INFINITY PHARMACEUTICALS, INC.
Form 10-Q
May 06, 2014
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, DC 20549

FORM 10-Q

(Mark One)

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

For the quarterly period ended March 31, 2014

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 000-31141

INFINITY PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Delaware	**33-0655706**
(State or other jurisdiction of incorporation or organization)	**(I.R.S. Employer Identification No.)**

780 Memorial Drive, Cambridge, Massachusetts 02139

(Address of principal executive offices) (zip code)

(617) 453-1000

(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 x No ¨

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T (§232.405 of this chapter) during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes x No ¨

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

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

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

Number of shares of the registrant s Common Stock, $0.001 par value, outstanding on April 21, 2014: 48,542,517

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INFINITY PHARMACEUTICALS, INC.

FORM 10-Q

FOR THE QUARTER ENDED MARCH 31, 2014

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PART I. FINANCIAL INFORMATION

Item 1. Unaudited Condensed Consolidated Financial Statements

INFINITY PHARMACEUTICALS, INC.

Condensed Consolidated Balance Sheets

(unaudited)

(in thousands, except share and per share amounts)

	March 31, 2014	December 31, 2013
Assets		
Current assets:		
Cash and cash equivalents	$ 54,971	$ 68,114
Available-for-sale securities	116,560	145,772
Loan commitment asset, net (note 8)	10,655	
Prepaid expenses and other current assets	12,064	11,055
Total current assets	194,250	224,941
Property and equipment, net	3,748	4,010
Long-term available-for-sale securities	565	582
Restricted cash	1,130	1,130
Other assets	88	47
Total assets	$ 199,781	$ 230,710
Liabilities and stockholders equity		
Current liabilities:		
Accounts payable	$ 5,852	$ 6,375
Accrued expenses	13,763	9,164
Due to Millennium, current	6,508	6,667
Total current liabilities	26,123	22,206
Due to Millennium, less current portion		6,456
Other liabilities	605	773
Total liabilities	26,728	29,435
Commitments and contingencies		
Stockholders equity:		
Preferred Stock, $0.001 par value; 1,000,000 shares authorized, no shares issued and outstanding at March 31, 2014 and December 31, 2013		
Common Stock, $0.001 par value; 100,000,000 shares authorized, and 48,518,382 and 48,227,838 shares issued and outstanding, at	48	48

March 31, 2014 and December 31, 2013, respectively				
Additional paid-in capital		664,912		650,867
Accumulated deficit		(492,062)		(449,796)
Accumulated other comprehensive income		155		156
Total stockholders equity		173,053		201,275
Total liabilities and stockholders equity	$	199,781	$	230,710

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

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INFINITY PHARMACEUTICALS, INC.

Condensed Consolidated Statements of Operations and Comprehensive Loss

(unaudited)

(in thousands, except share and per share amounts)

	Three Months Ended March 31,	
	2014	**2013**
Operating expenses:		
Research and development	$ 34,491	$ 20,231
General and administrative	6,804	7,430
Total operating expenses	41,295	27,661
Loss from operations	(41,295)	(27,661)
Other income (expense):		
Interest expense	(1,139)	
Investment and other income	168	335
Total other income (expense)	(971)	335
Net loss	$ (42,266)	$ (27,326)
Basic and diluted loss per common share	$ (0.87)	$ (0.57)
Basic and diluted weighted average number of common shares outstanding	48,348,767	47,620,147
Other comprehensive income (loss):		
Net unrealized holding gains (losses) on available-for-sale securities arising during the period	(1)	17
Comprehensive loss	$ (42,267)	$ (27,309)

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

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INFINITY PHARMACEUTICALS, INC.

Condensed Consolidated Statements of Cash Flows

(unaudited)

(in thousands)

	Three Months Ended March 31,	
	2014	**2013**
Operating activities		
Net loss	$ (42,266)	$ (27,326)
Adjustments to reconcile net loss to net cash used in operating activities:		
Depreciation	468	442
Stock-based compensation including 401(k) match	3,744	3,992
Net amortization of premium/discount on available-for-sale securities	592	393
Non-cash interest expense on Due to Millennium amount	52	
Amortization of loan commitment asset	1,139	
Other, net	(30)	102
Changes in operating assets and liabilities:		
Prepaid expenses and other assets	(1,050)	(1,474)
Accounts payable, accrued expenses and other liabilities	463	(1,429)
Due to Millennium	(6,667)	
Net cash used in operating activities	(43,555)	(25,300)
Investing activities		
Purchases of property and equipment	(176)	(287)
Purchases of available-for-sale securities	(12,536)	(91,829)
Proceeds from maturities of available-for-sale securities	41,172	40,340
Net cash provided by (used in) investing activities	28,460	(51,776)
Financing activities		
Proceeds from issuances of common stock related to stock incentive plans	1,952	2,476
Net cash provided by financing activities	1,952	2,476
Net decrease in cash and cash equivalents	(13,143)	(74,600)
Cash and cash equivalents at beginning of period	68,114	175,742
Cash and cash equivalents at end of period	$ 54,971	$ 101,142
Supplemental schedule of noncash investing and financing activities		
Loan commitment asset	$ 11,350	$
Facility fee	$ 3,000	$
Warrants issued	$ 8,350	$

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

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Infinity Pharmaceuticals, Inc.

Notes to Condensed Consolidated Financial Statements

(Unaudited)

1. Organization

Infinity Pharmaceuticals, Inc. is an innovative biopharmaceutical company dedicated to discovering, developing and delivering best-in-class medicines to patients with difficult-to-treat diseases. As used throughout these unaudited, condensed consolidated financial statements, the terms Infinity, we, us, and our refer to the business of Infinity Pharmaceuticals, Inc. and its wholly owned subsidiaries.

2. Basis of Presentation

These condensed consolidated financial statements include the accounts of Infinity and its wholly owned subsidiaries. We have eliminated all significant intercompany accounts and transactions in consolidation.

The accompanying condensed consolidated financial statements have been prepared in accordance with generally accepted accounting principles for interim financial information and with the instructions to Form 10-Q and Article 10 of Regulation S-X. Accordingly, they do not include all of the information and footnotes required by generally accepted accounting principles for complete financial statements. In the opinion of management, all adjustments, consisting of normal recurring accruals and revisions of estimates, considered necessary for a fair presentation of the accompanying condensed consolidated financial statements have been included. Interim results for the three months ended March 31, 2014 are not necessarily indicative of the results that may be expected for the fiscal year ending December 31, 2014.

The information presented in the condensed consolidated financial statements and related footnotes at March 31, 2014, and for the three months ended March 31, 2014 and 2013, is unaudited, and the condensed consolidated balance sheet amounts and related footnotes at December 31, 2013 have been derived from our audited financial statements. For further information, please refer to the consolidated financial statements and accompanying footnotes included in our annual report on Form 10-K for the fiscal year ended December 31, 2013, which was filed with the U.S. Securities and Exchange Commission on February 25, 2014.

3. Significant Accounting Policies

Cash Equivalents and Available-For-Sale Securities

Cash equivalents and available-for-sale securities primarily consist of money market funds, U.S. government-sponsored enterprise obligations, corporate obligations and mortgage-backed securities. Corporate obligations include obligations issued by corporations in countries other than the United States, including some obligations that have not been guaranteed by governments or government agencies. We consider all highly liquid investments with maturities of three months or less at the time of purchase to be cash equivalents. Cash equivalents, which consist of money market funds and corporate obligations, are stated at fair value. They are also readily convertible to known amounts of cash and have such short-term maturities that each presents insignificant risk of change in value due to changes in interest rates. Our classification of cash equivalents is consistent with prior periods.

We determine the appropriate classification of marketable securities at the time of purchase and reevaluate such designation at each balance sheet date. We have classified all of our marketable securities at March 31, 2014 and December 31, 2013 as available-for-sale. We carry available-for-sale securities at fair value, with the unrealized gains and losses reported in accumulated other comprehensive income, which is a separate component of stockholders equity.

We adjust the cost of available-for-sale debt securities for amortization of premiums and accretion of discounts to maturity. We include such amortization and accretion in investment and other income. The cost of securities sold is based on the specific identification method. We include in investment and other income interest and dividends on securities classified as available-for-sale.

We conduct periodic reviews to identify and evaluate each investment that is in an unrealized loss position in order to determine whether an other-than-temporary impairment exists. An unrealized loss exists when the current fair value of an individual security is less than its amortized cost basis. Unrealized losses on available-for-sale debt securities that are determined to be temporary, and not related to credit loss, are recorded, net of tax, in accumulated other comprehensive income.

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For available-for-sale debt securities in an unrealized loss position, we perform an analysis to assess whether we intend to sell or whether we would more likely than not be required to sell the security before the expected recovery of the amortized cost basis. Where we intend to sell a security, or may be required to do so, the security s decline in fair value is deemed to be other-than-temporary, and the full amount of the unrealized loss is recorded within earnings as an impairment loss.

Regardless of our intent to sell a security, we perform additional analysis on all securities in an unrealized loss position to evaluate losses associated with the creditworthiness of the security. Credit losses are identified where we do not expect to receive cash flows sufficient to recover the amortized cost basis of a security and are recorded within earnings as an impairment loss.

Segment Information

We operate in one business segment, which focuses on drug discovery and development. We make operating decisions based upon performance of the enterprise as a whole and utilize our consolidated financial statements for decision making.

All of our revenues to date have been generated under research collaboration agreements.

Basic and Diluted Net Loss per Common Share

Basic net loss per share is based upon the weighted average number of common shares outstanding during the period. Diluted net loss per share is based upon the weighted average number of common shares outstanding during the period plus the effect of 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) and the exercise of outstanding warrants. In addition, the assumed proceeds under the treasury stock method include the average unrecognized compensation expense of stock options that are in-the-money. This results in the assumed buyback of additional shares, thereby reducing the dilutive impact of stock options. Common equivalent shares have not been included in the net loss per share calculations for the periods presented because the effect of including them would have been anti-dilutive. Total potential gross common equivalent shares consisted of the following:

	At March 31,	
	2014	**2013**
Stock options	6,772,555	6,241,841
Warrants	1,000,000	

Comprehensive Loss

Comprehensive loss is comprised of net loss and other comprehensive income (loss). Other comprehensive income (loss) is comprised of unrealized holding gains and losses arising during the period on available-for-sale securities that are not other-than-temporarily impaired. During the three months ended March 31, 2014, there were no reclassifications out of accumulated other comprehensive income (loss).

Stock-Based Compensation Expense

For awards granted to employees and directors, including our Employee Stock Purchase Plan, or ESPP, we measure stock-based compensation cost at the grant date based on the estimated fair value of the award and recognize it as expense over the requisite service period on a straight-line basis. We record the expense of services rendered by non-employees based on the estimated fair value of the stock option as of the respective vesting date. We use the Black-Scholes valuation model in determining the fair value of all equity awards. For awards with performance conditions, we estimate the likelihood of satisfaction of the performance conditions, which affects the period over which the expense is recognized, and recognize the expense over the requisite service period on a straight-line basis. We have no awards with market conditions.

Revenue Recognition

To date, all of our revenue has been generated under research collaboration agreements. The terms of these research collaboration agreements may include payment to us of non-refundable, up-front license fees, funding or reimbursement of research and development efforts, milestone payments if specified objectives are achieved, and/or royalties on product sales. We recognize revenue based upon our best estimate of the selling price for an undelivered item when there is no other means to determine the fair value of that undelivered item.

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At the inception of each agreement that includes milestone payments, we evaluate whether each milestone is substantive on the basis of the contingent nature of the milestone. This evaluation includes an assessment of whether:

- the consideration is commensurate with either (1) our performance to achieve the milestone, or (2) the enhancement of the value of the delivered item(s) as a result of a specific outcome resulting from our performance to achieve the milestone,
- the consideration relates solely to past performance, and
- the consideration is reasonable relative to all of the deliverables and payment terms within the arrangement.

In making this assessment, we evaluate factors such as the clinical, regulatory, commercial and other risks that must be overcome to achieve the respective milestone, the level of effort and investment required, and whether the milestone consideration is reasonable relative to all deliverables and payment terms in the arrangement. We recognize revenues related to substantive milestones in full in the period in which the substantive milestone is achieved. If a milestone payment is not considered substantive, we recognize the applicable milestone over the remaining period of performance.

We will recognize royalty revenue, if any, based upon actual and estimated net sales by the licensee of licensed products in licensed territories, and in the period the sales occur. We have not recognized any royalty revenue to date.

Research and Development Expense

Research and development expense consists of expenses incurred in performing research and development activities, including salaries and benefits, overhead expenses including facilities expenses, materials and supplies, preclinical expenses, clinical trial and related clinical manufacturing expenses, comparator drug expenses, stock-based compensation expense, depreciation of equipment, contract services, and other outside expenses. We also include as research and development expense up-front license payments related to acquired technologies which have not yet reached technological feasibility and have no alternative use. We expense research and development costs as they are incurred. We have been a party to collaboration agreements in which we were reimbursed for work performed on behalf of the collaborator, as well as one in which we reimbursed the collaborator for work it had performed. We record all appropriate expenses under our collaborations as research and development expense. If the arrangement provides for reimbursement of research and development expenses, as was the case with our alliance with Mundipharma and Purdue, we record the reimbursement as revenue. If the arrangement provides for us to reimburse the collaborator for research and development expenses or achieving a development milestone for which a payment is due, as was the case with our agreement with Intellikine, Inc., or Intellikine, we record the reimbursement or the achievement of the development milestone as research and development expense. In January 2012, Intellikine was acquired by Takeda Pharmaceutical Company Limited, or Takeda, acting through its Millennium business unit. We refer to our PI3K program licensor as Millennium.

Income Taxes

We use the liability method to account for income taxes. Deferred tax assets and liabilities are determined based on temporary differences between financial reporting and income tax basis of assets and liabilities, as well as net

operating loss and tax credit carryforwards, and are measured using the enacted tax rates and laws that will be in effect when the differences reverse. Deferred tax assets are reduced by a valuation allowance to reflect the uncertainty associated with their ultimate realization. The effect of a change in tax rate on deferred taxes is recognized in income or loss in the period that includes the enactment date.

We use our judgment for the financial statement recognition and measurement of a tax position taken or expected to be taken in a tax return. We recognize any material interest and penalties related to unrecognized tax benefits in income tax expense.

Due to the uncertainty surrounding the realization of the net deferred tax assets in future periods, we have recorded a full valuation allowance against our otherwise recognizable net deferred tax assets as of March 31, 2014 and December 31, 2013.

Fair Value Measurements

We define fair value as the price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date. We determine fair value based on the assumptions market participants use when pricing the asset or liability. We also use the fair value hierarchy that prioritizes the information used to develop these assumptions.

We value our available-for-sale securities utilizing third party pricing services. The pricing services use many observable market inputs to determine value, including benchmark yields, reportable trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers, reference data, new issue data, monthly payment information and collateral performance. We validate the prices provided by our third party pricing services by understanding the models used, obtaining market values from other pricing sources, and confirming that those securities trade in active markets. We value the balance of the release payment due to Millennium based on a discounted cash flow model.

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Property and Equipment

Property and equipment are stated at cost. Depreciation is recorded using the straight-line method over the estimated useful lives of the applicable assets. Application development costs incurred for computer software developed or obtained for internal use are capitalized. Upon sale or retirement, the cost and related accumulated depreciation are eliminated from the respective account and the resulting gain or loss, if any, is included in current operations. Amortization of leasehold improvements and capital leases is recorded as depreciation expense and included in research and development and general and administrative expense. Repairs and maintenance charges that do not increase the useful life of the assets are charged to operations as incurred. Property and equipment are depreciated over the following periods:

Laboratory equipment	5 years
Computer equipment and software	3 to 5 years
Leasehold improvements	Shorter of lease term or useful life of asset
Furniture and fixtures	7 years

4. Stock-Based Compensation

Total stock-based compensation expense related to all equity awards for the three months ended March 31, 2014 and 2013 comprised the following:

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
	(in thousands)	
Effect of stock-based compensation on net loss by line item:		
Research and development	$ 2,205	$ 1,542
General and administrative	1,539	2,450

As of March 31, 2014, we had approximately $23.6 million of total unrecognized compensation cost, net of estimated forfeitures, related to unvested stock options and awards under our ESPP, which are expected to be recognized over a weighted-average period of 2.8 years.

During the three months ended March 31, 2014, two members of our board of directors retired and were granted the right to exercise their vested stock options for an additional six-month period. In addition, one employee whose employment terminated received an accelerated vesting of his unvested options. In connection with these modifications, we recognized an additional $0.4 million in stock-based compensation expense during the three months ended March 31, 2014.

Stock Options

During the three months ended March 31, 2014, we granted options to purchase 1,152,884 shares of our common stock at a weighted average fair value of $7.79 and a weighted average exercise price of $13.13. During the three months ended March 31, 2013, we granted options to purchase 986,094 shares of our common stock at a weighted average fair value of $20.44 and a weighted average exercise price of $37.33. For the three months ended March 31,

2014 and 2013, the fair values were estimated using the Black-Scholes valuation model using the following weighted-average assumptions:

	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013
Risk-free interest rate	1.7%	0.8%
Expected annual dividend yield		
Expected stock price volatility	71.1%	60.4%
Expected term of options	5.1 years	5.0 years

During the three months ended March 31, 2014, options to purchase 280,772 shares of common stock were exercised, with a weighted-average exercise price of $6.95.

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Employee Stock Purchase Plan

The weighted-average fair value of each purchase right granted during the three months ended March 31, 2014 was $6.33. For the three months ended March 31, 2014, the fair values were estimated using the Black-Scholes valuation model using the following weighted-average assumptions:

	Three Months Ended March 31, 2014
Risk-free interest rate	0.2%
Expected annual dividend yield	
Expected stock price volatility	75.21%
Expected term of options	1.2 years

5. Cash, Cash Equivalents and Available-for-Sale Securities

The following is a summary of cash, cash equivalents and available-for-sale securities:

	March 31, 2014			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
Cash and cash equivalents due in 90 days or less	$ 54,971	$	$	$ 54,971
Available-for-sale securities:				
Corporate obligations due in one year or less	78,107	32	(9)	78,130
Corporate obligations due in one to five years	10,162	18		10,180
Mortgage-backed securities due after ten years	461	104		565
U.S. government-sponsored enterprise obligations due in one year or less	28,240	12	(2)	28,250
Total available-for-sale securities	116,970	166	(11)	117,125
Total cash, cash equivalents and available-for-sale securities	$ 171,941	$ 166	$ (11)	$ 172,096

	December 31, 2013			
	Cost	Gross Unrealized Gains	Gross Unrealized Losses	Estimated Fair Value
		(in thousands)		
Cash and cash equivalents due in 90 days or less	$ 68,114	$	$	$ 68,114
Available-for-sale securities:				
Corporate obligations due in one year or less	103,889	18	(16)	103,891
Corporate obligations due in one to five years	13,513	32		13,545

Mortgage-backed securities due after ten years	478	104		582
U.S. government-sponsored enterprise obligations due in one year or less	24,144	13		24,157
U.S. government-sponsored enterprise obligations due in one to five years	4,174	5		4,179
Total available-for-sale securities	146,198	172	(16)	146,354
Total cash, cash equivalents and available-for-sale securities	$ 214,312	$ 172	$ (16)	$ 214,468

We held 17 debt securities at March 31, 2014 that had been in an unrealized loss position for less than 12 months and no debt securities that had been in an unrealized loss position for 12 months or greater. The fair value on these securities was $43.6 million. We evaluated our securities for other-than-temporary impairments based on quantitative and qualitative factors. We considered the decline in market value for these 17 securities to be primarily attributable to current economic and market conditions. It is not more likely than not that we will be required to sell these securities, and we do not intend to sell these securities before the recovery of their amortized cost bases. Based on our analysis, we do not consider these investments to be other-than-temporarily impaired as of March 31, 2014.

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As of March 31, 2014, we held 13 debt securities from financial institutions and other companies located in the United Kingdom, the Netherlands, Japan, Switzerland, Australia and France with a fair value of $41 million. Seven of these securities, which were issued by the Netherlands, Japan, France and the United Kingdom, had gross unrealized losses of $3,000 and a fair value of $14.3 million. These securities are short term in nature and are scheduled to mature research within 12 months. Based on our analysis, we do not consider these investments to be other-than-temporarily impaired as of March 31, 2014.

We had no material realized gains or losses on our available-for-sale securities for the three months ended March 31, 2014 and 2013. There were no other-than-temporary impairments recognized for the three months ended March 31, 2014 and 2013.

6. Fair Value

We use a valuation hierarchy for disclosure of the inputs used to measure fair value. This hierarchy prioritizes the inputs into three broad levels. Level 1 inputs, which we consider the highest level inputs, are quoted prices (unadjusted) in active markets for identical assets or liabilities. Level 2 inputs are quoted prices for similar assets and liabilities in active markets or inputs that are observable for the asset or liability, either directly or indirectly through market corroboration, for substantially the full term of the financial instrument. Level 3 inputs are unobservable inputs based on our own assumptions used to measure assets and liabilities at fair value. The classification of a financial asset or liability within the hierarchy is determined based on the lowest level input that is significant to the fair value measurement. For our fixed income securities, we reference pricing data supplied by our custodial agent and nationally known pricing vendors, using a variety of daily data sources, largely readily-available market data and broker quotes. We validate the prices provided by our third party pricing services by reviewing their pricing methods and obtaining market values from other pricing sources. After completing our validation procedures, we did not adjust or override any fair value measurements provided by our pricing services as of March 31, 2014 and December 31, 2013.

The following table provides the assets carried at fair value measured on a recurring basis as of March 31, 2014:

	Level 1	Level 2
	(in thousands)	
Assets:		
Cash and cash equivalents	$ 54,971	$
Corporate obligations (including commercial paper)		88,310
Mortgage-backed securities		565
U.S. government-sponsored enterprise obligations		28,250
Total	$ 54,971	$ 117,125

The fair value of the available-for-sale securities and cash and cash equivalents (including asset types listed below with maturities of three months or less at the time of purchase) is based on the following inputs:

Corporate Obligations:

Commercial paper: calculations by custodian based on the three month Treasury bill published on the last business day of the month.

Other: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data.

Mortgage-Backed Securities: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data, new issue data, monthly payment information and collateral performance.

U.S. Government-Sponsored Enterprise Obligations: benchmark yields, reported trades, broker/dealer quotes, issuer spreads, two-sided markets, benchmark securities, bids, offers and reference data.

The amount due to Millennium is recorded at its carrying value at March 31, 2014. The fair value of the amount due to Millennium, a Level 2 measurement, was approximately $6.6 million as of March 31, 2014 and was determined using a discounted cash flow model and based on an interest rate we would be charged for a similar loan as of March 31, 2014 (see note 7).

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The carrying amounts reflected in the condensed consolidated balance sheets for prepaid expenses and other current assets, other assets, accounts payable and accrued expenses approximate their fair value due to their short term maturities.

There have been no changes to the valuation methods during the three months ended March 31, 2014. We evaluate transfers between levels at the end of each reporting period. There were no transfers of assets or liabilities between Level 1 and Level 2 during the three months ended March 31, 2014. We had no available-for-sale securities that were classified as Level 3 at any point during the three months ended March 31, 2014 or during the year ended December 31, 2013.

7. Collaborations

Millennium

In July 2010, we entered into a development and license agreement with Intellikine under which we obtained rights to discover, develop and commercialize pharmaceutical products targeting the delta and/or gamma isoforms of PI3K, including IPI-145, and we paid Intellikine a $13.5 million up-front license fee. In January 2012, Intellikine was acquired by Takeda acting through its Millennium business unit. In December 2012, we amended and restated our development and license agreement with Millennium.

Under the terms of the amended and restated agreement, we retained worldwide development and commercialization rights for products arising from the agreement for all therapeutic indications, and we are solely responsible for research conducted under the agreement. Additionally, under the amended and restated agreement, Millennium waived certain commercial rights and, in consideration of such waiver, we agreed to pay to Millennium $15 million, payable in installments. During the year ended December 31, 2012, we paid $1.7 million of the $15 million, and we recorded the $15 million release payment at its fair value of $14.4 million in research and development expenses. During the three months ended March 31, 2014, we paid to Millennium the second installment of $6.7 million. The remaining amount is due in January 2015, which we recorded as short-term liability due to Millennium on our condensed consolidated balance sheet.

In addition to developing IPI-145, we are seeking to develop our second potent, oral PI3K-delta,gamma inhibitor product candidate, IPI-443, and we are seeking to identify additional novel inhibitors of PI3K-delta and/or PI3K-gamma for future development. We are obligated to pay to Millennium up to $5 million in remaining success-based milestone payments for the development of two distinct product candidates, and up to $450 million in success-based milestones for the approval and commercialization of two distinct products. In February 2014, we paid Millennium a $10 million milestone payment in connection with the initiation of our Phase 3 study of IPI-145 in patients with relapsed or refractory CLL. We recognized the $10 million payment as research and development expense during the three months ended March 31, 2014. In addition, we are obligated to pay Millennium tiered royalties on worldwide net sales ranging from 7 percent to 11 percent upon successful commercialization of products described in the agreement. Such royalties are payable until the later to occur of the expiration of specified patent rights and the expiration of non-patent regulatory exclusivities in a country, subject to reduction of the royalties, and limits on the number of products subject to a royalty obligation, in certain circumstances.

The amended and restated agreement expires on the later of the expiration of certain patents and the expiration of the royalty payment terms for the products, unless earlier terminated. Either party may terminate the agreement on 75 days prior written notice if the other party materially breaches the agreement and fails to cure such breach within the applicable notice period, provided that the notice period is reduced to 30 days where the alleged breach is non-payment. Millennium may also terminate the agreement if we are not diligent in developing or commercializing

the licensed products and do not, within three months after notice from Millennium, demonstrate to Millennium s reasonable satisfaction that we have not failed to be diligent. The foregoing periods are subject to extension in certain circumstances. Additionally, Millennium may terminate the agreement upon 30 days prior written notice if we or a related party bring an action challenging the validity of any of the licensed patents, provided that we have not withdrawn such action before the end of the 30-day notice period. We may terminate the agreement at any time upon 180 days prior written notice. The agreement also provides for customary reciprocal indemnification obligations of the parties.

Mundipharma and Purdue

Strategic Alliance Termination Agreements

On July 17, 2012, we terminated our strategic alliance with Mundipharma International Corporation Limited, or Mundipharma, and Purdue Pharmaceutical Products L.P., or Purdue, and entered into termination and revised relationship agreements with each of those entities, which we refer to as the 2012 Termination Agreements. We considered Mundipharma, Purdue and their respective associated entities to be related parties for financial reporting purposes prior to April 2013 because of their equity ownership in us. The alliance was previously governed by strategic alliance agreements that we entered into with each of Mundipharma and Purdue in November 2008. The strategic alliance agreement with Purdue was focused on the development and commercialization in the United States of products targeting fatty acid amide hydrolase, or FAAH. The strategic alliance agreement with Mundipharma was focused on the development and commercialization outside of the United States of all products and product candidates that inhibit or target the Hedgehog pathway, FAAH, phosphoinositide-3-kinase, or PI3K, and product candidates arising out of our early discovery projects in all disease fields. Our heat shock protein 90, or Hsp90, program was expressly excluded from the alliance.

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Under the terms of the 2012 Termination Agreements:

- All intellectual property rights that we had previously licensed to Mundipharma and Purdue to develop and commercialize products under the previous strategic alliance agreements terminated, with the result that we have worldwide rights to all product candidates that had previously been covered by the strategic alliance.

- We have no further obligation to provide research and development services to Mundipharma and Purdue as of July 17, 2012.

- Mundipharma and Purdue have no further obligation to provide research and development funding to us. Under the alliance, Mundipharma was obligated to reimburse us for research and development expenses we incurred, up to an annual aggregate cap for each alliance program other than FAAH. We did not record a liability for amounts previously funded by Purdue and Mundipharma as this relationship was not considered a financing arrangement.

- We are obligated to pay Mundipharma and Purdue a 4 percent royalty in the aggregate, subject to reduction as described below, on worldwide net sales of products that were covered by the alliance until such time as they have recovered approximately $260 million, representing the research and development funding paid to us for research and development services performed by us through the termination of the strategic alliance. After this cost recovery, our royalty obligations to Mundipharma and Purdue will be reduced to a one percent royalty on net sales in the United States of products that were previously subject to the strategic alliance. All payments are contingent upon the successful commercialization of products subject to the alliance, which products are subject to significant further development. As such, there is significant uncertainty about whether any such products will ever be approved or commercialized. If no products are commercialized, no payments will be due by us to Mundipharma and Purdue; therefore, no amounts have been accrued.

Royalties are payable under these agreements until the later to occur of the last-to-expire of specified patent rights and the expiration of non-patent regulatory exclusivities in a country, provided that if royalties are payable solely on the basis of non-patent regulatory exclusivity, each of the royalty rates is reduced by 50 percent. In addition, royalties payable under these agreements after Mundipharma and Purdue have recovered all research and development expenses paid to us are subject to reduction on account of third party royalty payments or patent litigation damages or settlements which might be required to be paid by us if litigation were to arise, with any such reductions capped at 50 percent of the amounts otherwise payable during the applicable royalty payment period.

Line of Credit Agreement

In connection with the previous strategic alliance with Mundipharma and Purdue, we also entered into a line of credit agreement with Purdue and its independent associated company, Purdue Pharma L.P., or PPLP, that provided for the borrowing by us of one or more unsecured loans up to an aggregate maximum principal amount of $50 million. On September 7, 2012, upon completion of the sale and issuance of common stock to PPLP under the 2012 Securities Purchase Agreement described below, the line of credit agreement with PPLP terminated in its entirety.

2012 Securities Purchase Agreement

On July 17, 2012, in connection with the termination of the strategic alliance with Mundipharma and Purdue, we executed a securities purchase agreement with PPLP, which we refer to as the 2012 Securities Purchase Agreement, under which we agreed to sell and issue 5,416,565 shares of our common stock to PPLP and two entities associated with PPLP, which we collectively refer to as the BRP entities, at a price of $14.50 per share for an aggregate consideration of approximately $78.5 million and, in connection therewith, to grant various rights to the BRP entities. The consideration was composed of extinguishment of approximately $51 million in principal and interest owed to PPLP under a line of credit agreement and $27.5 million in cash. We completed the sale and issuance on September 7, 2012 at which time the line of credit agreement with PPLP terminated in its entirety. The 2012 Securities Purchase Agreement terminated in its entirety.

April 2013 Offering and 2013 Termination Agreement

On April 16, 2013, the BRP entities, through two selling stockholders, sold 11,416,565 shares in an underwritten public offering at a price of $40 per share, representing their entire holdings in our common stock. In connection with the public offering and sale of their common stock, we entered into an agreement with the BRP entities, pursuant to which the 2012 Securities Purchase Agreement, as amended in connection with the offering, terminated in its entirety. Following the closing of the offering, the BRP entities no longer owned any shares of our common stock at such time, and, as such, are no longer related parties.

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8. Debt Facility Agreement

Facility Agreement

On February 24, 2014, we entered into a facility agreement with affiliates of Deerfield Management Company, L.P., or Deerfield, which we refer to as the Facility Agreement. Pursuant to the Facility Agreement, Deerfield agreed to loan us up to $100 million, subject to the terms and conditions set forth in the Facility Agreement. Under the terms of the Facility Agreement, we may draw down on the Facility Agreement in $25 million minimum disbursements, which we refer to as the Loan Commitment, at any time until February 27, 2015, which we will refer to as the Draw Period. Our ability to draw down under the Facility Agreement is subject to various customary conditions, including the entry into a guaranty and security agreement , or the Guaranty, with Deerfield and Infinity Discovery, Inc., or IDI, one of our wholly-owned subsidiaries, pursuant to which, as security for the repayment of our obligations under the Facility Agreement, IDI will guaranty all of our obligations under the Facility Agreement. As an additional condition to our initial draw down under the Facility Agreement, both IDI and we will grant to Deerfield a security interest in substantially all of our assets including intellectual property to secure our obligations under the Facility Agreement and the Guaranty. In exchange for the Loan Commitment, on February 24, 2014, we issued to Deerfield warrants to purchase 1,000,000 shares of our common stock at an exercise price of $13.83 per share.

Any amounts drawn under the Facility Agreement accrue interest at a rate of 7.95 percent per annum, and such interest shall be payable quarterly in arrears on the first day of each June, September, December and March following the disbursement date, provided that, subject to the next sentence, during the first five interest payment dates of any draw under the Facility Agreement, we may elect to pay all or a portion of such accrued interest by adding it to the principal amount outstanding. All such accrued interest will, regardless of which draw it applies to, be payable on the last business day of the sixth calendar quarter following the date of the first draw under the Facility Agreement. We have the right to terminate the Facility Agreement and/or to prepay amounts owed under the Facility Agreement at any time, provided that, to the extent that any amount was drawn less than three years before such early termination or prepayment, we will be required to pay an additional amount equal to three years of interest on the amount being prepaid less the amount of interest previously paid on such amount. For amounts drawn under the Facility Agreement, we will be required to repay them to Deerfield in installments equal to one-third of the outstanding amount of the total principal amount drawn under the Facility Agreement on each of the third, fourth and fifth anniversaries of the first draw; the final payment, however, must be made by December 15, 2019.

On February 27, 2015, or upon the earlier termination or acceleration of the facility, we are required to pay a fee equal to 3 percent of the difference between the $100 million commitment and the aggregate amount of disbursements under the Facility Agreement made prior to such date, which we refer to as the Facility Fee. As of March 31, 2014, we have not drawn under the Facility Agreement and have determined it probable that we will be required to pay the full Facility Fee amount of $3 million on February 27, 2015. We have recorded the full $3 million Facility Fee on the March 31, 2014 condensed consolidated balance sheet as a component of both the loan commitment asset and accrued expenses line items. The loan commitment asset is being amortized to interest expense in the condensed consolidated statements of operations and comprehensive loss on a straight line basis over the Draw Period.

Deerfield will have the right to accelerate payment of the facility in the event that we consummate a major transaction, which is generally defined as a change in control, a sale of all or substantially all of our assets, a tender or exchange offer for our common stock, a liquidation, bankruptcy, insolvency, dissolution or wind up, a delisting and/or the common stock ceases to be registered under the Securities Exchange Act of 1934, or the Exchange Act. Any amounts drawn under the Facility Agreement may become immediately due and payable upon (i) customary events of default, as defined in the Facility Agreement, or (ii) the consummation of certain major transactions, in which case Deerfield would have the right to require us to repay 100 percent of the principal amount of the loan, plus any accrued and

unpaid interest thereon, plus any applicable additional amounts relating to a prepayment or termination, as described above.

Principal and interest under the Facility Agreement may be paid in cash or freely tradable shares of common stock at our election, subject to specified conditions at any time of conversion. The Facility Agreement contains various representations and warranties, and affirmative covenants customary for agreements of this type, including the requirement that we maintain at all times a cash, cash equivalents and available-for-sales securities balance of not less than $25 million, as well as negative covenants customary for financings of this type that are applicable upon the first draw under the Facility Agreement. Additionally, the Facility Agreement contains conditions that must be met prior to disbursements, including the condition that the number of shares of our common stock issued or issuable pursuant to all warrants following the proposed disbursement, together with payments made in our common stock under the Facility Agreement, will not exceed 9,500,000 shares.

Our total cost of securing the Loan Commitment was $11.8 million and is comprised of $8.4 million representing the fair value of the 1,000,000 warrants issued on February 24, 2014, discussed below, $3 million representing the Facility Fee and $0.4 million of transaction costs. The total fair value, a Level 2 measurement, is considered a Loan Commitment Asset which has been classified as a current asset on the March 31, 2014 condensed consolidated balance sheets. This amount is considered a fee to secure the Loan Commitment and is being amortized to interest expense in the March 31, 2014 condensed consolidated statements of operations and comprehensive loss on a straight line basis over the Draw Period. We recorded $1.1 million of interest expense associated with the amortization of the loan commitment asset for the three months ended March 31, 2014.

Warrants

In connection with the entry into the Facility Agreement, on February 24, 2014, we issued to Deerfield warrants to purchase 1,000,000 shares of our common stock at an exercise price of $13.83 per share. As of March 31, 2014, all such warrants were outstanding and exercisable. The fair value of the warrants on February 24, 2014, was $8.4 million. The warrants were valued as of February 24, 2014 using a Black Scholes model with the following assumptions: expected life of seven years; risk free rate of 2.2 percent; expected volatility of 59.01 percent; and no expected dividend yield. The warrants qualify for permanent treatment as equity and are classified as additional paid-in capital on the March 31, 2014 condensed consolidated balance sheet.

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With each disbursement made by Deerfield, we have agreed to issue additional warrants to purchase a number of shares of our common stock equal to 50 percent times the quotient of the amount of such disbursement divided by an exercise price equal to the average daily volume weighted average price per share of our common stock for the 20 consecutive trading day period following Deerfield s receipt of the applicable disbursement request. The maximum number of shares of our common stock issued or issuable pursuant to all warrants and payments made in our common stock under the Facility Agreement is 9,500,000, subject to appropriate adjustment to reflect any stock splits, stock combination, reclassification or similar adjustments in the number of outstanding shares of common stock. The warrants have dividend rights to the same extent as if the warrants were exercised into shares of common stock.

Each warrant issued under the Facility Agreement expires on the seventh anniversary of its issuance and contains certain limitations that prevent the holder from acquiring shares upon exercise of a warrant that would result in the number of shares beneficially owned by it exceeding 9.985 percent of the total number of shares of common stock then issued and outstanding.

9. Accrued Expenses

Accrued expenses consisted of the following:

	March 31, 2014	December 31, 2013
	(in thousands)	
Accrued compensation and benefits	$ 3,169	$ 1,839
Accrued clinical studies	4,114	4,009
Accrued drug manufacturing costs	1,066	991
Accrued preclinical studies	268	303
Facility fee	3,000	
Other	2,146	2,022
Total accrued expenses	$ 13,763	$ 9,164

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

Forward-Looking Information

The following discussion of our financial condition and results of operations should be read in conjunction with our condensed consolidated financial statements and related notes included elsewhere in this report. Some of the information contained in this discussion and analysis and set forth elsewhere in this report, including information with respect to our plans and strategy for our business, the possible achievement of discovery and development milestones in 2014, our future discovery and development efforts, our collaborations, and our future operating results and financial position, includes forward-looking statements that involve risks and uncertainties. We often use words such as anticipate, believe, estimate, expect, intend, may, plan, predict, project, target, potential, w continue, and other words and terms of similar meaning to help identify forward-looking statements, although not all forward-looking statements contain these identifying words. You also can identify these forward-looking statements by the fact that they do not relate strictly to historical or current facts. There are a number of important risks and uncertainties that could cause actual results or events to differ materially from those indicated by forward-looking statements. These risks and uncertainties include those inherent in pharmaceutical research and development, such as adverse results in our drug discovery and clinical development activities, decisions made by the U.S. Food and Drug Administration, or FDA, and other regulatory authorities with respect to the development and commercialization of our product candidates, our ability to obtain, maintain and enforce intellectual property rights for our product candidates, our dependence on our alliance partners, competition, our ability to obtain any necessary financing to conduct our planned activities and other risk factors. You should review the section titled Risk Factors in Part II of this report for a discussion of important factors that could cause actual results to differ materially from the results described in or implied by the forward-looking statements contained in the following discussion and analysis. Unless required by law, we do not undertake any obligation to update any forward-looking statements.

Business Overview

We are an innovative biopharmaceutical company dedicated to discovering, developing and delivering best-in-class medicines to patients with difficult-to-treat diseases. We combine proven scientific expertise with a passion for developing novel small molecule drugs that target emerging disease pathways. We have worldwide development and commercialization rights to all of our development candidates and early discovery programs, subject to certain financial obligations to our current licensor and former development partners.

Research and Development Programs

PI3 Kinase Inhibitor Program

Phosphoinositide-3-kinases, or the PI3Ks, are a family of enzymes involved in multiple cellular functions, including cell proliferation and survival, cell differentiation, cell migration and immunity. The PI3K-delta and PI3K-gamma isoforms are preferentially expressed in white blood cells, where they have distinct and mostly non-overlapping roles in immune cell development and function. Targeting PI3K-delta and PI3K-gamma may provide multiple opportunities to develop differentiated therapies for the treatment of hematologic malignancies and inflammatory diseases. IPI-145, our lead product candidate, is a potent, oral inhibitor of Class I PI3K-delta and PI3K-gamma, or a PI3K delta,gamma inhibitor, which we are investigating in both hematologic malignancies and inflammatory diseases. We believe that IPI-145 is the only PI3K-delta,gamma inhibitor in Phase 3 of clinical development.

Hematologic Malignancies

We are conducting DUETTS™, a worldwide investigation of IPI-145 in blood cancers. As part of the DUETTS program, we are conducting DYNAMO™, a Phase 2, open-label, single arm study evaluating the safety and efficacy of IPI-145 dosed at 25mg twice daily, or BID, in approximately 120 patients with indolent non-Hodgkin lymphoma, or iNHL, including follicular lymphoma, marginal zone lymphoma and small lymphocytic lymphoma, or SLL, whose disease is refractory to radioimmunotherapy or both rituximab and chemotherapy. Patients enrolled in the study must have progressed within six months of receiving their last therapy. The primary endpoint of the study is response rate according to the International Working Group Criteria, or IWGC. The FDA has granted orphan drug designation to IPI-145 for the potential treatment of follicular lymphoma, the most common subtype of iNHL. We intend to expand the DUETTS program in 2014 with the initiation of DYNAMO+R, a Phase 3 study of IPI-145 in combination with rituximab, a monoclonal antibody therapy, in patients with relapsed iNHL, as well as a Phase 2 study in treatment-naïve patients with iNHL and at least one additional clinical study in patients with hematologic malignancies.

Additionally, under the DUETTS program we are also enrolling patients in DUO™, a Phase 3 study of IPI-145 in patients with chronic lymphocytic lymphoma, or CLL. This randomized study is designed to evaluate the safety and efficacy of IPI-145 dosed at 25 mg BID compared to ofatumumab in approximately 300 patients with relapsed or refractory CLL. The primary endpoint of the study is progression-free survival. The FDA and the European Medicines Agency, or EMA, have granted orphan drug designation to IPI-145 for the potential treatment of CLL and SLL.

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These trials are supported by data from our ongoing Phase 1, open-label, dose-escalation study designed to evaluate the safety, pharmacokinetics and clinical activity of IPI-145 in patients with advanced hematologic malignancies. The dose-escalation portion of the trial is complete, with the maximum tolerated dose defined at 75 mg BID. We are continuing to evaluate IPI-145 across two 25mg BID expansion cohorts in patients with relapsed/refractory CLL, iNHL and mantle cell lymphoma, or MCL, and treatment-naïve CLL in high-risk patients (those patients who are over age 65 or have either of two genetic abnormalities known as a 17p deletion or p53 mutation). Additionally, we are continuing to evaluate IPI-145 across five 75mg BID expansion cohorts in patients with relapsed/refractory CLL, iNHL and MCL; T-cell lymphomas; aggressive B-cell lymphomas; myeloid neoplasms; and T-cell or B-cell acute lymphoblastic leukemia/lymphoma. Data from this study, presented in December 2013 at the Annual Meeting of the American Society for Hematology, or ASH, and in January 2014 at the 6th Annual T-Cell Lymphoma Forum, showed that IPI-145 is clinically active in CLL, iNHL, T-Cell lymphoma, as well as other hematologic malignancies.

An investigator-sponsored Phase 1b, open-label study of IPI-145 in patients with B-cell NHL, CLL and T-cell lymphoma in combination with rituximab, bendamustine (a chemotherapy), or both rituximab and bendamustine is also open for enrollment (NCT01871675).

Inflammatory and Autoimmune Diseases

Within inflammatory diseases, IPI-145 is currently being evaluated in two Phase 2 trials. The first trial, which we refer to as the ASPIRA trial, is a Phase 2, randomized, double-blind, placebo-controlled study designed to evaluate the efficacy, safety and pharmacokinetics of IPI-145 in patients with rheumatoid arthritis, or RA. The study is expected to enroll approximately 316 adults with moderate-to-severe RA and is designed to examine three dose levels of IPI-145 given twice daily for 12 weeks in combination with methotrexate compared to treatment with methotrexate alone. The primary efficacy endpoint of the study is the American College of Rheumatology 20 response rate, or ACR20, which is defined as the proportion of patients who achieve at least a 20 percent improvement in ACR response criteria. The second trial is a Phase 2a randomized, double-blind, placebo-controlled trial of IPI-145 in patients with mild, allergic asthma. Endpoints of this multi-dose, two-way crossover study include safety, pharmacokinetics and FEV1, a measure of lung function. We expect to report topline data from each of these studies in 2014.

Pipeline Expansion

We are also developing our second PI3K product candidate, a potent, oral PI3K-delta, gamma inhibitor that we refer to as IPI-443. The nonclinical studies of IPI-443 required for Phase 1 development, and the data from the two Phase 2 studies of IPI-145 in inflammatory and autoimmune diseases will guide the next steps for the development of IPI-443.

Other Programs

In addition to our clinical stage programs, we have multiple innovative projects in earlier stages of development. Through our internal discovery efforts, we discovered IPI-940, a novel, orally available inhibitor of fatty acid amide hydrolase, or FAAH. It is believed that inhibition of FAAH may enable the body to bolster its own analgesic and anti-inflammatory response and may have applicability in a broad range of painful or inflammatory conditions. We are currently seeking potential partnering opportunities for our FAAH program.

Strategic Alliances

Millennium

In July 2010, we entered into a development and license agreement with Intellikine, Inc., or Intellikine, under which we obtained rights to discover, develop and commercialize pharmaceutical products targeting the delta and/or gamma isoforms of PI3K, including IPI-145, and we paid Intellikine a $13.5 million up-front license fee. In January 2012, Intellikine was acquired by Takeda Pharmaceutical Company Limited, or Takeda, acting through its Millennium business unit. We refer to our PI3K program licensor as Millennium. In December 2012, we amended and restated our development and license agreement with Millennium.

Under the terms of the amended and restated agreement, we retained worldwide development and commercialization rights for products arising from the agreement for all therapeutic indications, and we are solely responsible for research conducted under the agreement. Additionally, under the amended and restated agreement, Millennium waived certain commercial rights and, in consideration of such waiver, we agreed to pay to Millennium $15 million, payable in installments.

In addition to developing IPI-145, we are seeking to develop our second potent, oral PI3K-delta,gamma inhibitor product candidate, IPI-443, and we are seeking to identify additional novel inhibitors of PI3K-delta and/or PI3K-gamma for future development. We are obligated to pay to Millennium up to $5 million in remaining success-based milestone payments for the development of two distinct product candidates and up to $450 million in success-based milestones for the approval and commercialization of two distinct products. In February 2014, we paid Millennium a $10 million milestone payment in connection with the initiation of our Phase 3 study of IPI-145 in patients with relapsed or refractory CLL. In addition, we are obligated to pay

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Millennium tiered royalties on worldwide net sales ranging from 7 percent to 11 percent upon successful commercialization of products described in the agreement. Such royalties are payable until the later to occur of the expiration of specified patent rights and the expiration of non-patent regulatory exclusivities in a country, subject to reduction of the royalties, and limits on the number of products subject to a royalty obligation, in certain circumstances.

The amended and restated agreement expires on the later of the expiration of certain patents and the expiration of the royalty payment terms for the products, unless earlier terminated. Either party may terminate the agreement on 75 days prior written notice if the other party materially breaches the agreement and fails to cure such breach within the applicable notice period, provided that the notice period is reduced to 30 days where the alleged breach is non-payment. Millennium may also terminate the agreement if we are not diligent in developing or commercializing the licensed products and do not, within three months after notice from Millennium, demonstrate to Millennium s reasonable satisfaction that we have not failed to be diligent. The foregoing periods are subject to extension in certain circumstances. Additionally, Millennium may terminate the agreement upon 30 days prior written notice if we or a related party bring an action challenging the validity of any of the licensed patents, provided that we have not withdrawn such action before the end of the 30-day notice period. We may terminate the agreement at any time upon 180 days prior written notice. The agreement also provides for customary reciprocal indemnification obligations of the parties.

Mundipharma and Purdue

Strategic Alliance Termination Agreements

On July 17, 2012, we terminated our strategic alliance with Mundipharma International Corporation Limited, or Mundipharma, and Purdue Pharmaceutical Products L.P., or Purdue, and entered into termination and revised relationship agreements with each of those entities, which we refer to as the 2012 Termination Agreements. The alliance was previously governed by strategic alliance agreements that we entered into with each of Mundipharma and Purdue in November 2008. The strategic alliance agreement with Purdue was focused on the development and commercialization in the United States of products targeting FAAH. The strategic alliance agreement with Mundipharma was focused on the development and commercialization outside the United States of all products and product candidates that inhibit or target the Hedgehog pathway, FAAH, PI3K and product candidates arising out of our early discovery projects in all disease fields. Our Hsp90 program was expressly excluded from the alliance.

Under the terms of the 2012 Termination Agreements:

- All intellectual property rights that we had previously licensed to Mundipharma and Purdue to develop and commercialize products under the previous strategic alliance agreements terminated, with the result that we have worldwide rights to all product candidates that had previously been covered by the strategic alliance.

- We have no further obligation to provide research and development services to Mundipharma and Purdue as of July 17, 2012.

Mundipharma and Purdue have no further obligation to provide research and development funding to us. Under the alliance, Mundipharma was obligated to reimburse us for research and development expenses we incurred, up to an annual aggregate cap for each alliance program other than FAAH. We did not record a liability for amounts previously funded by Purdue and Mundipharma as this relationship was not considered a financing arrangement.

We are obligated to pay Mundipharma and Purdue a 4 percent royalty in the aggregate, subject to reduction as described below, on worldwide net sales of products that were covered by the alliance until such time as they have recovered approximately $260 million, representing the research and development funding paid to us for research and development services performed by us through the termination of the strategic alliance. After this cost recovery, our royalty obligations to Mundipharma and Purdue will be reduced to a one percent royalty on net sales in the United States of products that were previously subject to the strategic alliance. All payments are contingent upon the successful commercialization of products subject to the alliance, which products are subject to significant further development. As such, there is significant uncertainty about whether any such products will ever be approved or commercialized. If no products are commercialized, no payments will be due by us to Mundipharma and Purdue; therefore, no amounts have been accrued.

Royalties are payable under these agreements until the later to occur of the last-to-expire of specified patent rights and the expiration of non-patent regulatory exclusivities in a country, provided that if royalties are payable solely on the basis of non-patent regulatory exclusivity, each of the royalty rates is reduced by 50 percent. In addition, royalties payable under these agreements after Mundipharma and Purdue have recovered all research and development expenses paid to us are subject to reduction on account of third party royalty payments or patent litigation damages or settlements which might be required to be paid by us if litigation were to arise, with any such reductions capped at 50 percent of the amounts otherwise payable during the applicable royalty payment period.

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Strategic Debt Facility

Facility Agreement

On February 24, 2014, we entered into a facility agreement with affiliates of Deerfield Management Company, L.P., or Deerfield, which we refer to as the Facility Agreement. Pursuant to the Facility Agreement, Deerfield agreed to loan us up to $100 million, subject to the terms and conditions set forth in the Facility Agreement. Under the terms of the Facility Agreement, we may draw down on the Facility Agreement in $25 million minimum disbursements, which we refer to as the Loan Commitment, at any time until February 27, 2015, which we will refer to as the Draw Period. Our ability to draw down under the Facility Agreement is subject to various customary conditions, including the entry into a Guaranty and Security Agreement, or Guaranty, with Deerfield and Infinity Discovery, Inc., or IDI, our a wholly-owned subsidiary, pursuant to which, as security for the repayment of our obligations under the Facility Agreement, IDI will guaranty all our obligations under the Facility Agreement and, to secure the obligations under the Facility Agreement and the Guaranty, both we and IDI will grant to Deerfield a security interest in substantially all our assets including intellectual property.

Any amounts drawn under the Facility Agreement accrue interest at a rate of 7.95 percent per annum, and such interest shall be payable quarterly in arrears on the first day of each June, September, December and March following the disbursement date, provided that, subject to the next sentence, during the first five interest payment dates of any draw under the Facility Agreement, we may elect to pay all or a portion of such accrued interest by adding it to the principal amount outstanding. All such accrued interest will, regardless of which draw it applies to, be payable on the last business day of the sixth calendar quarter following the date of the first draw under the Facility Agreement. We have the right to terminate the Facility Agreement and/or to prepay amounts owed under the Facility Agreement at any time, provided that, to the extent that any amount was drawn less than three years before such early termination or prepayment, we will be required to pay an additional amount equal to three years of interest on the amount being prepaid less the amount of interest previously paid on such amount. For amounts drawn under the Facility Agreement, we will be required to repay them to Deerfield in installments equal to one-third of the outstanding amount of the total principal amount drawn under the Facility Agreement on each of the third, fourth and fifth anniversaries of the first draw; the final payment, however, must be made by December 15, 2019. On February 27, 2015, or upon the earlier termination or acceleration of the facility, we are required to pay a fee equal to 3 percent of the difference between the $100 million commitment and the aggregate amount of disbursements under the Facility Agreement made prior to such date, which we refer to as the Facility Fee.

Deerfield will have the right to accelerate payment of the facility in the event that we consummate a major transaction, which is generally defined as a change in control, a sale of all or substantially all of our assets, a tender or exchange offer for our common stock, a liquidation, bankruptcy, insolvency, dissolution or wind up, a delisting and/or the common stock ceases to be registered under the Securities Exchange Act of 1934, or the Exchange Act. Any amounts drawn under the Facility Agreement may become immediately due and payable upon (i) customary events of default, as defined in the Facility Agreement, or (ii) the consummation of certain major transactions, in which case Deerfield would have the right to require us to repay 100 percent of the principal amount of the loan, plus any accrued and unpaid interest thereon, plus any applicable additional amounts relating to a prepayment or termination, as described above.

Principal and interest under the Facility Agreement may be paid in cash or freely tradable shares of common stock at our election, subject to specified conditions at any time of conversion. The Facility Agreement contains various representations and warranties, and affirmative covenants customary for agreements of this type, including the requirement that we maintain at all times a cash, cash equivalents and available-for-sale securities balance of not less than $25 million, as well as negative covenants customary for financings of this type that are applicable upon the first

draw under the Facility Agreement. Additionally, the Facility Agreement contains conditions that must be met prior to disbursements, including the condition that the number of shares of our common stock issued or issuable pursuant to all warrants following the proposed disbursement, together with payments made in our common stock under the Facility Agreement, will not exceed 9,500,000 shares.

Warrants

In connection with the execution of the Facility Agreement, we issued to Deerfield warrants to purchase an aggregate of 1,000,000 shares of common stock at an exercise price of $13.83 per share, or the Initial Warrants. As noted above, pursuant to the Facility Agreement, we have the right to request from Deerfield one or more cash disbursements in the minimum amount of $25 million per disbursement, which disbursements shall be accompanied by the issuance to Deerfield of warrants, which we refer to as the Draw Warrants, to purchase an aggregate number of shares of common stock equal to 50 percent times the quotient of the amount of such disbursement divided by an exercise price equal to the average daily volume weighted average price per share of our common stock for the 20 consecutive trading day period following Deerfield s receipt of the applicable disbursement request. We refer to the Initial Warrants and the Draw Warrants individually as a Warrant or together as the Warrants. The maximum number of shares of our common stock issued or issuable pursuant to all warrants and payments made in our common stock under the Facility Agreement is 9,500,000, subject to appropriate adjustment to reflect any stock splits, stock combination, reclassification or similar adjustments in the number of outstanding shares of common stock. The warrants have dividend rights to the same extent as if the warrants were exercised into shares of common stock.

Each warrant issued under the Facility Agreement expires on the seventh anniversary of its issuance and contains certain limitations that prevent the holder from acquiring shares upon exercise of a warrant that would result in the number of shares beneficially owned by it exceeding 9.985 percent of the total number of shares of common stock then issued and outstanding.

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Registration Rights Agreement

In connection with the entry into the Facility Agreement and issuance of the Initial Warrants, we entered into a Registration Rights Agreement with Deerfield dated February 24, 2014. Pursuant to the terms of the Registration Rights Agreement, we filed a registration statement on Form S-3 with the Securities and Exchange Commission on February 25, 2014 to register for resale the shares of common stock issuable upon the exercise of the Initial Warrants. Additionally, pursuant to the terms of the Registration Rights Agreement, we agreed to file one or more additional registration statements with the SEC to register for resale the shares of common stock issuable upon the exercise of the applicable Draw Warrants, on or prior to 30 days after issuance of each of the Draw Warrants.

Financial Overview

Revenue

All of our revenue to date has been derived from license fees, the reimbursement of research and development costs, contract service revenue and milestone payments received from our collaboration partners. License fees were recognized as revenue ratably over the expected research and development period under our arrangement with Mundipharma and Purdue. Because our agreements with Mundipharma and Purdue also provided for funding for our research and development efforts, we recognized this cost reimbursement as revenue in the period earned in proportion to our forecasted total expenses as compared to the total research funding budget for the year. In the future, we may generate revenue from a combination of product sales, research and development support services and milestone payments in connection with strategic relationships, as well as royalties resulting from the sales of products developed under licenses of our intellectual property. We expect that any potential future revenue we generate will fluctuate from year to year as a result of the timing and amount of license fees, research and development reimbursement, milestone and other payments earned under our collaborative or strategic relationships and the amount and timing of payments that we earn upon the sale of our products, to the extent any are successfully commercialized.

Research and Development Expense

We are a drug discovery and development company. Our research and development expense primarily consists of the following:

- compensation of personnel associated with research and development activities;
- clinical testing costs, including payments made to contract research organizations;
- costs of comparator drugs used in clinical studies;
- costs of purchasing laboratory supplies and materials;
- costs of manufacturing product candidates for preclinical testing and clinical studies;

costs associated with the licensing of research and development programs;

preclinical testing costs, including costs of toxicology studies;

fees paid to external consultants;

fees paid to professional service providers for independent monitoring and analysis of our clinical trials;

costs for collaboration partners to perform research activities, including development milestones for which a payment is due when achieved;

depreciation of equipment; and

allocated costs of facilities.

General and Administrative Expense

General and administrative expense primarily consists of compensation of personnel in executive, finance, accounting, legal, information technology infrastructure, corporate communications, corporate development, human resources and commercial functions. Other costs include facilities costs not otherwise included in research and development expense and professional fees for legal and accounting services. General and administrative expense also consists of the costs of maintaining our intellectual property portfolio.

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Other Income and Expense

Interest and investment income typically consists of interest earned on cash, cash equivalents and available-for-sale securities, net of interest expense and amortization of warrants. Interest expense is related to the amortization of the loan commitment asset recognized under our Facility Agreement with Deerfield.

Critical Accounting Policies and Significant Judgments and Estimates

The discussion and analysis of our financial condition and results of operations is based on our condensed consolidated financial statements, which have been prepared in accordance with accounting principles generally accepted in the United States. The preparation of these financial statements requires us to make judgments, estimates and assumptions that affect the amounts reported in the financial statements and accompanying notes. On an ongoing basis, we evaluate our estimates, including those related to revenue recognition, accrued expenses, assumptions in the valuation of stock-based compensation and income taxes. We base our estimates on historical experience and on various other assumptions that we believe to be reasonable under the circumstances. Actual results could differ from those estimates.

There have been no material changes to our critical accounting policies during the three months ended March 31, 2014. Please refer to Part II, Item 7 Management s Discussion and Analysis of Financial Condition and Results of Operations of our annual report on Form 10-K for the fiscal year ended December 31, 2013 for a discussion of our critical accounting policies and significant judgments and estimates.

Results of Operations

The following tables summarize our results of operations for each of the three months ended March 31, 2014 and 2013, together with the change in these items in dollars and as a percentage:

	Three Months Ended March 31,			
	2014	2013	$ Change	% Change
	(in thousands)			
Research and development expense	$ (34,491)	$ (20,231)	$ (14,260)	70%
General and administrative expense	(6,804)	(7,430)	626	(8)%
Interest expense	(1,139)		(1,139)	
Investment and other income	168	335	(167)	(50)%

Research and Development Expense

The $14.3 million increase in research and development expense for the three months ended March 31, 2014 as compared to the three months ended March 31, 2013 was primarily due to a $10 million milestone payment made to Millennium in connection with the initiation of our Phase 3 study of IPI-145 recognized during the three months ended March 31, 2014 and $5.1 million in higher clinical expenses related to increased clinical development activities of IPI-145.

We began to track and accumulate expenses by major program starting on January 1, 2006. These expenses primarily relate to payroll and related expenses for personnel working on the programs, process development and manufacturing, preclinical toxicology studies, clinical trial costs and allocated costs of facilities. During the three

months ended March 31, 2014 and 2013, and from January 1, 2006 through March 31, 2014, we estimate that we incurred the following expenses by program:

Program	Three Months Ended March 31, 2014	Three Months Ended March 31, 2013	January 1, 2006 to March 31, 2014
		(in millions)	
PI3K inhibitor (1)	$ 27.8	$ 13.0	$ 189.8
Hsp90 inhibitor	0.9	4.8	137.0
Hedgehog pathway inhibitor	0.1	0.6	164.1

(1) Includes $10 million milestone payment in 2014

We expect expenses related to our PI3K programs to increase as we continue clinical development of IPI-145. We expect expenses related to our Hsp90 program to decrease significantly as we conclude development of retaspimycin HCl. We expect to incur minimal expenses related to our Hedgehog pathway inhibitor programs as a result of the discontinuation of company-sponsored development. We do not believe that the historical costs associated with our lead drug development programs are indicative of the future costs associated with these programs, nor represent what any other future drug development programs we initiate may cost. Due to the variability in the length of time and scope of activities necessary to develop a product candidate and uncertainties related to our cost estimates and our ability to obtain marketing approval for our product candidates, accurate and meaningful estimates of the total costs required to bring our product candidates to market are not available.

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Because of the risks inherent in drug discovery and development, we cannot reasonably estimate or know:

- the nature, timing and estimated costs of the efforts necessary to complete the development of our programs;
- the completion dates of these programs; or
- the period in which material net cash inflows are expected to commence, if at all, from the programs described above and any potential future product candidates.

There is significant uncertainty regarding our ability to successfully develop any product candidates. These risks include the uncertainty of:

- the scope, rate of progress and cost of our clinical trials that we are currently conducting or may commence in the future;
- the scope and rate of progress of our preclinical studies and other research and development activities;
- clinical trial results;
- the cost and availability of comparator drugs;
- the cost of filing, prosecuting, defending and enforcing any patent claims and other intellectual property rights relating to our programs under development;
- the terms and timing of any strategic alliance, licensing and other arrangements that we have or may establish in the future relating to our programs under development;
- the cost and timing of regulatory approvals;
- the cost of establishing clinical supplies of any product candidates; and
- the effect of competing technological and market developments.

General and Administrative Expense

The decrease in general and administrative expense for the three months ended March 31, 2014 as compared to the three months ended March 31, 2013 is primarily attributable to $0.9 million in lower stock-based compensation expense, primarily related to non-employee stock options.

Interest Expense

Interest expense for the three months ended March 31, 2014 is related to the amortization of the loan commitment asset recognized under our Facility Agreement with Deerfield.

Investment and Other Income

Investment and other income decreased in the three months ended March 31, 2014 as compared to the three months ended March 31, 2013 primarily as a result a non-recurring cash distribution received from one of our insurance carriers during the three months ended March 31, 2013.

Liquidity and Capital Resources

We have not generated any revenue from the sale of drugs to date, and we do not expect to generate any such revenue for the next several years, if at all. We have instead relied on the proceeds from sales of equity securities, interest on investments, up-front license fees, expense reimbursement, milestones and cost sharing under our collaborations and debt to fund our operations. Our available-for-sale debt securities primarily trade in liquid markets, and the average days to maturity of our portfolio, as of December 31, 2013, is less than six months. Because our product candidates are in various stages of clinical and preclinical development and the outcome of these efforts is uncertain, we cannot estimate the actual amounts necessary to successfully complete the development and commercialization of our product candidates or whether, or when, we may achieve profitability.

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Our significant capital resources are as follows:

	March 31, 2014	December 31, 2013
	(in thousands)	
Cash, cash equivalents and available-for-sale securities	$ 172,096	$ 214,468
Working capital	168,127	202,735

	Three Months Ended March 31,	
	2014	2013
	(in thousands)	
Cash provided by (used in):		
Operating activities	$ (43,555)	$ (25,300)
Investing activities	28,460	(51,776)
Capital expenditures (included in investing activities above)	(176)	(287)