

VERTEX PHARMACEUTICALS INC / MA
Form 10-Q
May 12, 2008

[QuickLinks](#) -- Click here to rapidly navigate through this document

**UNITED STATES
SECURITIES AND EXCHANGE COMMISSION**

Washington, D.C. 20549

FORM 10-Q

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

FOR THE QUARTERLY PERIOD ENDED MARCH 31, 2008

OR

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

**FOR THE TRANSITION PERIOD FROM TO
COMMISSION FILE NUMBER 000-19319**

VERTEX PHARMACEUTICALS INCORPORATED

(Exact name of registrant as specified in its charter)

MASSACHUSETTS
(State or other jurisdiction of
incorporation or organization)

04-3039129
(I.R.S. Employer
Identification No.)

**130 WAVERLY STREET
CAMBRIDGE, MASSACHUSETTS**
(Address of principal executive offices)

02139-4242
(zip code)

(617) 444-6100

(Registrant's telephone number, including area code)

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

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

Large accelerated filer

Accelerated filer

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

Smaller reporting company

Edgar Filing: VERTEX PHARMACEUTICALS INC / MA - Form 10-Q

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

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

Common Stock, par value \$0.01 per share
Class

140,569,141
Outstanding at May 6, 2008

VERTEX PHARMACEUTICALS INCORPORATED

FORM 10-Q

FOR THE QUARTER ENDED MARCH 31, 2008

TABLE OF CONTENTS

Part I. Financial Information

<i>Item 1.</i>	<i>Financial Statements</i>	
	Condensed Consolidated Financial Statements (unaudited)	
	Condensed Consolidated Balance Sheets March 31, 2008 and December 31, 2007	1
	Condensed Consolidated Statements of Operations Three Months Ended March 31, 2008 and 2007	2
	Condensed Consolidated Statements of Cash Flows Three Months Ended March 31, 2008 and 2007	3
	Notes to Condensed Consolidated Financial Statements	4
<i>Item 2.</i>	<i>Management's Discussion and Analysis of Financial Condition and Results of Operations</i>	19
<i>Item 3.</i>	<i>Quantitative and Qualitative Disclosures About Market Risk</i>	31
<i>Item 4.</i>	<i>Controls and Procedures</i>	31

Part II. Other Information

<i>Item 1.</i>	<i>Legal Proceedings</i>	32
<i>Item 1A.</i>	<i>Risk Factors</i>	32
<i>Item 2.</i>	<i>Unregistered Sales of Equity Securities and Use of Proceeds</i>	34
<i>Item 6.</i>	<i>Exhibits</i>	35
Signatures		36

"We," "us," the "Company" and "Vertex" as used in this Quarterly Report on Form 10-Q, refer to Vertex Pharmaceuticals Incorporated, a Massachusetts corporation, and its subsidiaries.

"Vertex" is a registered trademark of Vertex. "Agenerase," "Lexiva" and "Telzir" are registered trademarks of GlaxoSmithKline plc. Other brands, names and trademarks contained in this Quarterly Report on Form 10-Q are the property of their respective owners.

Part I. Financial Information**Item 1. Financial Statements**

Vertex Pharmaceuticals Incorporated
Condensed Consolidated Balance Sheets
(Unaudited)

(In thousands, except share and per share amounts)

	<u>March 31, 2008</u>	<u>December 31, 2007</u>
Assets		
Current assets:		
Cash and cash equivalents	\$ 490,696	\$ 355,663
Marketable securities, available for sale, current portion	258,947	105,208
Accounts receivable	24,825	31,320
Prepaid expenses	9,470	4,660
	<u>783,938</u>	<u>496,851</u>
Total current assets	783,938	496,851
Marketable securities, available for sale, excluding current portion		6,925
Restricted cash	30,258	30,258
Property and equipment, net	64,712	66,509
Other assets	10,597	934
	<u>889,505</u>	<u>601,477</u>
Total assets	\$ 889,505	\$ 601,477
Liabilities and Stockholders' Equity		
Current liabilities:		
Accounts payable	\$ 31,281	\$ 32,750
Accrued expenses and other current liabilities	69,398	98,350
Accrued interest	1,707	
Deferred revenues, current portion	23,683	25,528
Accrued restructuring expense, current portion	5,947	5,606
Collaborator development loan (due May 2008)	19,997	19,997
Other obligations	21,310	17,048
	<u>173,323</u>	<u>199,279</u>
Total current liabilities	173,323	199,279
Accrued restructuring expense, excluding current portion	28,862	29,686
Convertible senior subordinated notes (due 2013)	287,500	
Deferred revenues, excluding current portion	95,565	101,217
	<u>585,250</u>	<u>330,182</u>
Total liabilities	585,250	330,182
Commitments and contingencies		
Stockholders' equity:		
Preferred stock, \$0.01 par value; 1,000,000 shares authorized; none issued and outstanding at March 31, 2008 and December 31, 2007, respectively		
Common stock, \$0.01 par value; 200,000,000 shares authorized; 140,382,535 and 132,875,540 shares issued and outstanding at March 31, 2008 and December 31, 2007, respectively	1,385	1,312
Additional paid-in capital	1,984,785	1,856,856
Accumulated other comprehensive income	1,993	881

Edgar Filing: VERTEX PHARMACEUTICALS INC / MA - Form 10-Q

	<u>March 31, 2008</u>	<u>December 31, 2007</u>
Accumulated deficit	(1,683,908)	(1,587,754)
Total stockholders' equity	304,255	271,295
Total liabilities and stockholders' equity	\$ 889,505	\$ 601,477

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

Vertex Pharmaceuticals Incorporated
Condensed Consolidated Statements of Operations
(Unaudited)

(In thousands, except per share amounts)

	Three Months Ended March 31,	
	2008	2007
Revenues:		
Royalties	\$ 10,851	\$ 9,796
Collaborative and other research and development revenues	30,824	59,014
	41,675	68,810
Costs and expenses:		
Royalty payments	3,576	3,269
Research and development expenses	114,582	132,578
Sales, general and administrative expenses	21,623	16,537
Restructuring expense	630	5,055
	140,411	157,439
Loss from operations	(98,736)	(88,629)
Interest income	4,496	9,122
Interest expense	(1,914)	(1,221)
	(96,154)	(80,728)
Net loss	\$ (96,154)	\$ (80,728)
	(0.72)	(0.64)
Basic and diluted net loss per common share	\$	\$
	134,471	125,756
Basic and diluted weighted-average number of common shares outstanding	134,471	125,756

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

Vertex Pharmaceuticals Incorporated

Condensed Consolidated Statements of Cash Flows

(Unaudited)

(In thousands)

	Three Months Ended March 31,	
	2008	2007
Cash flows from operating activities:		
Net loss	\$ (96,154)	\$ (80,728)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation and amortization	7,498	6,321
Stock-based compensation expense	13,072	12,320
Other non-cash based compensation expense	945	846
Realized (gain) loss on marketable securities	(147)	43
Changes in operating assets and liabilities:		
Accounts receivable	6,495	18,824
Prepaid expenses	(4,810)	(3,444)
Accounts payable	(1,469)	(6,227)
Accrued expenses and other current liabilities	(24,692)	(9,103)
Accrued restructuring	(483)	3,435
Accrued interest	1,707	(1,623)
Deferred revenues	(7,497)	(8,472)
	(105,535)	(67,808)
Cash flows from investing activities:		
Purchases of marketable securities	(174,718)	(28,115)
Sales and maturities of marketable securities	29,178	241,014
Expenditures for property and equipment	(5,494)	(6,133)
Other assets	(370)	(1,101)
	(151,404)	205,665
Cash flows from financing activities:		
Issuances of common stock from employee benefit plans, net	1,910	3,393
Issuances of common stock from stock offering, net	112,069	
Issuances of convertible senior subordinated notes, net	278,000	
Debt exchange costs		(49)
	391,979	3,344
Effect of changes in exchange rates on cash	(7)	(44)
	135,033	141,157
Net increase in cash and cash equivalents	135,033	141,157
Cash and cash equivalents beginning of period	355,663	213,171
	\$ 490,696	\$ 354,328
Supplemental disclosure of cash flow information:		
Cash paid for interest	\$	\$ 2,767

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

Vertex Pharmaceuticals Incorporated

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Basis of Presentation

The accompanying condensed consolidated financial statements are unaudited and have been prepared by Vertex Pharmaceuticals Incorporated ("Vertex" or the "Company") in accordance with accounting principles generally accepted in the United States of America ("GAAP").

The condensed consolidated financial statements reflect the operations of the Company and its wholly-owned subsidiaries. All significant intercompany balances and transactions have been eliminated.

Certain information and footnote disclosures normally included in the Company's annual financial statements have been condensed or omitted. The interim financial statements, in the opinion of management, reflect all normal recurring adjustments (including accruals) necessary for a fair presentation of the financial position and results of operations for the interim periods ended March 31, 2008 and 2007.

The results of operations for the interim periods are not necessarily indicative of the results of operations to be expected for the fiscal year, although the Company expects to incur a substantial loss for the year ending December 31, 2008. These interim financial statements should be read in conjunction with the audited financial statements for the year ended December 31, 2007, which are contained in the Company's Annual Report on Form 10-K for the year ended December 31, 2007 that was filed with the Securities and Exchange Commission (the "SEC") on February 11, 2008.

2. Accounting Policies*Basic and Diluted Net Loss per Common Share*

Basic net loss per common share is based upon the weighted-average number of common shares outstanding during the period, excluding restricted stock that has been issued but has not yet vested. Diluted net loss per common share is based upon the weighted-average number of common shares outstanding during the period plus additional weighted-average common equivalent shares outstanding during the period when the effect of adding such shares is dilutive. Common equivalent shares result from the assumed exercise of outstanding stock options (the proceeds of which are then assumed to have been used to repurchase outstanding stock using the treasury stock method), the assumed conversion of convertible notes and vesting of unvested restricted shares of common stock. Common equivalent shares have not been included in the net loss per common share calculations because the effect of including such shares would have been anti-dilutive. Total potential gross common equivalent shares consisted of the following (in thousands, except per share amounts):

	At March 31,	
	2008	2007
Stock options	16,259	15,382
Weighted-average exercise price, per share	\$ 28.00	\$ 27.54
Convertible notes	12,425	456
Conversion price, per share	\$ 23.14	\$ 92.26
Unvested restricted shares	1,929	2,045

Vertex Pharmaceuticals Incorporated

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

2. Accounting Policies (Continued)

Stock-based Compensation Expense

The Company records stock-based compensation expense in accordance with Financial Accounting Standards Board ("FASB") Statement No. 123(R), "Share-Based Payment" ("SFAS 123(R)"). SFAS 123(R) requires companies to expense the fair value of employee stock options and other forms of stock-based employee compensation over the employees' service periods or the derived service period for awards with market conditions. Compensation expense is measured at the fair value of the award at the grant date, including estimated forfeitures, and is adjusted to reflect actual forfeitures and the outcomes of certain conditions. Please refer to Note 3, "Stock-based Compensation Expense," for further information.

Research and Development Expenses

All research and development expenses, including amounts funded by research and development collaborations, are expensed as incurred. On January 1, 2008, the Company adopted Emerging Issues Task Force ("EITF") Issue No. 07-3, "Accounting for Nonrefundable Advance Payments for Goods or Services to Be Used in Future Research and Development Activities," pursuant to which the Company defers and capitalizes nonrefundable advance payments made by the Company for research and development activities until the related goods are delivered or the related services are performed. Prior to the adoption of EITF Issue No. 07-3, the Company expensed nonrefundable advance payments for research and development activities upon payment. Research and development expenses are comprised of costs incurred in performing research and development activities, including salary and benefits; stock-based compensation expense; laboratory supplies and other direct expenses; contractual services, including clinical trial and pharmaceutical development costs; and infrastructure costs, including facilities costs and depreciation. Due to telaprevir's stage of development, costs related to the investment in its commercial supply are included in research and development expenses.

The Company's collaborators have funded portions of the Company's research and development programs related to specific drug candidates and research targets, including, in the three months ended March 31, 2008, telaprevir and certain cystic fibrosis research targets and in the three months ended March 31, 2007, telaprevir, VX-702, VX-770, kinases and certain cystic fibrosis research targets. The Company's collaborative and other research and development revenues were \$30.8 million and \$59.0 million, respectively, for the three months ended March 31, 2008 and 2007. The Company's research and development expenses allocated to programs in which a collaborator funded at least a portion of the research and development expenses were \$33.9 million and \$81.5 million, respectively, for the three months ended March 31, 2008 and 2007.

Restructuring Expense

The Company records costs and liabilities associated with exit and disposal activities, as defined in FASB Statement No. 146, "Accounting for Costs Associated with Exit or Disposal Activities" ("SFAS 146"), based on estimates of fair value in the period the liabilities are incurred. In periods subsequent to initial measurement, changes to the amount of the liability are measured using the credit-adjusted risk-free discount rate applied in the initial period. In the three months ended March 31, 2008 and 2007, the Company recorded costs and liabilities for exit and disposal activities related to a restructuring plan in accordance with SFAS 146. The liability is evaluated and adjusted as

Vertex Pharmaceuticals Incorporated

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

2. Accounting Policies (Continued)

appropriate on at least a quarterly basis for changes in circumstances. Please refer to Note 7, "Restructuring Expense," for further information.

Revenue Recognition

The Company recognizes revenues in accordance with the SEC's Staff Accounting Bulletin No. 101, "Revenue Recognition in Financial Statements," as amended by SEC Staff Accounting Bulletin No. 104, "Revenue Recognition," and for revenue arrangements entered into after June 30, 2003, EITF Issue No. 00-21, "Revenue Arrangements with Multiple Deliverables" ("EITF 00-21").

The Company's revenues are generated primarily through collaborative research, development and/or commercialization agreements. The terms of these agreements typically include payment to Vertex of one or more of the following: non-refundable, up-front license fees; funding of research and/or development efforts; milestone payments; and royalties on product sales.

Agreements containing multiple elements are divided into separate units of accounting if certain criteria are met, including whether the delivered element has stand-alone value to the collaborator and whether there is objective and reliable evidence of the fair value of the undelivered obligation(s). The consideration received is allocated among the separate units either on the basis of each unit's fair value or using the residual method, and the applicable revenue recognition criteria are applied to each of the separate units.

The Company recognizes revenues from non-refundable, up-front license fees on a straight-line basis over the contracted or estimated period of performance, which is typically the research or development term. Research and development funding is recognized as earned, ratably over the period of effort.

Substantive milestones achieved in collaboration arrangements are recognized as earned when the corresponding payment is reasonably assured, subject to the following policies in those circumstances where the Company has obligations remaining after achievement of the milestone:

In those circumstances where collection of a substantive milestone payment is reasonably assured, the Company has remaining obligations to perform under the collaboration arrangement and the Company has sufficient evidence of the fair value for the performance of its remaining obligations, management considers the milestone payment and the remaining obligations to be separate units of accounting. In these circumstances, the Company uses the residual method under EITF 00-21 to allocate revenue among the milestones and the remaining obligations.

In those circumstances where collection of a substantive milestone payment is reasonably assured and the Company has remaining obligations to perform under the collaboration arrangement, but the Company does not have sufficient evidence of fair value for its remaining obligations, management considers the milestone payment and the remaining obligations under the contract as a single unit of accounting. If the collaboration does not require specific deliverables at specific times or at the end of the contract term, but rather, the Company's obligations are satisfied over a period of time, substantive milestone payments are recognized over the period of performance. This typically results in a portion of the milestone payment being recognized as

Vertex Pharmaceuticals Incorporated

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

2. Accounting Policies (Continued)

revenue on the date the milestone is achieved equal to the applicable percentage of the performance period that has elapsed as of the date the milestone is achieved, with the balance being deferred and recognized over the remaining period of performance.

At the inception of each agreement, the Company evaluates whether milestones are substantive on the basis of the contingent nature of the milestone, specifically reviewing factors such as the scientific and other risks that must be overcome to achieve the milestone as well as the level of effort and investment required. Milestones that are not considered substantive and that do not meet the separation criteria are accounted for as license payments and recognized on a straight-line basis over the remaining period of performance.

Payments received or reasonably assured after performance obligations are met completely are recognized as earned.

Royalty revenues are recognized based upon actual and estimated net sales of licensed products in licensed territories, as provided by the licensee, and are recognized in the period the sales occur. The Company reconciles and adjusts for differences between actual royalty revenues and estimated royalty revenues in the quarter they become known. These differences have not historically been significant.

Debt Issuance Costs

Debt issuance costs incurred to complete Vertex's convertible subordinated note offerings are deferred and included in other assets on the condensed consolidated balance sheets. The costs are amortized based on the effective interest method over the term of the related debt issuance. The amortization expense is included in interest expense on the condensed consolidated statements of operations.

3. Stock-based Compensation Expense

At March 31, 2008, the Company had five stock-based employee compensation plans: the 1991 Stock Option Plan (the "1991 Plan"), the 1994 Stock and Option Plan (the "1994 Plan"), the 1996 Stock and Option Plan (the "1996 Plan"), the 2006 Stock and Option Plan (the "2006 Plan") and the 2007 New Hire Stock and Option Plan (the "2007 Plan," and together with the 1991 Plan, the 1994 Plan, the 1996 Plan and the 2006 Plan, collectively, the "Stock and Option Plans"), and one Employee Stock Purchase Plan (the "ESPP"). In connection with the Stock and Option Plans, the Company issues stock options and restricted stock awards with service conditions, which are generally the vesting periods of the awards. The Company also issues to certain members of senior management restricted stock awards that vest upon the earlier of the satisfaction of a market condition or a service condition ("PARS").

The Company records stock-based compensation expense in accordance with SFAS 123(R). SFAS 123(R) requires companies to recognize share-based payments to employees as compensation expense using the "fair value" method. The fair value of stock options and shares purchased pursuant to the ESPP is calculated using the Black-Scholes valuation model. The fair value of restricted stock awards is typically based on intrinsic value on the date of grant. Under the fair value recognition provisions of SFAS 123(R), stock-based compensation, measured at the grant date based on the fair

Vertex Pharmaceuticals Incorporated

Notes to Condensed Consolidated Financial Statements (Continued)

(Unaudited)

3. Stock-based Compensation Expense (Continued)

value of the award, is recognized as expense ratably over the service period. The expense recognized over the service period includes an estimate of awards that will be forfeited.

For PARS awards, a portion of the fair value of the common stock on the date of grant is recognized ratably over a derived service period that is equal to the estimated time to satisfy the market condition. The portion of the fair value of the common stock that is recognized over the derived service period is determined on the basis of the estimated probability that the PARS award will vest as a result of the market condition. For the PARS awards granted in 2008, 2007 and 2006, the derived service period relating to each market condition was shorter than the four year service-based vesting period of the PARS. The difference between the fair value of the common stock on the date of grant and the value recognized over the derived service period is recognized ratably over the four year service-based vesting period of the PARS. The stock-based compensation expense recognized over each of the derived service periods and the four year service periods includes an estimate of awards that will be forfeited prior to the end of the derived service periods or the four year service periods, respectively.

The effect of recording stock-based compensation expense for the three months ended March 31, 2008 and 2007 was as follows (in thousands):

	Three Months Ended March 31, 2008	Three Months Ended March 31, 2007
Stock-based compensation expense by type of award:		
Stock options	\$ 8,288	\$ 8,307
Restricted shares	3,799	3,340
ESPP issuances	985	673