services performance obligation are being recognized using the inputs method based on our internal development projected cost estimates through the current estimated patent expiration of cabozantinib in Japan, which is early 2030. As of September 30, 2018, $28.5 million of the transaction price allocated to our research and development services performance obligation had not been satisfied.

As of September 30, 2018, the net contract liability for the collaboration agreement with Takeda was $2.3 million, which was included in Long-term portion of deferred revenue in the accompanying Condensed Consolidated Balance Sheets.

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Collaboration revenues under the collaboration agreement with Takeda were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Takeda collaboration revenues	$1,940	$4,023	$6,843	$10,848

Genentech Collaboration

Royalty revenues on ex-U.S. sales and our share of the profits and losses recognized in connection with COTELLIC's commercialization in the U.S. were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Royalty revenues on ex-U.S. sales	$1,390	$1,392	$4,285	$5,057
Profits and losses on U.S. commercialization	$1,935	$(891)	$6,004	$(2,298)

The royalty revenues on ex-U.S. sales were included in Collaboration revenues. Prior to 2017, royalty revenues from the collaboration agreement with Genentech were based on amounts reported to us by our collaboration partner and were recorded when such information becomes available to us; beginning in the first quarter of 2017 such information became available in the current quarter and for 2016 such information was not available until the following quarter, meaning that through December 31, 2016 we recorded royalty revenues on a one quarter lag. As a result of this change, royalty revenues for the nine months ended September 30, 2017 included $1.1 million in royalty revenues for sales in the fourth quarter of 2016 in addition to the royalty revenues for sales for the nine months ended September 30, 2017.

Losses on the U.S. commercialization of COTELLIC for the three and nine months ended September 30, 2017 were included in Selling, general and administrative expenses in the accompanying Condensed Consolidated Statements of Operations. We expect an overall profit on the U.S. commercialization of COTELLIC for the year ending December 31, 2018 and therefore we have included the profit for the three and nine months ended September 30, 2018 in Collaboration revenues.

GSK Collaboration

Royalties accruing to GSK in connection with the sales of COMETRIQ and CABOMETYX are included in Cost of goods sold for net sales by us and as a reduction of Collaboration revenues for net sales by Ipsen in the accompanying Condensed Consolidated Statements of Operations. Such royalties were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Royalties accruing to GSK	$6,268	$3,446	$17,021	$8,809

StemSynergy Collaboration

In January 2018, we entered into an exclusive collaboration and license agreement with StemSynergy Therapeutics, Inc. ("StemSynergy") for the discovery and development of novel oncology compounds targeting Casein Kinase 1 alpha ("CK1 ") a component of the Wnt signaling pathway implicated in key oncogenic processes. Under the terms of the agreement, we will partner with StemSynergy to conduct preclinical and clinical studies with compounds targeting CK1 . We paid StemSynergy an upfront payment of $3.0 million in initial research and development funding. As of September 30, 2018, we have accrued $0.6 million to fund additional research and development under the agreement and StemSynergy is eligible for an additional $2.9 million of such funding. The funding costs incurred to date, including the $3.0 million initial payment, was included in Research and development expenses in the accompanying Condensed Consolidated Statements of Operations. StemSynergy will also be eligible for up to $56.5 million in milestones for the first product to emerge from the collaboration, including preclinical and clinical development and regulatory milestone payments, commercial milestones, as well as single-digit royalties on worldwide sales. We will

be solely responsible for the commercialization of products that arise from the collaboration.

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Invenra Collaboration

In May 2018, we entered into a collaboration and license agreement with Invenra, Inc. ("Invenra"), which is focused on developing next-generation biologics, to discover and develop multispecific antibodies for the treatment of cancer. Invenra is responsible for antibody lead discovery and generation while we will lead Investigational New Drug enabling studies, manufacturing, clinical development in single-agent and combination therapy regimens, and future regulatory and commercialization activities. The collaboration agreement also provides that we will receive an exclusive, worldwide license to one preclinical asset (the "lead preclinical asset"), and that we and Invenra will pursue up to six additional discovery projects during the term of the collaboration, which in total are directed to three discovery programs.

In consideration for the exclusive worldwide license and other rights contained in the collaboration agreement, we paid Invenra an upfront payment of $2.0 million and second project initiation fee of $2.0 million. The $4.0 million of total payments we made during the nine months ended September 30, 2018 are included in Research and development expenses in the accompanying Condensed Consolidated Statements of Operations. Invenra is eligible to receive payments of up to $131.5 million based on the achievement of specific development and regulatory milestones for a product containing the lead preclinical asset in the first indication. Upon successful commercialization of a product, Invenra is eligible to receive global milestone payments up to $325.0 million if certain sales thresholds are achieved as well as single digit tiered royalties on net sales of the approved product. We also have the right to initiate five additional discovery projects for development subject to an upfront payment of $2.0 million for each project as well as additional global milestone payments and royalties for any products that arise from these discovery efforts.

Unless earlier terminated, the collaboration agreement has a term that continues, on a product-by-product and country-by-country basis, until the later of (i) ten years after the first commercial sale of such product in such country or (ii) expiration of patent claims covering the product in such country. We may terminate the collaboration agreement in its entirety or on a project-by-project basis at any time prior to commercialization, for any or no reason, upon thirty days' written notice to Invenra. The collaboration agreement also may be terminated by either party for a material breach by the other, subject to notice and cure provisions.

Other Collaborations

For a description of our other existing collaboration agreements, see "Note 2. Collaboration Agreements" to our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on February 26, 2018.

We have determined that each of our other existing collaboration agreements have one performance obligation, the delivery of an intellectual property license to each collaboration partner, which was satisfied for all such agreements prior to the adoption of Topic 606. As a result, any consideration earned and received from these collaborations will be recognized immediately as the licenses we provided represent functional intellectual property that was transferred at a point in time prior to the adoption of Topic 606, when the agreements were executed. Potential variable consideration for these collaborations related to regulatory and development milestones was constrained due to the fact that it was not probable that a significant reversal of cumulative revenue would not occur, given the inherent uncertainty of success with these milestones. Any variable consideration related to sales-based milestones, including royalties, will be recognized when the related sales occur as these amounts have been determined to relate predominantly to the licenses transferred and therefore are recognized at the later of when the performance obligation is satisfied or the related sales occur.

In February 2018, upon Daiichi Sankyo's submission of a regulatory application to the Japanese Pharmaceutical and Medical Devices Agency for esaxerenone as a treatment for patients with essential hypertension, we earned a $20.0 million milestone, which is included in Collaboration revenues during the nine months ended September 30, 2018.

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NOTE 4. CASH AND INVESTMENTS

Cash, Cash Equivalents and Restricted Cash

A reconciliation of Cash, cash equivalents, and restricted cash reported within our Condensed Consolidated Balance Sheets to the amount reported within the accompanying Condensed Consolidated Statements of Cash Flows was as follows (in thousands):

	September 30, 2018	December 31, 2017	September 30, 2017	December 31, 2016
Cash and cash equivalents	$ 353,623	$ 183,164	$ 149,357	$ 151,686
Restricted cash included in short-term restricted cash and investments	504	504	—	—
Restricted cash included in long-term restricted cash and investments	1,100	4,646	4,650	4,150
Cash, cash equivalents, and restricted cash as reported within the accompanying Condensed Consolidated Statements of Cash Flows	$ 355,227	$ 188,314	$ 154,007	$ 155,836

Restricted cash includes certificates of deposit used to collateralize letters of credit and, in prior periods, a purchasing card program.

Investments Available-for-sale

Investments by security type were as follows; the amounts presented exclude cash, but include investments classified as cash equivalents (in thousands):

	September 30, 2018			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Money market funds	$62,325	$ —	$ —	$62,325
Certificates of deposit	19,098	—	—	19,098
Commercial paper	355,720	—	—	355,720
Corporate bonds	262,050	93	(549)	261,594
U.S. Treasury and government sponsored enterprises	50,621	1	(58)	50,564
Total	$749,814	$ 94	$ (607)	$749,301

	December 31, 2017			
	Amortized Cost	Gross Unrealized Gains	Gross Unrealized Losses	Fair Value
Money market funds	$45,478	$ —	$ —	$45,478
Commercial paper	199,647	—	—	199,647
Corporate bonds	179,336	18	(332)	179,022
U.S. Treasury and government sponsored enterprises	16,295	—	(32)	16,263
Total	$440,756	$ 18	$ (364)	$440,410

Gains and losses on the sales of investments available-for-sale were nominal during the three and nine months ended September 30, 2018 and 2017.

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The fair value of gross unrealized losses on investments available-for-sale in an unrealized loss position were as follows (in thousands):

	September 30, 2018					
	In an Unrealized Loss Position Less than 12 Months		In an Unrealized Loss Position 12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds	$175,380	$ (507)	$11,211	$ (42)	$186,591	$ (549)
U.S. Treasury and government sponsored enterprises	42,669	(58)	—	—	42,669	(58)
Total	$218,049	$ (565)	$11,211	$ (42)	$229,260	$ (607)

	December 31, 2017					
	In an Unrealized Loss Position Less than 12 Months		In an Unrealized Loss Position 12 Months or Greater		Total	
	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses	Fair Value	Gross Unrealized Losses
Corporate bonds	$140,746	$ (296)	$20,047	$ (36)	$160,793	$ (332)
U.S. Treasury and government sponsored enterprises	13,611	(23)	2,651	(9)	16,262	(32)
Total	$154,357	$ (319)	$22,698	$ (45)	$177,055	$ (364)

There were 151 and 134 investments in an unrealized loss position as of September 30, 2018 and December 31, 2017, respectively. During the three and nine months ended September 30, 2018 and 2017 we did not record any other-than-temporary impairment charges on our available-for-sale securities. Based upon our quarterly impairment review, we determined that the unrealized losses were not attributed to credit risk, but were primarily associated with changes in interest rates. Based on the scheduled maturities of our investments and our determination that it was more likely than not that we will hold these investments for a period of time sufficient for a recovery of our cost basis, we concluded that the unrealized losses in our investment securities were not other-than-temporary.

The fair value of cash equivalents and investments by contractual maturity were as follows (in thousands):

	September 30, 2018	December 31, 2017
Maturing in one year or less	$ 635,208	$ 377,155
Maturing after one year through five years	114,093	63,255
Total	$ 749,301	$ 440,410

Related Party Transactions

During the three months ended September 30, 2018, BlackRock, Inc. (“BlackRock”), a global provider of investment, advisory and risk management solutions, reported that their beneficial ownership increased to more than 10% of our outstanding common stock. BlackRock manages a portion of our cash and investments portfolio. As of September 30, 2018 and December 31, 2017, respectively, the fair value of cash and investments managed by BlackRock was $263.5 million and $141.0 million, which included $21.3 million and $1.1 million invested in the BlackRock Liquidity Money Market Fund. We paid BlackRock $0.1 million in fees for advisory services during the nine months periods ended September 30, 2018.

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NOTE 5. INVENTORY

Inventory consisted of the following (in thousands):

	September 30, 2018	December 31, 2017
Raw materials	$ 2,344	$ 498
Work in process	5,203	3,997
Finished goods	4,082	2,854
Total	$ 11,629	$ 7,349
Balance Sheet classification:		
Inventory	$ 10,433	$ 6,657
Other long-term assets	1,196	692
Total	$ 11,629	$ 7,349

Write-downs related to excess and expiring inventory are charged to either Cost of goods sold or the cost of supplied product included in Collaboration revenues. Such write-downs were $0.8 million and $1.2 million for the nine months ended September 30, 2018 and September 30, 2017, respectively.

Inventory expected to be used in production or sold in periods more than 12 months from the date presented is classified as Other long-term assets in the accompanying Condensed Consolidated Balance Sheets. As of both September 30, 2018 and December 31, 2017, the non-current portion of inventory consisted of a portion of our finished goods.

NOTE 6. PROPERTY AND EQUIPMENT

Property and equipment consisted of the following (in thousands):

	September 30, 2018	December 31, 2017
Leasehold improvements	$ 42,581	$4,715
Computer equipment and software	15,533	14,146
Furniture and fixtures	3,780	1,609
Laboratory equipment	2,936	5,959
Construction in progress	2,071	22,114
	66,901	48,543
Less: accumulated depreciation and amortization	(15,855)	(22,800)
Property and equipment, net	$ 51,046	$25,743

Depreciation expense was $1.7 million and $2.9 million for the three and nine months ended September 30, 2018, respectively, as compared to $0.3 million and $0.8 million for the comparable periods in 2017.

In May 2017, we entered into the Lease for office and research facilities located at 1851, 1801, and 1751 Harbor Bay Parkway, Alameda, California (the “Premises”). The Lease was amended in October 2017 and June 2018 to increase the space leased to an aggregate of 134,765 square feet. For a description of the Lease, see “Note 11. Leases.” In June 2018, we relocated our offices and research facilities to the Premises. Accordingly, we placed into service $46.3 million in related Leasehold improvements, Furniture and fixtures and Computer equipment and software, portions of which were included in Construction in progress at prior period ends. We are continuing to review the allocation of these additions between Leasehold improvements and Furniture and fixtures.

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NOTE 7. STOCK-BASED COMPENSATION

We allocated the stock-based compensation expense for our equity incentive plans and our 2000 Employee Stock Purchase Plan ("ESPP") as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Research and development	$3,169	$1,663	$9,102	$4,741
Selling, general and administrative	6,573	3,626	19,228	10,288
Total stock-based compensation	$9,742	$5,289	$28,330	$15,029

We have several equity incentive plans under which we have granted stock options and restricted stock units ("RSUs") to employees and directors. At September 30, 2018, 14,408,816 shares were available for grant under our equity incentive plans.

We used a Monte Carlo simulation pricing model to value stock options that include market vesting conditions and a Black-Scholes Merton option pricing model to value other stock options and ESPP purchases. The weighted average grant-date fair value per share of stock options and ESPP purchases were as follows:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Stock options	$8.67	$11.75	$9.13	$10.32
ESPP	$6.19	$6.85	$6.96	$5.29

The grant-date fair value of stock option grants and ESPP purchases was estimated using the following assumptions:

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Stock options:				
Risk-free interest rate	2.91 %	1.70 %	2.83 %	1.68 %
Dividend yield	— %	— %	— %	— %
Volatility	55 %	58 %	55 %	61 %
Expected life	4.4 years	4.0 years	4.4 years	4.1 years
ESPP:				
Risk-free interest rate	2.11 %	1.14 %	1.74 %	0.88 %
Dividend yield	— %	— %	— %	— %
Volatility	51 %	55 %	52 %	61 %
Expected life	6 months	6 months	6 months	6 months

We considered our implied volatility and our historical volatility in developing our estimates of expected volatility. The assumptions for the expected life of stock options were based on historical exercise patterns and post-vesting termination behavior.

The fair value of RSUs was based on the closing price of the underlying common stock on the date of grant.

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Activity for stock options during the nine months ended September 30, 2018 was as follows (dollars in thousands, except per share amounts):

	Shares	Weighted Average Exercise Price Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
Options outstanding at December 31, 2017	22,208,446	$ 6.83		
Granted	3,022,113	$ 19.52		
Exercised	(2,083,457)	$ 5.01		
Forfeited	(216,522)	$ 14.40		
Expired	(5,548)	$ 18.62		
Options outstanding at September 30, 2018	22,925,032	$ 8.59	3.9 years	$ 226,821
Exercisable at September 30, 2018	15,896,370	$ 5.03	3.1 years	$ 203,118

In September 2018, in connection with our long-term incentive compensation program, we granted 308,365 stock options to our President and Chief Executive Officer that have a market vesting condition ("PSOs"). In addition to the standard service conditions included in our other stock options, these PSOs may not be exercised unless, at any time after the grant date, the fair market value of a share of our Common Stock is at least 125% of the per share exercise price of the PSOs over a period of at least 30 consecutive calendar days.

As of September 30, 2018, there was $52.8 million of unrecognized compensation expense related to our unvested stock options that will be recognized over a weighted-average period of 2.6 years.

Activity for RSUs during the nine months ended September 30, 2018 was as follows (dollars in thousands, except per share amounts):

	Shares	Weighted Average Grant Date Fair Value Per Share	Weighted Average Remaining Contractual Term	Aggregate Intrinsic Value
RSUs outstanding at December 31, 2017	3,762,990	$ 17.76		
Awarded	2,411,245	$ 18.50		
Vested and released	(374,992)	$ 8.18		
Forfeited	(249,362)	$ 18.64		
RSUs outstanding at September 30, 2018	5,549,881	$ 18.69	2.1 years	$ 98,344

In September 2018, in connection with our long-term incentive compensation program, we awarded 693,131 RSUs that will vest upon the achievement of certain product revenue, late-stage clinical development and pipeline expansion performance targets ("PSUs"). The PSUs were designed to drive the performance of our management team toward the achievement of key corporate objectives and will be forfeited if the performance targets are not met by December 31, 2021.

Expense recognition for PSUs commences when it is determined that attainment of the performance goal is probable. We have not recognized any compensation expense related to these PSUs. As of September 30, 2018, the total unrecognized compensation expense related to the unvested PSUs was $12.7 million.

As of September 30, 2018, there was $87.6 million of unrecognized compensation expense related to our unvested RSUs, including the PSUs described above. The RSUs will be recognized over a weighted-average period of 3.2 years.

NOTE 8. INCOME TAXES

Provision for income taxes was as follows (in thousands):

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

	2018	2017	2018	2017
Provision for income taxes	$2,324	$3,206	$5,739	$3,921

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Provision for income taxes for the three and nine months ended September 30, 2018 and 2017 primarily relates to state taxes for which we do not have net operating loss carry-forwards due to a limited operating history. Our historical losses are sufficient to fully offset our federal taxable income.

On December 22, 2017, the Tax Cuts and Jobs Act of 2017 was signed into law. The Tax Cuts and Jobs Act contained significant changes to corporate taxation, including among other items, a reduction of the corporate tax rate from a top marginal rate of 35% to a flat rate of 21%. Further guidance may be forthcoming from the FASB and the SEC, as well as regulations, interpretations and rulings from federal and state tax agencies, which could result in additional impacts. The Provision for income taxes for the three and nine months ended September 30, 2018 did not reflect any adjustment to the impact of the Tax Cuts and Jobs Act enactment that we recorded during the year ended December 31, 2017.

NOTE 9. NET INCOME PER SHARE

The computation of basic and diluted net income per share was as follows (in thousands, except per share amounts):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Numerator:				
Net income	$126,630	$81,382	$329,981	$115,738
Net income allocated to participating securities	—	(221)	—	(368)
Net income allocable to common stock for basic net income per share	126,630	81,161	329,981	115,370
Adjustment to net income allocated to participating securities	—	14	—	23
Net income allocable to common stock for diluted net income per share	$126,630	$81,175	$329,981	$115,393
Denominator:				
Weighted-average shares of common stock outstanding used in computing basic net income per share	298,416	294,269	297,700	292,776
Dilutive securities:				
Outstanding stock options, unvested RSUs and ESPP contributions	13,930	18,671	15,500	18,779
Weighted-average shares of common stock outstanding and dilutive securities used in computing diluted net income per share	312,346	312,940	313,200	311,555
Net income per share, basic	$0.42	$0.28	$1.11	$0.39
Net income per share, diluted	$0.41	$0.26	$1.05	$0.37

The two-year warrants to purchase an aggregate of 1,000,000 shares of our common stock issued in January 2014 (“2014 Warrants”) were participating securities. The warrant holders did not have a contractual obligation to share in our losses. The 2014 Warrants were fully exercised in September 2017. For a description of the 2014 Warrants, see “Note 7. Common Stock and Warrants” to our Consolidated Financial Statements included in our Annual Report on Form 10-K for the year ended December 31, 2017 filed with the SEC on February 26, 2018.

Potential shares of common stock not included in the computation of diluted net income per share because to do so would be anti-dilutive was as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Outstanding stock options, unvested RSUs and ESPP contributions	5,687	583	2,938	1,108
Total	5,687	583	2,938	1,108

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NOTE 10. FAIR VALUE MEASUREMENTS

The classification of our financial assets within the fair value hierarchy that were measured and recorded at fair value on a recurring basis was as follows; the amounts presented exclude cash, but include investments classified as cash equivalents (in thousands):

	September 30, 2018		
	Level 1	Level 2	Total
Money market funds	$62,325	$—	$62,325
Certificates of deposit	—	19,098	19,098
Commercial paper	—	355,720	355,720
Corporate bonds	—	261,594	261,594
U.S. Treasury and government sponsored enterprises	—	50,564	50,564
Total financial assets	$62,325	$686,976	$749,301
	December 31, 2017		
	Level 1	Level 2	Total
Money market funds	$45,478	$—	$45,478
Commercial paper	—	199,647	199,647
Corporate bonds	—	179,022	179,022
U.S. Treasury and government sponsored enterprises	—	16,263	16,263
Total financial assets	$45,478	$394,932	$440,410

We did not have any financial liabilities measured and recorded at fair value on a recurring basis as of those dates. We did not have any financial assets or liabilities classified as Level 3 in the fair value hierarchy as of September 30, 2018 or December 31, 2017 and there were no transfers of financial assets or liabilities classified as Level 3 during the nine months ended September 30, 2018 or 2017.

When available, we value investments based on quoted prices for those financial instruments, which is a Level 1 input. Our remaining investments are valued using third-party pricing sources, which use observable market prices, interest rates and yield curves observable at commonly quoted intervals for similar assets as observable inputs for pricing, which is a Level 2 input.

Our remaining financial assets and liabilities include Cash, Trade and other receivables, Unbilled collaboration revenue, Accounts payable, Accrued compensation and benefits, Accrued clinical trial liabilities, Accrued collaboration liabilities, Rebates and fees due to customers, and other current and long-term liabilities. Those financial assets and liabilities are carried at cost which approximates their fair values.

NOTE 11. LEASES

In May 2017, we entered into the Lease with Ascentris for office and research facilities located at the Premises in Alameda, California. The Lease was amended in October 2017 and June 2018 to increase the space leased to an aggregate of 134,765 square feet. We have the right to make certain tenant improvements to the space leased on the Premises. The Lease has an initial term through January 31, 2028. Rent payments began February 1, 2018, following the conclusion of a partial twelve-month rent abatement period. We have two five-year options to extend the Lease and a one-time option to terminate the Lease without cause on the last day of the 8th year of the initial term; none of these optional periods have been considered in the determination of the right-of-use asset or the lease liability for the Lease as we did not consider it reasonably certain that we would exercise any such options. The Lease further provides that we are obligated to pay to Ascentris certain costs, including taxes and operating expenses. We also have a right of first offer to lease certain additional space, in the aggregate of approximately 170,000 square feet of space, as that additional space becomes available at 1601, 1701 and 1751 Harbor Bay Parkway, Alameda, California over the remainder of the initial term of the Lease at a market rate determined according to the Lease.

We had a lease for two buildings in South San Francisco, California with a total area of 116,063 square feet which expired in July 2018.

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We have evaluated our facility leases and determined that, effective upon the adoption of Topic 842, they were all operating leases.

In April 2018, we entered into a three-year financing lease for office equipment that commenced in May 2018. We will be required to make cash payments totaling $0.2 million during the term of the lease.

We have performed an evaluation of our other contracts with customers and suppliers in accordance with Topic 842 and have determined that, except for the facility and equipment leases described above, none of our contracts contain a lease.

The balance sheet classification of our lease liabilities was as follows (in thousands):

	September 30, 2018	December 31, 2017
Operating lease liabilities:		
Current portion included in Other current liabilities	$ 2,315	$ —
Long-term portion of lease liabilities	12,529	—
Total operating lease liabilities	14,844	—
Financing lease liabilities:		
Financing obligation for build-to-suit lease	—	14,530
Current portion included in Other current liabilities	49	—
Long-term portion of lease liabilities	90	—
Total financing lease liabilities	139	14,530
Total lease liabilities	$ 14,983	$ 14,530

The components of lease costs, which were included in Operating expenses in our Condensed Consolidated Statements of Operations, were as follows (in thousands):

	Three Months Ended September 30,		Nine Months Ended September 30,	
	2018	2017	2018	2017
Operating lease cost	$1,614	$986	$3,587	$4,292
Variable lease cost	363	229	1,366	705
Sublease income	—	—	—	(1,225)
Total lease costs	$1,977	$1,215	$4,953	$3,772

Cash paid for amounts included in the measurement of lease liabilities for the nine months ended September 30, 2018 was $3.3 million and was included in Net cash provided by operating activities in our Condensed Consolidated Statements of Cash Flows

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As of September 30, 2018, the maturities of our operating lease liabilities were as follows (in thousands):

	Operating leases
Remainder of 2018	$403
Years ending December 31,	
2019	2,654
2020	2,823
2021	2,904
2022	3,000
Thereafter	16,665
Total lease payments	28,449
Less:	
Imputed interest	(5,435)
Tenant improvement reimbursements	(8,170)
Operating lease liabilities	$14,844

As of September 30, 2018, the weighted average remaining lease term is 9.3 years and the weighted average operating discount rate used to determine the operating lease liability was 4.50%.

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

This Quarterly Report on Form 10-Q contains forward-looking statements. These statements are based on Exelixis, Inc.'s ("Exelixis," "we," "our" or "us") current expectations, assumptions, estimates and projections about our business and our industry, and involve known and unknown risks, uncertainties and other factors that may cause our or our industry's results, levels of activity, performance or achievements to be materially different from any future results, levels of activity, performance or achievements expressed or implied in, or contemplated by, the forward-looking statements. Words such as "expect," "potential," "will," "goal," "would," "intend," "continues," "objective," "anticipate," "initiate," "believe," "plan," "trend," or the negative of such terms or other similar expressions identify forward-looking statements. Our actual results and the timing of events may differ significantly from the results discussed in the forward-looking statements. Factors that might cause such a difference include those discussed in Part II, Item 1A of this Form 10-Q, as well as those discussed elsewhere in this report. We undertake no obligation to update any forward-looking statement to reflect events after the date of this report.

This discussion and analysis should be read in conjunction with our financial statements and accompanying notes included in this report and the financial statements and accompanying notes thereto included in our Annual Report on Form 10-K for the fiscal year ended December 31, 2017 filed with the Securities and Exchange Commission, or SEC, on February 26, 2018.

Overview

We are a biotechnology company committed to the discovery, development and commercialization of new medicines to improve care and outcomes for people with cancer. Since our founding in 1994, three products discovered at Exelixis have progressed through clinical development, received regulatory approval, and entered the marketplace. Two are derived from cabozantinib, an inhibitor of multiple tyrosine kinases including MET, AXL, VEGF receptors, and RET: CABOMETYX® (cabozantinib) tablets approved for advanced renal cell carcinoma, or RCC; and COMETRIQ® (cabozantinib) capsules approved for progressive, metastatic medullary thyroid cancer, or MTC. The third product, COTELLIC® (cobimetinib) tablets, is an inhibitor of MEK, marketed under a collaboration agreement with Genentech, Inc. (a member of the Roche Group), or Genentech, and is approved as part of a combination regimen to treat advanced melanoma. Both cabozantinib and cobimetinib have shown potential in a variety of forms of cancer and are the subject of broad clinical development programs for multiple potential oncology indications.

CABOMETYX was approved by the U.S. Food and Drug Administration, or FDA, for previously-treated patients with advanced RCC in April 2016, and then on December 19, 2017, approximately two months ahead of the assigned Prescription Drug User Fee Act, or PDUFA, action date, the FDA expanded CABOMETYX's approval in this indication to include previously-untreated patients with advanced RCC. We continue to be highly focused on optimizing the execution of this commercial launch in the U.S. through our commercial and medical affairs organizations and established distribution network.

To develop and commercialize CABOMETYX and COMETRIQ outside the U.S., we have entered into license agreements with Ipsen Pharma SAS, or Ipsen, and Takeda Pharmaceutical Company Ltd., or Takeda. Ipsen has been granted rights to cabozantinib outside of the U.S. and Japan, and Takeda has been granted rights to cabozantinib in Japan. Ipsen and Takeda also contribute financially and operationally to the further global development and commercialization of cabozantinib in other potential indications, and we continue to work closely with them on these activities.

In addition to our commercialization efforts, we are also focused on the next wave of cabozantinib's clinical development program, pursuing other indications that have the potential to expand the number of cancer patients who could benefit from this medicine. Furthest advanced is our effort to secure regulatory approval of CABOMETYX as a treatment for patients with previously-treated advanced hepatocellular carcinoma, or HCC. In September 2018, our partner Ipsen received a positive opinion from the Committee for Medicinal Products for Human Use, or CHMP, for CABOMETYX as a treatment in the European Union