
**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 June 30, 2011

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 001-33103

CADENCE PHARMACEUTICALS, INC.

(Exact name of registrant as specified in its charter)

Delaware
(State or other jurisdiction
of incorporation)

41-2142317
(I.R.S. Employer
Identification No.)

12481 High Bluff Drive, Suite 200
San Diego, CA 92130
(Address of principal executive offices) (Zip code)

(858) 436-1400
(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 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 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 definitions 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 Smaller reporting company
(Do not check if a 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

As of July 31, 2011, there were 63,614,881 shares of the registrant's Common Stock outstanding.

CADENCE PHARMACEUTICALS, INC.

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PART I. FINANCIAL INFORMATION

Item 1. *Financial Statements*CADENCE PHARMACEUTICALS, INC.
CONDENSED BALANCE SHEETS
(in thousands, except share and per share data)

| | June 30, 2011 (unaudited) | December 31, 2010 |
|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|---------------------------------|----------------------|
| Assets | | |
| Current assets: | | |
| Cash and cash equivalents | \$ 61,742 | \$ 112,175 |
| Investments in marketable securities | 32,392 | 21,966 |
| Restricted cash | 450 | 150 |
| Accounts receivable, net | 1,136 | - |
| Inventory | 6,726 | 485 |
| Prepaid expenses | 875 | 1,232 |
| Other current assets | 83 | 36 |
| Total current assets | 103,404 | 136,044 |
| Property and equipment, net | 10,102 | 8,986 |
| Intangible assets, net | 14,104 | 15,000 |
| Restricted cash | 190 | 190 |
| Other assets | 3,505 | 3,566 |
| Total assets | <u>\$ 131,305</u> | <u>\$ 163,786</u> |
| Liabilities and Stockholders' Equity | | |
| Current liabilities: | | |
| Accounts payable | \$ 6,068 | \$ 3,416 |
| Accrued liabilities | 8,630 | 7,286 |
| Deferred revenue | 677 | - |
| Current debt, less discount of \$429 | 9,638 | 4,023 |
| Total current liabilities | 25,013 | 14,725 |
| Long-term debt, less current portion and discount of \$506 and \$894, respectively | 19,427 | 24,654 |
| Other liabilities | 520 | 447 |
| Total liabilities | 44,960 | 39,826 |
| Commitments and contingencies (Note 11) | | |
| Stockholders' equity : | | |
| Common stock, \$0.0001 par value; 100,000,000 shares authorized, 63,583,065 shares and 63,107,361 shares issued and outstanding at June 30, 2011 and December 31, 2010, respectively | 6 | 6 |
| Additional paid-in capital | 403,587 | 397,616 |
| Accumulated other comprehensive income | - | - |
| Accumulated deficit | (317,248) | (273,662) |
| Total stockholders' equity | 86,345 | 123,960 |
| Total liabilities and stockholders' equity | <u>\$ 131,305</u> | <u>\$ 163,786</u> |

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

CADENCE PHARMACEUTICALS, INC.
CONDENSED STATEMENTS OF OPERATIONS
(Unaudited)
(in thousands, except per share amounts)

| | Three Months Ended June 30, | | Six Months Ended June 30, | |
|----------------------------------------------------------------------------|--------------------------------|--------------------|------------------------------|--------------------|
| | 2011 | 2010 | 2011 | 2010 |
| Revenues: | | | | |
| Product revenue, net | \$ 1,706 | \$ - | \$ 2,056 | \$ - |
| License revenues | 5,210 | - | 5,210 | - |
| Total revenues | <u>6,916</u> | <u>-</u> | <u>7,266</u> | <u>-</u> |
| Costs and expenses: | | | | |
| Cost of product sales | 981 | - | 1,270 | - |
| Amortization of patent license | 336 | - | 896 | - |
| Research and development | 2,600 | 2,797 | 5,346 | 7,028 |
| Selling, general and administrative | 21,082 | 7,802 | 41,060 | 17,318 |
| Other | (1) | 1,286 | (1) | 1,298 |
| Total costs and expenses | <u>24,998</u> | <u>11,885</u> | <u>48,571</u> | <u>25,644</u> |
| Loss from operations | (18,082) | (11,885) | (41,305) | (25,644) |
| Other (expense) income: | | | | |
| Interest income | 37 | 20 | 79 | 44 |
| Interest expense | (1,163) | (369) | (2,353) | (553) |
| Other expense | (6) | 15 | (7) | 15 |
| Total other expense, net | <u>(1,132)</u> | <u>(334)</u> | <u>(2,281)</u> | <u>(494)</u> |
| Net loss | <u>\$ (19,214)</u> | <u>\$ (12,219)</u> | <u>\$ (43,586)</u> | <u>\$ (26,138)</u> |
| Basic and diluted net loss per share ⁽¹⁾ | <u>\$ (0.30)</u> | <u>\$ (0.24)</u> | <u>\$ (0.69)</u> | <u>\$ (0.52)</u> |
| Shares used to compute basic and diluted net loss per share ⁽¹⁾ | <u>63,428</u> | <u>50,522</u> | <u>63,307</u> | <u>50,516</u> |

⁽¹⁾ As a result of the issuance of shares of common stock pursuant to a public offering in the fourth quarter of 2010, there is a lack of comparability in the per share amounts between the periods presented. Please see Note 4 of the Notes to Financial statements for further discussion.

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

CADENCE PHARMACEUTICALS, INC.
CONDENSED STATEMENTS OF CASH FLOWS
(Unaudited)
(in thousands)

| | Six Months Ended June 30, | |
|------------------------------------------------------------------------------------------|------------------------------|------------------|
| | 2011 | 2010 |
| Operating activities | | |
| Net loss | \$ (43,586) | \$ (26,138) |
| Adjustments to reconcile net loss to net cash used in operating activities: | | |
| Depreciation | 822 | 339 |
| (Gain) loss on disposal of assets | (1) | 9 |
| Impairment of long-lived assets | - | 1,186 |
| Stock-based compensation | 4,570 | 5,902 |
| Non-cash interest expense | 35 | 20 |
| Amortization of intangible assets | 896 | - |
| Amortization of discount on note payable | 388 | 158 |
| Amortization of premiums on available-for-sale securities, net of accretion of discounts | 22 | 33 |
| Changes in operating assets and liabilities: | | |
| Accounts receivable | (1,136) | - |
| Inventory | (6,241) | - |
| Prepaid expenses and other current assets | 356 | 396 |
| Accounts payable | 2,108 | (576) |
| Deferred revenue | 677 | - |
| Accrued liabilities and other liabilities | 1,445 | (2,551) |
| Net cash used in operating activities | <u>(39,645)</u> | <u>(21,222)</u> |
| Investing activities | | |
| Purchases of marketable securities | (36,826) | (7,050) |
| Maturities of marketable securities | 26,358 | 6,000 |
| Investment in unconsolidated subsidiary | - | (3,500) |
| Restricted cash | (300) | - |
| Purchases of property and equipment | (1,422) | (1,925) |
| Proceeds from the sale of property and equipment | 1 | 3 |
| Net cash used in investing activities | <u>(12,189)</u> | <u>(6,472)</u> |
| Financing activities | | |
| Proceeds from issuance of common stock, net | 1,401 | 83 |
| Borrowings under debt agreements, net of fees | - | 19,591 |
| Payments under debt agreements | - | (6,351) |
| Net cash provided by financing activities | <u>1,401</u> | <u>13,323</u> |
| Net decrease in cash and cash equivalents | (50,433) | (14,371) |
| Cash and cash equivalents at beginning of period | 112,175 | 75,859 |
| Cash and cash equivalents at end of period | <u>\$ 61,742</u> | <u>\$ 61,488</u> |
| Supplemental disclosures | | |
| Issuance of warrants in connection with loan and security agreement | \$ - | \$ 1,237 |
| Shares in unconsolidated entity acquired in option purchase agreement | \$ - | \$ 500 |
| Property and equipment purchases in accounts payable and accrued expenses | \$ 887 | \$ 184 |
| Cash paid for interest and fees | \$ 1,637 | \$ 938 |

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

CADENCE PHARMACEUTICALS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS
(Unaudited)

1. The Company

Cadence Pharmaceuticals, Inc. (the “Company”) was incorporated in the state of Delaware in May 2004. The Company is a biopharmaceutical company focused on in-licensing, developing and commercializing proprietary product candidates principally for use in the hospital setting. In March 2006, the Company in-licensed the exclusive U.S. and Canadian rights to OFIRMEV®, an intravenous formulation of acetaminophen, from Bristol-Myers Squibb Company (“BMS”). In November 2010, the Food and Drug Administration (“FDA”) approved the Company’s New Drug Application (“NDA”) for OFIRMEV for the management of mild to moderate pain, moderate to severe pain with adjunctive opioid analgesics, and the reduction of fever in adults and children two years of age and older. In January 2011, the Company commenced commercial sales of the product in the U.S., and therefore it is no longer considered a development stage company.

2. Summary of Significant Accounting Policies

Basis of Presentation

The Company has prepared the accompanying unaudited condensed financial statements in accordance with accounting principles generally accepted in the United States of America (“GAAP”). However, certain information and disclosures normally included in financial statements prepared in accordance with GAAP have been condensed, or omitted, pursuant to the rules and regulations of the U.S. Securities and Exchange Commission (“SEC”). In addition, the preparation of financial statements in conformity with GAAP requires management to make estimates and judgments that affect the amounts reported in the financial statements and accompanying notes. In the opinion of the Company’s management, all adjustments consisting of normal, recurring adjustments considered necessary for a fair presentation of the results of the interim periods presented have been included. These condensed financial statements should be read in conjunction with the audited financial statements of the Company for the fiscal year ended December 31, 2010, as included in the Company’s 2010 Annual Report on Form 10-K filed with the SEC on March 4, 2011.

Revenue Recognition

The Company recognizes revenue when there is persuasive evidence that an arrangement exists, title has passed, collection is reasonably assured and the price is fixed or determinable. It sells OFIRMEV mostly to wholesalers who in-turn sell the product to hospitals. Sales to wholesalers provide for selling prices that are fixed on the date of sale, although the Company offers certain discounts to group purchasing organizations. The wholesalers take title to the product, bear the risk of loss of ownership, and have economic substance to the inventory. Further, the Company has no significant obligations for future performance to generate pull-through sales, however it does allow wholesalers to return product that is damaged or received in error. In addition, the Company allows for product to be returned beginning six months prior to, and ending twelve months following, product expiration. As OFIRMEV is the Company’s first and only commercially available product, it does not believe it has sufficient sales and returns history at this time to accurately predict product returns from its wholesaler distribution channel. Therefore, the Company will recognize revenue when the wholesalers sell OFIRMEV to hospitals or other end-user customers, until the point at which it has obtained sufficient history to accurately estimate returns from the wholesalers. Shipments of product that are not recognized as revenue are treated as deferred revenue until evidence exists to confirm that pull-through sales to hospitals or other end-user customers have occurred.

The Company also records certain sales reserves and allowances as a reduction to gross revenue and deferred revenue. These reserves and allowances include distribution service fees, a prompt payment reserve, a product return reserve, a group purchasing discount and chargeback reserve, and an allowance for bad debts. Distribution service fees arise from contractual agreements the Company has with certain wholesalers for distribution services they provide with respect to OFIRMEV. These fees are generally a fixed percentage of the price of the product purchased by these wholesalers. The prompt payment reserve is based upon cash discounts the Company offers certain wholesalers as an incentive to meet certain payment terms. It accounts for these cash discounts at the time the sale is made to the wholesalers and reduces its accounts receivable accordingly. The group purchasing discount and chargeback reserve is based upon contracted discounts the Company provides to members of certain purchasing groups. The Company estimates the sales through its wholesalers to these group purchasing organizations and accrues for the chargebacks it anticipates from its wholesalers for the difference between the current retail price and the reduced price paid by the members of the group purchasing organizations. A group purchasing organization fee the Company incurs for these transactions is also recorded at the time of sale. The return reserve and allowance for bad debt is based on management’s best estimate of the sales recorded during the period that are anticipated to be returned or that will be uncollectable.

CADENCE PHARMACEUTICALS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS - Continued
(Unaudited)

The Company has entered into a data license agreement among Terumo Corporation (“Terumo”), the Company and SCR Pharmatop S.A. (“Pharmatop”). Under the data license agreement, the Company provided to Terumo certain data and information resulting from the Company’s clinical development program for OFIRMEV for Terumo’s use in obtaining regulatory approval for and commercializing the same intravenous formulation of acetaminophen in Japan. Further, the Company will provide to Terumo, without charge, up to 500 hours of technical assistance and consulting services regarding the licensed technical information, data and know-how, as reasonably necessary to assist Terumo in obtaining regulatory approval and manufacturing capacity for the product candidate. In April 2011, the Company received an upfront payment of \$5,329,000 under the terms of the data license agreement. If Terumo is successful in obtaining regulatory approval for and commercializing the product in Japan, the Company may also be entitled to an additional lump-sum payment upon the first commercial sale of the product candidate, and royalty payments on any commercial sales of the product in Japan.

In accordance with multiple-element arrangement guidance, the Company determined both the data license and consulting service deliverables were separate units of accounting, each having value on a standalone basis. The Company estimated the fair value of the data license based upon similar proposals from third parties and internal costs incurred in developing the data and obtaining similar rights. The value of the consulting services was based on contracts the Company had engaged with third parties for similar services. The Company allocated the value of the payment received on a relative fair value basis and will recognize the consideration allocated to the data license upon delivery and the consideration allocated to the consulting services as such services are rendered. There is no right of return or similar refund provisions in the data license agreement. As of June 30, 2011, the Company had transferred the data and related information to Terumo and provided a portion of the consulting hours. As such, for the three and six months ended June 30, 2011, the Company recognized \$5,210,000 of licensing revenue under this agreement for the data and consulting hours provided. The remaining payment balance of \$119,000 reflects the value of the outstanding consulting hours the Company is obligated to provide under the terms of the contract through November 2012. This balance is recorded as deferred revenue on the Company’s balance sheet at June 30, 2011 and will be recognized as revenue as the consulting services are rendered. No similar revenue was recognized during the three and six months ended June 30, 2010.

Accounts Receivable

The Company extends credit to its customers in the normal course of business based upon an evaluation of the customer’s credit history, financial condition and other factors. Trade accounts receivable are recorded on gross sales to wholesalers, net of allowances for prompt payment discounts, chargebacks and doubtful accounts. Wholesaler distribution fees are recorded as accounts payable and accrued liabilities. Estimates of allowances for doubtful accounts are determined by evaluating individual customer circumstances, historical payment patterns, length of time past due, economic and other factors. As of June 30, 2011 and December 31, 2010, the Company had no reserves for doubtful accounts on its balance sheets. Further, during the three and six months ended June 30, 2011 and 2010, no charges had been incurred to reserve or write-off past due accounts.

Stock-Based Compensation

Stock option awards. Stock options are valued using the Black-Scholes option pricing model on the date of grant. This option pricing model involves a number of estimates, including the expected lives of stock options, the Company’s anticipated stock volatility and interest rates. The following table summarizes the weighted average estimates the Company used in the Black-Scholes option-pricing model during the periods presented, to determine the fair value of employee and non-employee director stock options granted during each period:

| | Three Months Ended | | Six Months Ended | |
|--------------------------|--------------------|-----------|------------------|-----------|
| | June 30, | | June 30, | |
| | 2011 | 2010 | 2011 | 2010 |
| Risk free interest rates | 1.7% | 2.5% | 2.2% | 2.8% |
| Expected life in years | 5.5 years | 5.4 years | 6.3 years | 5.8 years |
| Expected dividend yield | 0.0% | 0.0% | 0.0% | 0.0% |
| Expected volatility | 73.2% | 76.5% | 73.9% | 76.8% |

CADENCE PHARMACEUTICALS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS - Continued
(Unaudited)

Restricted stock units. Restricted stock units (“RSUs”) are valued based on the fair market value of the Company’s stock on the date of grant.

Compensation expense for all stock-based payment awards is recognized using the straight-line method. Stock-based compensation expense recognized during the period is based on the value of the portion of awards that is ultimately expected to vest. Hence, the gross expense is reduced for estimated forfeitures and adjusted for the probability of achieving performance criteria. If awards are forfeited prior to vesting, all previous expense recognized for unvested awards is recovered during the period in which the forfeiture occurs.

The table below summarizes the total stock-based compensation expense included in the Company’s statements of operations for the periods presented (in thousands):

| | Three Months Ended | | Six Months Ended | |
|-------------------------------------------------------------------------|---------------------------|-----------------|-------------------------|-----------------|
| | June 30, | | June 30, | |
| | <u>2011</u> | <u>2010</u> | <u>2011</u> | <u>2010</u> |
| Cost of product sales | \$ 76 | \$ - | \$ 132 | \$ - |
| Research and development | 613 | 658 | 1,221 | 1,638 |
| Selling, general and administrative | <u>1,607</u> | <u>2,250</u> | <u>3,217</u> | <u>4,264</u> |
| Total stock-based compensation expense included in loss from operations | <u>\$ 2,296</u> | <u>\$ 2,908</u> | <u>\$ 4,570</u> | <u>\$ 5,902</u> |

Fair Value Reporting

The Company’s financial instruments consist of cash and cash equivalents, marketable securities, restricted cash, trade receivables and payables, an option purchase right, equity securities of an unconsolidated privately-held entity, accrued liabilities and long-term debt. Fair value estimates of these instruments are made at a specific point in time, based on relevant market information. These estimates may be subjective in nature and involve uncertainties and matters of significant judgment and therefore cannot be determined with precision. The carrying amount of cash and cash equivalents, restricted cash, accounts payable and accrued liabilities are generally considered to be representative of their respective fair values because of the short-term nature of those instruments. The Company’s option purchase right and equity securities of an unconsolidated privately-held entity have been initially valued based upon the transaction price under the cost method of accounting. These assets are subject to fair value adjustments in certain circumstances, such as when there is evidence of impairment. The fair value of marketable securities is based upon market prices quoted on the last day of the fiscal period.

Current accounting guidance defines fair value, establishes a framework for measuring fair value in accordance with GAAP, and requires certain disclosures about fair value measurements. The valuation techniques included in the guidance are based on observable and unobservable inputs. Observable inputs reflect readily obtainable data from independent sources, while unobservable inputs reflect market assumptions and are classified into the following fair value hierarchy:

- Level 1 Inputs* – Quoted prices for identical instruments in active markets.
- Level 2 Inputs* – Quoted prices for similar instruments in active markets; quoted prices for identical or similar instruments in markets that are not active; and model-derived valuations in which all significant inputs and significant value drivers are observable.
- Level 3 Inputs* – Valuation derived from valuation techniques in which one or more significant inputs or significant value drivers are unobservable.

CADENCE PHARMACEUTICALS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS - Continued
(Unaudited)

The following table presents further detail of the financial instruments carried at fair value on the Company's balance sheet as of June 30, 2011. The table does not include assets and liabilities which are measured at historical cost or on any basis other than fair value (in thousands):

| Description | Balance at June 30, 2011 | Fair Value Measurements as of June 30, 2011 | | |
|----------------------------------------------------|-----------------------------|---------------------------------------------|------------------|-------------|
| | | Level 1 | Level 2 | Level 3 |
| Assets: | | | | |
| Cash equivalents: | | | | |
| Money market funds | \$ 41,770 | \$ 41,770 | \$ - | \$ - |
| Debt instruments – Corporate debt obligations | 17,229 | - | 17,229 | - |
| Debt instruments – Agency debt obligations | 2,684 | - | 2,684 | - |
| Investments in marketable securities – short-term: | | | | |
| Debt instruments – Corporate debt obligations | 18,347 | - | 18,347 | - |
| Debt instruments – Municipal debt obligations | 13,045 | - | 13,045 | - |
| Certificates of deposit | 1,000 | - | 1,000 | - |
| Assets at fair value | <u>\$ 94,075</u> | <u>\$ 41,770</u> | <u>\$ 52,305</u> | <u>\$ -</u> |

The Company's level 2 financial instruments are valued using market prices on less active markets. These valuations use pricing models that vary by asset class, incorporating such data as available trade information for similar securities, expected cash flows and credit information.

3. Recent Accounting Pronouncements

In June 2011, the Financial Accounting Standards Board ("FASB") issued Accounting Standards Update ("ASU") No. 2011-05, *Comprehensive Income (Topic 220)—Presentation of Comprehensive Income*. ASU 2011-05 amends the presentation of comprehensive income to allow an entity the option to present the total of comprehensive income, the components of net income, and the components of other comprehensive income either in a single continuous statement of comprehensive income or in two separate but consecutive statements. In both options, the entity is required to present each component of net income along with total net income, each component of other comprehensive income along with a total for other comprehensive income, and a total amount for comprehensive income. The guidance eliminates the option to present the components of other comprehensive income as part of the statement of changes in stockholders' equity. The amended guidance for public entities is effective for annual and interim periods within those years beginning after December 15, 2011, and is to be applied retrospectively. The Company intends to adopt this guidance at the beginning of its first quarter of fiscal year 2012, which is not expected to have a material impact on the Company's consolidated financial statements.

In May 2011, the FASB issued ASU No. 2011-04, *Amendments to Achieve Common Fair Value Measurement and Disclosure Requirements in U.S. GAAP and International Financial Reporting Standards (Topic 820)—Fair Value Measurement* (ASU 2011-04). ASU 2011-04 provides a consistent definition of fair value and ensure that the fair value measurement and disclosure requirements are similar between U.S. GAAP and International Financial Reporting Standards. Additionally, ASU 2011-04 amends certain fair value measurement principles and enhances the disclosure requirements particularly for level 3 fair value measurements. ASU 2011-04 guidance is effective for interim and annual periods beginning after December 15, 2011, and is to be applied prospectively. The Company intends to adopt this guidance at the beginning of its first quarter of fiscal year 2012, which is not expected to have a material impact on the Company's consolidated financial statements.

In April 2011, the FASB issued ASU No. 2011-02, *A Creditor's Determination of Whether a Restructuring is a Troubled Debt Restructuring*. ASU 2011-02 clarifies existing guidance on a creditor's evaluation of whether a restructuring constitutes a troubled debt restructuring, including clarification of a creditor's evaluation of whether it has granted a concession and of whether a debtor is experiencing financial difficulties. The guidance for public entities is effective for the first interim or annual period beginning on or after June 15, 2011. The Company adopted the provisions on July 1, 2011, which had no impact on its financial statements.

CADENCE PHARMACEUTICALS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS - Continued
(Unaudited)

4. Net Loss Per Share

Net loss per share is presented as basic and diluted net loss per share. Basic net loss per share is calculated by dividing the net loss by the weighted average number of common shares outstanding for the period, without consideration for common stock equivalents. Diluted net loss per share is computed by dividing the net loss by the weighted average number of common share equivalents outstanding for the period determined using the treasury-stock method. For purposes of this calculation, stock options, restricted stock units and warrants are considered to be common stock equivalents, however they are not included in the calculations of diluted net loss per share as their effect is anti-dilutive. Additionally, the restricted stock units outstanding during the three and six months ended June 30, 2011 and 2010, were excluded from the basic net loss calculation as these units do not include dividend rights and therefore are not considered to be participating securities.

The actual net loss per share amounts for the three and six months ended June 30, 2011 and 2010 were computed based on the weighted average shares of common stock outstanding during the respective periods. The net loss per share for the three and six months ended June 30, 2011 includes the effect of the 12,500,000 common shares issued pursuant to a public offering in the fourth quarter of 2010. As a result of the issuance of these common shares, there is a lack of comparability in the basic and diluted net loss per share amounts for the three and six month periods presented.

The following is a reconciliation of the basic and diluted shares for the periods presented (in thousands):

| | <u>Three Months Ended</u> <u>June 30,</u> | | <u>Six Months Ended</u> <u>June 30,</u> | |
|---------------------------------------------------------------|----------------------------------------------|---------------|--------------------------------------------|---------------|
| | <u>2011</u> | <u>2010</u> | <u>2011</u> | <u>2010</u> |
| Shares for basic and dilutive net loss per share: | | | | |
| Weighted average common shares outstanding | 63,428 | 50,522 | 63,307 | 50,518 |
| Weighted average unvested common shares subject to repurchase | - | - | - | (2) |
| Denominator for basic and diluted earnings per share | <u>63,428</u> | <u>50,522</u> | <u>63,307</u> | <u>50,516</u> |

At June 30, 2011 and 2010, stock options, restricted stock units, and warrants totaling 14,693,000 and 13,387,000 shares, respectively, were excluded from the calculations as their effect would have been antidilutive.

5. Comprehensive Income (Loss)

Comprehensive income (loss) is defined as the change in equity during a period from transactions and other events and circumstances from non-owner sources. Components of comprehensive income (loss) include foreign currency translation adjustments and unrealized gains and losses on the changes in fair value of investments. These components are added, net of their related tax effect, to the reported net income (loss) to arrive at comprehensive income (loss). The components of other comprehensive loss for the periods presented were as follows (in thousands):

| | <u>Three Months Ended</u> <u>June 30,</u> | | <u>Six Months Ended</u> <u>June 30,</u> | |
|-------------------------------------------------------|----------------------------------------------|-------------------|--------------------------------------------|-------------------|
| | <u>2011</u> | <u>2010</u> | <u>2011</u> | <u>2010</u> |
| Net loss | <u>\$(19,214)</u> | <u>\$(12,219)</u> | <u>\$(43,586)</u> | <u>\$(26,138)</u> |
| Other comprehensive income: | | | | |
| Net unrealized gain on available-for-sale investments | <u>1</u> | <u>-</u> | <u>-</u> | <u>-</u> |
| Comprehensive loss | <u>\$(19,213)</u> | <u>\$(12,219)</u> | <u>\$(43,586)</u> | <u>\$(26,138)</u> |

CADENCE PHARMACEUTICALS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS - Continued
(Unaudited)

6. Inventory

Inventories, stated at the lower of cost or market, consisted of the following (in thousands):

| | June 30, 2011 | December 31, 2010 |
|-------------------|------------------|----------------------|
| Inventory: | | |
| Raw material | \$ 94 | \$ 68 |
| Finished goods | 6,632 | 417 |
| Total | <u>\$6,726</u> | <u>\$ 485</u> |

7. Property and Equipment

Property and equipment for operations were as follows (in thousands):

| | June 30, 2011 | December 31, 2010 |
|---------------------------------|------------------|----------------------|
| Property and equipment: | | |
| Manufacturing equipment | \$ 6,823 | \$ 4,016 |
| Leasehold improvements | 1,610 | 1,610 |
| Computer equipment and software | 1,479 | 1,505 |
| Furniture and fixtures | 455 | 455 |
| Construction-in-process | 2,924 | 3,813 |
| | <u>13,291</u> | <u>11,399</u> |
| Less accumulated depreciation | <u>(3,189)</u> | <u>(2,413)</u> |
| Total | <u>\$10,102</u> | <u>\$ 8,986</u> |

For the three months ended June 30, 2011 and 2010, the Company incurred depreciation expense of \$424,000 and \$181,000, respectively. For the six months ended June 30, 2011 and 2010, the Company incurred depreciation expense of \$822,000 and \$339,000, respectively.

8. Investments in Marketable Securities

The cost, gross unrealized holding gains, gross unrealized holding losses and fair value of available-for-sale investments by types and classes of security at June 30, 2011 and December 31, 2010 consisted of the following (in thousands):

| <u>At June 30, 2011</u> | <u>Amortized Cost Basis</u> | <u>Other-than- temporary Impairments</u> | <u>Gross Unrealized Holding Gains</u> | <u>Gross Unrealized Holding Losses</u> | <u>Fair Value</u> |
|-----------------------------------------------|---------------------------------|--------------------------------------------------|-----------------------------------------------|------------------------------------------------|-------------------|
| Available-for-sale: | | | | | |
| Debt instruments – Corporate debt obligations | \$ 18,347 | \$ - | \$ - | \$ - | \$ 18,347 |
| Debt instruments – Municipal debt obligations | 13,045 | - | - | - | 13,045 |
| Certificates of deposit | 1,000 | - | - | - | 1,000 |
| | <u>\$ 32,392</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 32,392</u> |

CADENCE PHARMACEUTICALS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS - Continued
(Unaudited)

| <u>At December 31, 2010</u> | <u>Amortized Cost Basis</u> | <u>Other-than- temporary Impairments</u> | <u>Gross Unrealized Holding Gains</u> | <u>Gross Unrealized Holding Losses</u> | <u>Fair Value</u> |
|-----------------------------------------------|---------------------------------|--------------------------------------------------|-----------------------------------------------|------------------------------------------------|-------------------|
| <u>Available-for-sale:</u> | | | | | |
| Debt instruments – Municipal debt obligations | \$ 15,466 | \$ - | \$ - | \$ - | \$ 15,466 |
| Debt instruments – Corporate debt obligations | 5,500 | - | - | - | 5,500 |
| Certificates of deposit | 1,000 | - | - | - | 1,000 |
| | <u>\$ 21,966</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ -</u> | <u>\$ 21,966</u> |

Investments by contractual maturity are as follows (in thousands):

| | <u>June 30, 2011</u> | | <u>December 31, 2010</u> | |
|-------------------------------------|----------------------|-------------------|--------------------------|-------------------|
| | <u>Cost</u> | <u>Fair Value</u> | <u>Cost</u> | <u>Fair Value</u> |
| Due or callable in one year or less | \$32,392 | \$ 32,392 | \$21,966 | \$ 21,966 |
| Due after one year | \$ - | \$ - | \$ - | \$ - |

9. Investment in Incline

On June 21, 2010, the Company entered into an option agreement (the “Option Agreement”) with Incline Therapeutics, Inc. (“Incline”), a privately held specialty pharmaceutical company, pursuant to which the Company obtained an exclusive, irrevocable option to acquire Incline during two option periods, and has additional rights after the expiration of the second period. Incline is developing IONSYS™ (fentanyl iontophoretic transdermal system), an investigational product candidate intended to provide patient-controlled analgesia for adult inpatients requiring opioids following surgery.

As consideration for the option, the Company paid Incline a \$3,500,000 upfront option fee and may pay Incline a second \$3,500,000 fee upon Incline’s receipt of the second tranche of its Series A financing if the Company has not yet exercised its option to acquire Incline. During the first option period, the Company may acquire Incline for an amount not to exceed \$135,000,000. During the second option period, the Company may acquire Incline for an amount not to exceed \$228,000,000, plus payment of an additional amount not to exceed \$57,000,000 upon FDA approval of IONSYS. The Company has notified Incline that it has decided not to exercise its option to acquire Incline during the first option period, however, the Company continues to have the right to acquire Incline during the second option period. The Company has received notice from Incline that the closing of the second tranche of its Series A financing is expected to occur on or about September 1, 2011, which would open the second option period.

The first option period, which commenced on June 21, 2010, extends through the later to occur of (1) 12 months or (2) one day prior to the date on which Incline receives the second tranche of its Series A financing. The second option period commences on the expiration of the first option period and extends until the earliest to occur of (a) 30 days after the date on which Incline submits a supplemental NDA for IONSYS to the FDA, (b) 30 days after the filing of an initial public offering by Incline, or (c) 42 months. The Company has an exclusive right of first negotiation to acquire Incline for the six-month period following the expiration of the second option period and may elect to extend the second option period for two additional three-month periods upon the payment of \$2,500,000 to Incline for each period. During the option periods, Incline will remain primarily responsible for the development of IONSYS. However, the Company and Incline have formed a joint development committee to oversee the global development and regulatory approval for the IONSYS product candidate.

The Company has determined that Incline is a variable interest entity (“VIE”). However, because it will not absorb a disproportionate amount of Incline’s expected losses or receive a disproportionate amount of Incline’s expected residual returns, the Company is not the primary beneficiary of this entity at this time. Further, Cadence will have no oversight of the day-to-day operations of Incline, nor does it have sufficient rights or voting representation to influence the operating or financial decisions of Incline. Additionally, the Company was not a founder of Incline and has no additional equity or funding requirements in future financings or otherwise. Therefore, the Company is not required to consolidate Incline into its financial statements. This consolidation status could change in the future if the option agreement is exercised, or if other changes occur in the relationship between the Company and Incline. Frazier Healthcare VI, L.P. owns approximately 22.1% of Incline’s Series A Preferred Stock. Alan D. Frazier, one of the Company’s directors, has an ownership interest in Frazier Healthcare VI, L.P., and is a member of the general partner of the entity that serves as general partner of Frazier Healthcare VI, L.P.

CADENCE PHARMACEUTICALS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS - Continued
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In consideration of the Company's expenditure of funds in connection with conducting due diligence on IONSYS, the Company received \$500,000 of Incline Series A preferred stock, or 500,000 shares, on terms generally consistent with Incline's other Series A preferred stock investors. The Company valued the initial \$3,500,000 payment in June 2010 using the cost method, assigning \$500,000 to the preferred stock and \$3,000,000 to the option. Under the cost method, the fair value of the investment is not estimated if there are no identified events or changes in circumstances that may have a significant adverse effect on the fair value of the investment. As of June 30, 2011, the Company was not aware of any such adverse effects and therefore there has been no change to the carrying value of the investment. Both assets are recorded as other long-term assets on the Company's balance sheets at June 30, 2011 and December 31, 2010, respectively.

10. Loan and Security Agreement

In June 2010, the Company entered into an Amended and Restated Loan and Security Agreement (the "Restated Agreement") with Oxford Finance Corporation, Silicon Valley Bank and GE Business Financial Services Inc. (collectively, the "lenders"). The Restated Agreement amended and restated a previous agreement with the lenders and provided the Company with a new \$30,000,000 growth capital loan facility, available to the Company in two advances. The first advance of \$20,000,000 was made in conjunction with securing the facility in June 2010 at a fixed interest rate of 11.33%. The second advance of \$10,000,000 was made available upon approval by the FDA of OFIRMEV and was drawn in November 2010 at a fixed interest rate of 10.08%. The Company paid an upfront fee of \$300,000 and reimbursed the lenders for their expenses incurred in initiating the loan. The Company will also be required to make a growth capital final payment of \$1,800,000 at the termination of the Restated Agreement. Further warrants, as described below, were issued as part of the transaction.

In connection with the establishment of the \$30,000,000 facility, the outstanding balance of the Company's previous \$15,000,000 facility was paid in full, including accrued interest, and a \$375,000 term loan final payment. Upon the repayment of the \$15,000,000 facility, the Company recorded a charge of approximately \$145,000 in the second quarter of 2010 to (i) fully amortize the balance of the loan discount and related issuance costs and (ii) fully accrue the term loan final payment. The Company will make interest-only payments on the outstanding balance of the Restated Agreement through July 1, 2011, and subsequently make principal and interest payments to fully amortize the balance over the remaining 30 month term.

The warrants issued and the upfront fees paid in connection with the Restated Agreement, have been recognized as a discount on the loan issuance. The legal and related expenses have been recognized as debt issuance costs on the Company's balance sheets which, together with the warrants, upfront fee, growth capital final payment and fixed interest rate, will be amortized to interest expense throughout the life of the loan using an effective interest rate of 15.95%. The loans are collateralized by substantially all the assets of the Company (excluding intellectual property). Under the terms of the Restated Agreement, the Company may be precluded from entering into certain financing and other transactions, including disposing of certain assets and paying dividends, and is subject to certain non-financial covenants and prepayment penalties. Upon the occurrence of an event of default, including a Material Adverse Change (as defined in the Restated Agreement), the lenders may declare all outstanding amounts due and payable under the Agreement. As of June 30, 2011, the Company was in compliance with all covenants under the Restated Agreement.

Warrants

In connection with the establishment of the previous \$15,000,000 facility in 2007, the Company issued six fully exercisable warrants to the lenders to purchase an aggregate of 50,331 shares of the Company's common stock at an exercise price of \$12.67 per share, expiring November 30, 2014. The Company determined the fair value of these warrants to be \$474,000 under the Black-Scholes valuation model using the following assumptions: risk-free interest rate of 3.64%; dividend yield of 0.0%; expected volatility of 70.0%; and a contractual term of seven years. As of June 30, 2011, all warrants related to the Second Amendment were outstanding.

In connection with the Restated Agreement, the Company issued three fully exercisable warrants to the lenders to purchase an aggregate of 254,793 shares of the Company's common stock at an exercise price of \$7.0645 per share, expiring June 18, 2017. The Company determined the relative fair value of these warrants to be \$1,237,000, using the Black-Scholes valuation model. The value of the warrants was recorded as a discount to the note payable, and will be amortized to interest expense over the expected term of the loan agreement. The warrants were valued using the following assumptions: risk-free interest rate of 2.7%; dividend yield of 0.0%; expected volatility of 76.5%; and a contractual term of seven years. As of June 30, 2011, all warrants related to the Restated Agreement were outstanding.

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(Unaudited)

11. Commitments and Contingencies*Leases*

In May 2006, the Company entered into a six-year operating lease for 23,494 square feet of office space. The Company received certain tenant improvement allowances and rent abatement and has an option to extend the lease for five years following the expiration of the initial term. Monthly rental payments are adjusted on an annual basis and the lease expires in September 2012. As security for the lease, a letter of credit in the initial amount of \$1,581,000 was required by the landlord. The letter of credit is collateralized by a certificate of deposit in the same amount that is classified as restricted cash in the Company's balance sheets. The required amount subject to the letter of credit and corresponding certificate of deposit was eligible to be reduced by 22% on each of the first four anniversaries of the commencement of the lease and, as of June 30, 2011, the letter of credit and corresponding certificate of deposit had been reduced on each of the four anniversaries by an aggregate of \$1,391,000. The value of the letter of credit and corresponding certificate of deposit, classified as restricted cash on the Company's balance sheets was \$190,000 at June 30, 2011 and December 31, 2010, respectively.

Rent expense under the Company's lease agreement for the three months ended June 30, 2011 and 2010 was \$215,000 and \$214,000, respectively. Rent expense under the Company's lease agreement for the six months ended June 30, 2011 and 2010 was \$428,000 and \$429,000, respectively.

Corporate Credit Card

In 2009, the Company entered into a pledge agreement pursuant to the establishment of a corporate credit card program whereby the Company pledged \$150,000 in a certificate of deposit as collateral. During the six months ended June 30, 2011, the Company increased its pledged amount by \$300,000 related to an increase in its credit limit. These funds are classified as restricted cash on the Company's balance sheets at June 30, 2011 and December 31, 2010, respectively.

*Supply Agreements***Baxter Healthcare Corporation**

In July 2007, the Company entered into a development and supply agreement (the "Supply Agreement") with Baxter Healthcare Corporation ("Baxter") for the completion of pre-commercialization manufacturing development activities and the manufacture of commercial supplies of the finished drug product for OFIRMEV with an initial term of five years. Pursuant to the terms of the Supply Agreement, Baxter received development fees from the Company upon the completion of specified development activities, which the Company expensed as these activities had no alternative future uses at the time they were incurred. The Supply Agreement also required the Company to fund specified improvements at Baxter's manufacturing facility and purchase certain equipment for use by Baxter in manufacturing OFIRMEV. Certain equipment purchased for the manufacture of OFIRMEV to which the Company retains title, has been capitalized on the Company's balance sheets as property and equipment. During the three and six months ended June 30, 2010, the Company reimbursed Baxter approximately \$622,000 and \$650,000, respectively, for the facility improvements under this agreement, which were expensed as these costs were incurred. No reimbursements under this agreement were made during the three or six months ended June 30, 2011. Further, no development fees were paid by the Company during the three or six months ended June 30, 2011 and 2010.

In January 2011, the Company amended and restated the Supply Agreement (the "Amended Supply Agreement") in connection with plans to expand the manufacturing capacity for OFIRMEV at Baxter. Similar to original Supply Agreement, all capital equipment and facility improvements included in the plan will be funded by the Company. The Company intends to capitalize these costs, as OFIRMEV has been approved by the FDA, however the Company is not able to reasonably estimate the cost of expansion until the capacity increase development plan is completed. Further, the Company will pay Baxter a per unit purchase price based on the amount of finished OFIRMEV drug product produced, which price will be increased annually, and may be adjusted to reflect an increase or decrease, as the case may be, in the cost of material required to manufacture OFIRMEV, subject to specified limitations. The Company is obligated to purchase a minimum number of units of OFIRMEV each year or pay Baxter an amount equal to the purchase price multiplied by the shortfall in units. In addition, Baxter will be the Company's primary supplier of OFIRMEV up to a specified number of units in each year, subject to Baxter's ability to timely supply the specified volumes required by the Company. However, if Baxter fails or declines to supply a sufficient quantity of OFIRMEV in accordance with the Company's purchase orders during a specified period of time, then the Company may purchase that OFIRMEV from third party suppliers and such quantity will be deducted from the quantity of OFIRMEV that the Company otherwise would have been required to purchase from Baxter. The Company is also obligated to reimburse Baxter for all reasonable costs directly related to work performed by Baxter in support of any change in the active pharmaceutical ingredient ("API") source or API manufacturing process. For the three and six months ended June 30, 2011, the Company had reimbursed Baxter approximately \$160,000 for facility improvements pursuant to this amended contract. No reimbursements under this agreement were made during the three or six months ended June 30, 2010.

CADENCE PHARMACEUTICALS, INC.
NOTES TO CONDENSED FINANCIAL STATEMENTS - Continued
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The initial term of the Amended Supply Agreement will terminate on November 1, 2015, and will automatically renew for successive one-year periods thereafter, unless either party provides at least two years prior written notice of termination to the other party. In addition, either party may terminate the Agreement (1) within 90 days, after written notice in the event of a material uncured breach of the Agreement by the other party or (2) immediately, upon the filing of a petition of bankruptcy by the other party. The Company may also terminate the Agreement, effective 30 days after providing written notice, in the event that Baxter does not agree to the assignment of the Agreement by the Company to a competitor of Baxter. Baxter has agreed that, for the initial term and any renewals or extensions of the Agreement, neither it nor any of its affiliates will develop or commercially produce, for itself or for any third party, any intravenous formulation of a product containing acetaminophen for distribution or sale in the United States.

If the Amended Supply Agreement with Baxter is terminated, except as a result of a material uncured breach or bankruptcy by Baxter, the Company will reimburse Baxter for all materials ordered prior to the termination of the Amended Supply Agreement that are not cancelable at no cost to Baxter. Upon termination of the agreement and subject to certain exceptions, the Company will purchase from Baxter all undelivered products manufactured or packaged under a purchase order from the Company, at the price in effect at the time the purchase order was placed. The Company is also obligated to reimburse Baxter for reasonable costs incurred in returning all Company-owned equipment and for restoring Baxter's manufacturing facility to its condition prior to the installation of OFIRMEV-related improvements, other than restoration costs for changes that Baxter reasonably agrees are usable by Baxter at the time of removal of the Company-owned equipment. The Company is not able to reasonably estimate the cost and the timing of these expenses at this time and therefore cannot reasonably estimate the fair value of the retirement obligation.

Lawrence Laboratories

In December 2010, the Company entered into a supplemental Supply Agreement (the "Supplemental Agreement") with Lawrence Laboratories ("Lawrence"), an indirectly wholly-owned subsidiary of BMS, for the manufacture of commercial supplies of the finished drug product for OFIRMEV. Bristol-Myers Squibb Srl ("BMS Anagni"), an indirect subsidiary of BMS, will manufacture the product on behalf of Lawrence. BMS Anagni also currently manufactures intravenous acetaminophen for sale and distribution by BMS and its affiliates in a number of countries outside of the U.S. and Canada. At the time the Supplemental Agreement was executed, the Company submitted a supplemental NDA ("sNDA") to the FDA, seeking the approval of the BMS Anagni facility as an additional manufacturing site for OFIRMEV. The FDA approved the BMS Anagni facility as an additional manufacturing site for OFIRMEV in March 2011.

Pursuant to the terms of the Supplemental Agreement, Lawrence will receive from the Company a set price for the OFIRMEV purchased, which prices may be adjusted by Lawrence, subject to specified limitations. In addition, the Company is obligated to purchase a minimum number of units each year following regulatory approval of OFIRMEV manufactured by Lawrence, or pay Lawrence an amount equal to the per-unit purchase price less Lawrence's average material and direct labor costs for OFIRMEV, multiplied by the amount of the shortfall. The Company currently believes it will be required to pay a fee for a minimum purchase shortfall during the initial contract year ending in April 2012. However, the anticipated fee is expected to be recoverable through sales of the product received pursuant to the contract. As such, the Company will account for the fee as an increase to the cost of the product received during the contract year.

The Supplemental Agreement has an initial term that ends upon the 36-month anniversary of the date the sNDA is approved by the FDA, unless the Supplemental Agreement is terminated sooner: (1) by mutual agreement of the parties, (2) by either party for convenience following eighteen months' prior written notice of termination to the other party, (3) upon the termination of the Company's license agreement for the product with BMS, or (4) upon the dissolution or termination of the Company, other than in connection with or following the assignment of the Supplemental Agreement. In addition, either party may terminate the Supplemental Agreement: (a) within 60 days after written notice in the event of a material uncured breach of the Supplemental Agreement by the other party, or (b) immediately, if the other party becomes insolvent or admits in writing its inability to pay its debts as they become due, files a petition for bankruptcy, makes an assignment for the benefit of its creditors or has a receiver or other court officer appointed for its properties or assets.

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NOTES TO CONDENSED FINANCIAL STATEMENTS - Continued
(Unaudited)

If the Supplemental Agreement is terminated by the Company for its convenience or by Lawrence due to the Company's material breach of the agreement, the Company will reimburse Lawrence for: (1) any product ordered under a firm order and received by the Company, and (2) any inventory of materials used to manufacture OFIRMEV that are specific to OFIRMEV and that Lawrence is unable to reasonably utilize. Additionally, the Company's minimum purchase requirement for the year in which the termination takes effect will be reduced proportionally, and the Company will not be required to fulfill the minimum purchase requirement for any subsequent contract year. If the Supplemental Agreement is terminated for any reason other than by the Company for its convenience or by Lawrence due to the Company's material breach of the agreement, the Company will not be required to reimburse Lawrence for any inventory of materials used to manufacture OFIRMEV, and will have no obligation to purchase the minimum purchase requirement for the year in which the termination takes effect, or for any subsequent contract year.

License Agreements and Acquired Development and Commercialization Rights

In March 2006, the Company in-licensed the technology and the exclusive development and commercialization rights to OFIRMEV in the U.S. and Canada from BMS. BMS sublicensed these rights to the Company under a license agreement with Pharmatop. As consideration for the license, the Company paid a \$25,000,000 up-front fee and, as a result of the approval of the Company's NDA for OFIRMEV in the fourth quarter of 2010, the Company paid an additional milestone payment of \$15,000,000 in the fourth quarter of 2010. The Company may be required to make future milestone payments totaling up to \$25,000,000 upon the achievement of certain levels of net sales. In addition, the Company is obligated to pay a royalty on net sales of the licensed products and has the right to grant sublicenses to third parties. The amount of such royalty ranges from the mid-teens to the mid-twenties, depending on the aggregate amount of net sales. The \$25,000,000 up-front fee was recognized as research and development expense at the time the payment was made. The \$15,000,000 milestone payment was recorded as an intangible asset on the Company's balance sheets and is being amortized over the estimated useful life of the patent.

12. Stockholder's Equity

Public Offering

In November and December 2010, the Company issued an aggregate of 12,500,000 shares of its common stock at a purchase price of \$8.00 per share pursuant to a public offering. The offering raised proceeds, net of offering costs and underwriting discounts and commissions, of \$93,554,000.

Private Placement

In February 2009, the Company issued 12,039,794 shares of its common stock at a purchase price of \$7.13 per share pursuant to a private placement. In addition to the shares of the Company's common stock, warrants to purchase up to 6,019,897 additional shares of the Company's common stock were also issued as part of the transaction at a price of \$0.125 per warrant. Each warrant is immediately exercisable and has a five-year term. The warrants may be exercised through either cash or net exercise for one share of common stock at a price of \$7.84 and have been accounted for as permanent equity. As of June 30, 2011, all warrants related to the private placement were outstanding.

The Company is required to maintain the effectiveness of the registration statement and may be subject to liquidated damages of one percent per month of the aggregate purchase price of the common shares then held by the investor that are registrable securities, subject to an aggregate cap of eight percent per calendar year. The Company has not recorded a liability for the potential damages associated with these liquidated damages provisions, as it does not currently believe that the transfer of consideration is probable under the agreement.

Shelf Registration

On April 4, 2011, the Company filed a universal shelf registration statement to allow the Company to sell up to \$150,000,000 of debt securities, preferred stock, common stock, debt warrants and equity warrants.

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NOTES TO CONDENSED FINANCIAL STATEMENTS - Continued
(Unaudited)

13. Segment Information

The Company operates and manages its business as principally one segment. It sells its only product, OFIRMEV, primarily to established wholesale distributors in the pharmaceutical industry, including to the nation's three leading wholesale pharmaceutical distributors: AmerisourceBergen Corporation, Cardinal Health, Inc. and McKesson Corporation.

Shipments to wholesalers representing approximately 10% or more of total product sales for the periods presented were as follows (as a percentage of total gross product sales):

| | <u>Three Months Ended</u> <u>June 30, 2011</u> | <u>Six Months Ended</u> <u>June 30, 2011</u> |
|-------------------------------|---------------------------------------------------|-------------------------------------------------|
| AmerisourceBergen Corporation | 40% | 36% |
| Cardinal Health, Inc. | 39% | 33% |
| McKesson Corporation Inc. | 11% | 22% |

14. Income Taxes

The Company is subject to taxation in the U.S. and various state jurisdictions. The Company's tax years for 2004 and forward are subject to examination by the Federal and California tax authorities due to the carryforward of unutilized net operating losses and research and development credits. The Company's practice is to recognize interest and/or penalties related to income tax matters in income tax expense. The Company had no accrued interest and/or penalties related to income tax matters in the Company's balance sheets at June 30, 2011 and December 31, 2010, and has recognized no interest and/or penalties in the Company's statements of operations for the three or six months ended June 30, 2011 and 2010, respectively. Further, as of June 30, 2011, the Company had not recorded any unrecognized tax benefits.

Pursuant to Internal Revenue Code ("IRC") Sections 382 and 383, annual use of the Company's net operating loss and research and development credit carryforwards may be limited in the event a cumulative change in ownership of more than 50% occurs within a three-year period. The Company has not completed an Internal Revenue Code Section 382/383 analysis regarding the limitation of net operating loss and research and development credit carryforwards. Until this analysis has been completed, the Company has removed the (i) deferred tax assets for net operating losses of approximately \$89,176,000 and (ii) the research and development credits of approximately \$5,679,000, generated through 2010 from its deferred tax asset schedule, and has recorded a corresponding decrease to its valuation allowance. When this analysis is finalized, the Company plans to update its unrecognized tax benefits accordingly. The Company expects to complete this analysis in the next 12 months and, as a result, the Company may have a change in the unrecognized tax benefits that are recorded in the next 12 months. Due to the existence of the valuation allowance, future changes in the Company's unrecognized tax benefits will not impact the Company's effective tax rate.

15. Subsequent Events

On July 8, 2011 and July 13, 2011, the Company received a notice from Paddock Laboratories, Inc. ("Paddock"), a Minneapolis, Minnesota based company, and Exela Pharma Sciences, LCC, a North Carolina based company, respectively, stating that the sender had filed an Abbreviated New Drug Application ("ANDA") containing a "Paragraph IV" patent certification with the FDA for a generic version of the Company's drug, OFIRMEV® (acetaminophen) injection (1000 mg/100 mL, 10 mg/mL). These notices state that the Paragraph IV patent certifications were made with respect to both patents for OFIRMEV listed in the FDA's Approved Drug Products with Therapeutic Equivalence Evaluations, commonly known as the Orange Book. A Paragraph IV patent certification is a certification by a generic applicant that, in the opinion of that applicant, the patent listed in the Orange Book for a branded product is invalid, unenforceable, or will not be infringed by the manufacture, use or sale of the generic product.

The Company is currently reviewing the details of the notice. Under the Federal Food, Drug, and Cosmetic Act and the FDA's implementing regulations, the filing of a patent infringement lawsuit within 45 days of the receipt of notice of a Paragraph IV patent certification automatically prevents the FDA from approving the ANDA until the earlier of the expiration of a 30-month period, the expiration of the patents, the entry of a settlement order stating that the patents are invalid or not infringed, a decision in the infringement case that is favorable to the ANDA applicant, or such shorter or longer period as the court may order.

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NOTES TO CONDENSED FINANCIAL STATEMENTS - Continued
(Unaudited)

The Company intends to vigorously enforce its intellectual property rights relating to OFIRMEV, but cannot predict the outcome of this matter or guarantee the outcome of any litigation. OFIRMEV is protected by two patents, both of which are listed in the Orange Book.

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

Introduction

This discussion may contain forward-looking statements that involve risks and uncertainties. As used herein, the terms "we," "us," or "our" refer to Cadence Pharmaceuticals, Inc., a Delaware corporation. Our actual results could differ materially from those anticipated in any forward-looking statements as a result of many factors, including those set forth below under the caption "Risk Factors." The interim financial statements and this Management's Discussion and Analysis of Financial Condition and Results of Operations should be read in conjunction with the financial statements and notes thereto for the year ended December 31, 2010 and the related Management's Discussion and Analysis of Financial Condition and Results of Operations, both of which are contained in our Annual Report on Form 10-K for the year ended December 31, 2010 as filed with the SEC on March 4, 2011.

Overview

We are a biopharmaceutical company focused on in-licensing, developing and commercializing proprietary product candidates principally for use in the hospital setting. We intend to build a leading franchise in the hospital setting, continuing to focus on products that are in late stages of development, currently commercialized outside the U.S., or approved in the U.S. but with significant commercial potential for proprietary new uses or formulations. In 2006, we in-licensed the exclusive U.S. and Canadian rights to OFIRMEV® (acetaminophen) injection, an intravenous formulation of acetaminophen, from Bristol-Myers Squibb Company, or BMS, which currently markets the product in Europe and several other markets under the brand name Perfalgan®. In November 2010, OFIRMEV was approved by the U.S. Food and Drug Administration, or FDA, and we commercially launched OFIRMEV in the U.S. in January 2011. As of July 31, 2011, OFIRMEV had been approved on over 1,150 hospital formularies, which we believe positions us well for future revenue growth.

In June 2010 we entered into an agreement with Incline Therapeutics, Inc., or Incline, that provides us with the exclusive, irrevocable option to acquire Incline within a specified future time period. Incline is developing IONSYS™ (fentanyl iontophoretic transdermal system), an investigational product candidate intended to provide patient-controlled analgesia for adult inpatients requiring opioids following surgery. We believe that, if approved by the FDA, IONSYS could represent a potentially significant commercial opportunity and be an excellent strategic fit with OFIRMEV. Our initial option period to acquire Incline extends until one day prior to Incline's receipt of the second tranche of its Series A financing, or June 2011, whichever occurs later. During this period, we may acquire Incline for an amount not to exceed \$135.0 million. During the following option period, the acquisition cost would be an amount not to exceed \$228.0 million, plus payment of an additional amount not to exceed \$57.0 million upon FDA approval of IONSYS. We have notified Incline that we have decided not to exercise our option to acquire Incline during the first option period, but we continue to have the right to acquire Incline during the second option period. We have received notice from Incline that the closing of the second tranche of its Series A financing is expected to occur on or about September 1, 2011, which would open the second option period.

We have incurred significant net losses since our inception and have financed our operations primarily through the sale of equity securities in both public and private offerings. Most recently, we sold 12.5 million shares in a public offering in the fourth quarter of 2010 and received aggregate net proceeds of approximately \$93.6 million (after underwriting discounts and offering costs). From inception through June 30, 2011, we have received net proceeds of approximately \$366.3 million from the sale of our preferred stock, common stock and warrants to purchase common stock. Additionally, we have entered into loan and security agreements with Oxford Finance Corporation, Silicon Valley Bank and GE Business Financial Services Inc. to provide us with growth capital. As of June 30, 2011 the principal balance outstanding on our current facility with this loan syndicate was \$30.0 million.

We were incorporated under the laws of the State of Delaware in May 2004. Our principal executive offices are located at 12481 High Bluff Drive, Suite 200, San Diego, California 92130 and our telephone number is (858) 436-1400. Information about the company is also available on our website at www.cadencepharm.com, which includes links to reports we have filed with the Securities and Exchange Commission, or SEC, which are available free of charge. The contents of our website are not incorporated by reference in this Quarterly Report on Form 10-Q.

We own or have rights to various trademarks, copyrights and tradenames used in our business, including the following: Cadence®, OFIRMEV® and the OFIRMEV logo. This report also contains trademarks of other companies, including IONSYS™, a registered trademark of Incline, Perfalgan®, a registered trademark of BMS, and Caldolor® a registered trademark of Cumberland Pharmaceuticals, Inc.

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Revenue

Product Revenue

In January 2011, we commercially launched OFIRMEV and began to recognize revenue on wholesaler shipment to hospitals and other end-user customers. For the three and six months ended June 30, 2011, we recognized net revenue for sales to hospitals and other end-users of \$1.7 million and \$2.1 million, respectively. As of June 30, 2011, over 1,200 U.S. hospitals had placed an order for OFIRMEV, and approximately 60% of those institutions had placed multiple orders for the product.

Our revenue is reported net of certain sales reserves and allowances. These reserves and allowances include distribution service fees, a prompt payment reserve, a product return reserve, a group purchasing discount and administrative service reserve, and an allowance for bad debts. Distribution service fees arise from contractual agreements between us and certain wholesalers for distribution services they provide with respect to OFIRMEV. These fees are generally a fixed percentage of the price of the product purchased by these wholesalers. The prompt payment reserve is based upon cash discounts we offer certain wholesalers as an incentive to meet certain payment terms. We account for these cash discounts at the time the sale is made to the wholesalers and reduce our accounts receivable accordingly. The group purchasing discount and administrative service fee is based upon contracted discounts we provide to members of certain purchasing groups. We estimate the sales through our wholesalers to the group purchasing organization members and accrue for the chargebacks we anticipate from such sales based on the difference between the current retail price and the reduced price paid by the group purchasing organization members. A group purchasing organization administrative fee that we incur in exchange for administrative services provided by the group purchasing organizations for these transactions is also recorded at the time of sale. The return reserve and allowance for bad debt is based on management's best estimate of the sales recorded during the period that are anticipated to be returned or that will be uncollectable.

Until we have sufficient sales and returns history, we are deferring the recognition of revenue from shipments to independent third-party wholesalers until the product is sold to the end-user customer. Revenue from product sales that remains with the wholesalers at period end is recorded as deferred revenue.

Licensing Revenue

In November 2010 we entered into a data license agreement with Terumo Corporation, or Terumo, and SCR Pharmatop S.A., or Pharmatop. As part of the data license agreement, we provided to Terumo certain data and information resulting from our clinical development program for OFIRMEV for Terumo's use in obtaining regulatory approval for and commercializing the same intravenous formulation of acetaminophen in Japan. Further, we will provide to Terumo, without charge, up to 500 hours of technical assistance and consulting services in relation to the licensed technical information, data and know-how in order to assist Terumo in obtaining regulatory approval and manufacturing capacity for the product candidate. In April 2011, we received an upfront payment of \$5.3 million under the terms of the data license agreement. If Terumo is successful in its efforts to obtain regulatory approval for and commercialize the product in Japan, we may be entitled to an additional lump-sum payment upon the first commercial sale of the product candidates and royalty payments upon any commercial sales of the product in Japan.

We reviewed the agreement pursuant to multiple-element arrangement guidance and determined both the data license and consulting service deliverables were separate units of accounting, each having value on a standalone basis. We estimated the fair value of the data license based upon similar proposals from third parties and internal costs we incurred in developing the data and obtaining similar rights. The value of the consulting services was based on contracts we had engaged with third parties for similar services. We allocated the value of the payment received on a relative fair value basis and will recognize the consideration allocated to the data license upon delivery and the consideration allocated to the consulting services as such services are rendered. There is no right of return or similar refund provisions in the data license agreement. As such, during the three and six months ended June 30, 2011, we recognized \$5.2 million of licensing revenue under the data license agreement with Terumo for the data provided and consulting hours incurred. The remaining payment balance of \$0.1 million reflects the value of the outstanding consulting hours we are obligated to provide under the terms of the contract through November 2012. This balance is recorded as deferred revenue on our balance sheet at June 30, 2011 and will be recognized as revenue as the consulting services are rendered. No similar revenue was recognized during the three and six months ended June 30, 2010.

Cost of Sales

Our cost of sales consists primarily of our third-party manufacturing costs, internal manufacturing overhead, indirect and personnel overhead costs, freight, excess or obsolete inventory adjustments, the cost of purchasing the active pharmaceutical ingredient for OFIRMEV, acetaminophen, and royalties due under our license agreement with BMS. These royalties ranges from the mid-teens to the mid-twenties, depending on the aggregate amount of net sales we record per contract year.

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License Fees and Patent Amortization

As a result of the FDA's approval of OFIRMEV, we paid a \$15.0 million license fee in the fourth quarter of 2010 pursuant to the term of our license agreement with BMS. We have capitalized this payment on our balance sheets and are amortizing the balance on a straight-line basis, based upon the estimated life of the underlying patent assets. We may be required to make two additional milestone payments totaling up to \$25.0 million based upon the achievement of certain levels of net sales of OFIRMEV, which will be recognized as license fees in the period they are incurred, as appropriate. In addition, we paid a \$25.0 million up-front license in 2006 to acquire the rights to OFIRMEV, which was immediately expensed as the asset had no established technological feasibility or alternative future use at that time.

Research and Development Expenses

Our historical research and development expenses relate predominantly to OFIRMEV and our discontinued omiganan pentahydrochloride product candidate. These expenses have consisted of salaries and related employee benefits for our research and development team, license fees paid to our licensors prior to approval of our drug candidates, pre-commercialization manufacturing development activities, costs associated with clinical trials, and costs associated with non-clinical activities, such as expenses related to regulatory submissions. We have expensed these charges as the costs were incurred in developing, testing and seeking marketing approval of our product candidates. We received marketing approval for OFIRMEV from the FDA in November 2010 and we have capitalized non-investigational costs incurred since that time to inventory and capital, as appropriate. We expect to continue to incur research and development expenses related to OFIRMEV, however, it is difficult to anticipate the scope and magnitude of our future research and development expenses. For example, the FDA has required that we complete a post-approval clinical trial for OFIRMEV in pediatric patients under two years of age, and we may also conduct clinical studies to expand the indications for OFIRMEV. Moreover, any product candidates we may in-license or acquire in the future would likely require significant research and development resources. Therefore, we are unable to estimate with any certainty the costs we will incur in completing our development efforts for OFIRMEV or any other product candidate we might acquire or in-license.

Selling, General and Administrative Expenses

Our selling, general and administrative expenses consist primarily of salaries and related employee benefits for our sales and marketing staff; advertising, marketing and other promotional costs for OFIRMEV; selling expenses for our sales representatives, including travel-related costs; salaries and related employee benefits for our administrative, finance, human resources, legal, business development and internal systems support functions; costs incurred in relation to our medical affairs programs, including salaries, related employee benefits and costs incurred by our medical science liaisons; as well as the related professional fees for these functions, insurance and facility costs.

Our selling, general and administrative costs have increased significantly since we began to focus significant resources on establishing our commercial organization in preparation for the commercial launch of OFIRMEV. Following approval of OFIRMEV in November 2010, we began the process of hiring and training our sales force and related personnel, and we currently have approximately 150 dedicated, hospital-focused sales representatives covering territories across the U.S. These sales representatives are focusing their efforts on the top 1,800 to 1,900 U.S. hospitals, which we believe represent approximately 80% of the market opportunity for OFIRMEV. We anticipate our selling, general and administrative expenses will continue to increase in the coming periods as we execute our marketing and sales strategies for OFIRMEV, implement a variety of marketing programs to educate customers and continue to build our corporate infrastructure and support our commercial operations in connection with the launch of OFIRMEV.

Interest and Other Income and Expense

Our interest income consists primarily of interest earned on our cash, cash equivalents and short-term investments. Interest expense consists of the interest we have incurred under our loan and security agreements and the amortization of debt issuance costs. Other income and expense includes federal grants we have received, gains or losses recognized on transactions denominated in foreign currencies and other transactions not related to our operations.

Income Taxes

We assess income tax positions and record tax benefits for all years subject to examination based upon our evaluation of the facts, circumstances and information available at the reporting date. For those tax positions where there is a greater than 50% likelihood that a tax benefit will be sustained, we have recorded the largest amount of tax benefit that may potentially be realized upon ultimate settlement with a taxing authority that has full knowledge of all relevant information. For those income tax positions where there is less than 50% likelihood that a tax benefit will be sustained, no tax benefit has been recognized in the financial statements.

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As of December 31, 2010, we had federal and state net operating loss carryforwards of approximately \$219.3 million and \$224.7 million, respectively. If not utilized, the net operating loss carryforwards will begin expiring in 2024 for federal purposes and 2018 for state purposes. Additionally, we had both federal and state research and development tax credit carryforwards of approximately \$4.2 million and \$2.2 million, respectively. The federal tax credits will begin expiring in 2024 unless previously utilized and the state tax credits carryforward indefinitely. Under Sections 382 and 383 of the Internal Revenue Code of 1986, as amended, or the Internal Revenue Code, substantial changes in our ownership may limit the amount of net operating loss carryforwards and development tax credit carryforwards that could be utilized annually in the future to offset taxable income. Any such annual limitation may significantly reduce the utilization of the net operating losses and tax credits before they expire. We have not completed a Section 382/383 study at this time to determine the impact ownership changes have had on our carryforwards. In each period since our inception, we have recorded a valuation allowance for the full amount of our deferred tax asset, as the realization of the deferred tax asset is uncertain. As a result, we have not recognized any federal or state income tax benefit in our statement of operations.

Critical Accounting Policies and Estimates

The preparation of financial statements in conformity with accounting principles generally accepted in the U.S., or GAAP, requires us to make certain estimates, judgments and assumptions that affect the reported amounts of assets and liabilities, the disclosure of contingent assets and liabilities at the date of the financial statements, and the reported amounts of expenses during the reporting period. Some of our accounting policies require us to make difficult and subjective judgments, often as a result of the need to make estimates of matters that are inherently uncertain. The following accounting policies involve critical accounting estimates because they are particularly dependent on estimates and assumptions made by management about matters that are highly uncertain at the time the accounting estimates are made. In addition, while we have used our best estimates based on facts and circumstances available to us at the time, different estimates reasonably could have been used. Changes in the accounting estimates we use are reasonably likely to occur from time to time, which may have a material impact on the presentation of our financial condition and results of operations.

Our most critical accounting estimates include the recognition of revenue; the valuation of our inventory, which impacts gross margin; our recognition of research and development expenses, which impacts operating expenses and accrued liabilities; stock-based compensation which impacts operating expenses; and the assessment of recoverability of long-lived assets, which primarily impacts operating expenses when we impair assets or accelerate depreciation. We also have other policies that we consider to be key accounting policies, such as our policies for deferred income tax assets and liabilities and our reserves for commitments and contingencies; however, these policies either do not meet the definition of critical accounting estimates described above or are related to items that are not currently material to our financial statements.

We review our estimates, judgments, and assumptions used in our accounting practices periodically and reflect the effects of revisions in the period in which they are deemed to be necessary. We believe that these estimates are reasonable, however, our actual results may differ from these estimates.

Revenue Recognition

We sell OFIRMEV to wholesalers and directly to hospitals. Our distribution channel includes our sales representatives, our third party logistics distributor and independent wholesalers who distribute the product directly to hospitals and other end-user customers. The majority of our shipments are made to wholesalers, with whom we have contracted to distribute the product. We have also contracted with group purchasing organizations to increase awareness of, and reduce market barriers for, OFIRMEV.

Our wholesaler agreements provide selling prices that are fixed on the date of sale, although we offer certain discounts to group purchasing organizations. The wholesalers take title to the product, bear the risk of loss of ownership, and have economic substance to the inventory. Further, we have no significant obligations for future performance to generate pull-through sales, however we do allow our wholesalers to return product that is damaged or received in error. Additionally, we allow for product to be returned beginning six months prior to, and ending twelve months following, product expiration. As OFIRMEV is our first and only commercially available product, we do not believe we have sufficient history to accurately predict product returns from our wholesaler distribution channel. Therefore, we will recognize revenue when these wholesalers sell OFIRMEV to hospitals or other end-user customers until we have sufficient history to accurately estimate returns from the wholesalers. Shipments of product that are not recognized as revenue are treated as deferred revenue until evidence exists to confirm pull-through sales to hospitals or other end-user customers have occurred.

We also record certain sales reserves and allowances as a reduction to gross revenue and deferred revenue. These reserves and allowances include distribution service fees, a prompt payment reserve, a product return reserve, a group purchasing discount and administrative service fee, and an allowance for bad debts. Distribution service fees arise from contractual agreements between us and certain wholesalers for distribution services they provide with respect to OFIRMEV. These fees are generally a fixed percentage of the price of the product purchased by these wholesalers. The prompt payment reserve is based upon cash discounts we offer certain

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wholesalers as an incentive to meet certain payment terms. We account for these cash discounts at the time the sale is made to the wholesalers and reduce our accounts receivable accordingly. The group purchasing discount and administrative service fee is based upon contracted discounts we provide to members of certain purchasing groups. We estimate the sales through our wholesalers to the group purchasing organization members and accrue for the chargebacks we anticipate from such sales based on the difference between the current retail price and the reduced price paid by the group purchasing organization members. A group purchasing organization administrative fee that we incur in exchange for administrative services provided by the group purchasing organizations for these transactions is also recorded at the time of sale. The return reserve and allowance for bad debt is based on management's best estimate of the sales recorded during the period that are anticipated on being returned or that will be uncollectable.

Revenue from our data license agreement is recognized upon delivery of the goods and services provided, based upon the consideration allocated to each deliverable. Consideration allocated to the data license is recognized as revenue upon delivery of the data. Consideration allocated to the consulting services is recognized as revenue as such services are rendered.

Inventories

We state our inventories at the lower of cost or market. We use a combination of standard and actual costing methodologies to determine the cost basis for our inventories. These methodologies approximate actual costs on a first-in, first-out basis. In addition to stating inventory at the lower of cost or market, we also evaluate our inventories each period for excess quantities and obsolescence. This evaluation includes identifying those items specifically identified as obsolete and analyzing forecasted demand versus quantities on hand so that this inventory can be valued appropriately.

Research and Development Expenses

A substantial portion of our research and development activities is performed under agreements we enter into with external service providers. We accrue for costs incurred under these contracts based on factors such as estimates of work performed, milestones achieved, patient enrollment and experience with similar contracts. As actual costs become known, we adjust our accruals. To date, our accruals have been within management's estimates. Subsequent changes in estimates may result in a change in our accruals, which could also materially affect our results of operations.

Accounts Receivable

We extend credit to our customers in the normal course of business based upon an evaluation of the customer's credit history, financial condition and other factors. Trade accounts receivable are recorded on gross sales to wholesalers, net of allowances for prompt payment discounts, chargebacks and doubtful accounts. Wholesaler distribution fees are recorded as accounts payable and accrued liabilities. Estimates of allowances for doubtful accounts are determined by evaluating individual customer circumstances, historical payment patterns, length of time past due, economic and other factors.

Stock-Based Compensation

We account for stock-based compensation by calculating the fair value of the award on the date of grant and recognize the expense over the applicable vesting period. We calculate the fair value of stock options using the Black-Scholes pricing model, which requires a number of estimates, including the expected lives of awards, interest rates, stock volatility and other assumptions. Restricted stock units, or RSUs, are measured based on the fair market values of the underlying stock on the date of grant. We apply a forfeiture rate to estimate the number of grants that will ultimately vest. If the awards are performance based, we also assess the likelihood of the vesting conditions occurring and apply an appropriate factor in recognizing the expense.

Long-Lived Assets

A substantial portion of our capital assets are associated with our manufacturing equipment at our primary third-party manufacturer, Baxter Healthcare Corporation. In building these assets and creating additional capacity, we have entered into agreements whereby we fund specified improvements to the facilities and the construction of the manufacturing equipment to be used for the production of OFIRMEV. During the build-out of the facility and construction of our equipment, we accrue for costs incurred based on factors such as estimates of work performed, milestones achieved and experience with similar contracts. As actual costs become known, we adjust our accruals accordingly.

We evaluate these long-lived assets for impairment of their carrying value when events or circumstances indicate that the carrying value may not be recoverable. Factors we consider in deciding when to perform an impairment review include significant negative industry or economic trends, significant changes or planned changes in our use of the assets, technological obsolescence, or other changes in circumstances which indicate the carrying value of the assets may not be recoverable. If such an event occurs, we evaluate whether the sum of the estimated undiscounted cash flows attributable to the assets in question is less than their carrying value. If this is the case, we recognize an impairment loss to the extent that carrying value exceeds fair value. Fair value is determined

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based on market prices or discounted cash flow analysis, depending on the nature of the asset and the availability of market data. Any estimate of future cash flows is inherently uncertain. The factors we take into consideration in making estimates of future cash flows include product life cycles, pricing trends, future capital needs, cost trends, product development costs, competitive factors and technology trends as they each affect cash inflows and outflows. If an asset is written down to fair value, that value becomes the asset's new carrying value and is depreciated over the remaining useful life of the asset.

Results of Operations

Three-Month Periods Ended June 30, 2011 and 2010

Revenue

During the three months ended June 30, 2011, we recognized \$1.7 million of net product revenue from the sale of OFIRMEV to hospitals and other end-users. We launched OFIRMEV in January 2011 and it is our first commercial product. Until we have a sufficient history to predict product returns, we are deferring the recognition of revenue from shipments to independent third-party wholesalers until the product is sold by these wholesalers to hospitals or other end-user customers. Included in the net revenue recognized are reductions for distribution service fees, prompt payment discounts and other reserves and allowances.

Additionally, we recognized \$5.2 million of licensing revenue under the data license agreement with Terumo for the data we provided and consulting hours incurred pursuant to the terms of the agreement. No similar revenues were recognized during the three months ended June 30, 2010.

Cost and Expenses

Cost of Sales. Our cost of product sales for the three months ended June 30, 2011 was \$1.0 million, which includes the direct costs for manufacturing and inventory management of OFIRMEV, indirect costs associated with manufacturing, including management personnel and depreciation of the manufacturing equipment, and royalties incurred on sales of OFIRMEV.

Amortization of patent license. For the three months ended June 30, 2011, we incurred \$0.3 million of non-cash expense related to the amortization of the \$15.0 million license payment made to BMS following the New Drug Application, or NDA, approval of OFIRMEV. No such amortization was incurred during the three months ended June 30, 2010.

Research and Development Expenses. Research and development expenses decreased \$0.2 million for the three months ended June 30, 2011, to \$2.6 million, from \$2.8 million for the three months ended June 30, 2010. This decrease was primarily due to a reduction in manufacturing development expenses incurred during the three months ended June 30, 2010 in preparation for the 2010 commercialization of OFIRMEV that were not incurred during the current period.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased \$13.3 million, to \$21.1 million, for the three months ended June 30, 2011, compared to \$ 7.8 million for the comparable period in 2010. This increase was primarily due to costs related to the approximately 150 hospital sales specialists that we hired following the FDA approval of OFIRMEV in November 2010, including labor-related costs, travel expenses, selling and education related costs. Further, we incurred additional marketing and promotion expenses and medical affairs costs during the three months ended June 30, 2011 as compared to 2010, in support of the commercial launch of OFIRMEV.

Other Operating Expenses. During the second quarter of 2010 we modified the design of our planned second production line for OFIRMEV, resulting in the partial cancellation of a capital equipment order for which the Company identified an alternative supplier. As a result of the partial cancellation of the equipment, we incurred a charge of \$1.2 million during the three months ended June 30, 2010 to impair the costs accumulated in construction-in-process for the equipment. Additionally, we incurred a charge of \$0.1 million related to a reduction in force of six individuals during the three months ended June 30, 2010. No similar charges were recorded for the three months ended June 30, 2011.

Other Income and Expense, Net

Net other expense increased \$0.8 million during the three months ended June 30, 2011, to \$1.1 million, compared to \$0.3 million for the three months ended June 30, 2010. This increase is primarily due to additional interest expense incurred on our outstanding debt balance, primarily due to a higher outstanding principal during the three months ended June 30, 2011 as compared to the same period in 2010.

Six-Month Periods Ended June 30, 2011 and 2010

Revenue

During the six months ended June 30, 2011, we recognized \$2.1 million of revenue from the sale of OFIRMEV to hospitals and other end-users, net of discounts and reserves. Additionally, during the six months ended June 30, 2011, we recognized \$5.2 million of revenue related to our data license agreement with Terumo and Pharmatop. No similar revenue was recognized during the six months ended June 30, 2010. As of June 30, 2011, revenue of \$0.6 million on shipments to third-party wholesalers had not been recognized and was reported as deferred revenue on our balance sheet. Further, revenue of \$0.1 million received under our data license agreement with Terumo and Pharmatop was reported as deferred revenue on our balance sheet as of June 30, 2011.

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Cost and Expenses

Cost of Sales. Our cost of product sales for the six months ended June 30, 2011 was \$1.3 million and includes a higher absorption rate of overhead as we commenced manufacturing and began to increase our manufacturing throughput during the period.

Amortization of patent license. For the six months ended June 30, 2011, we incurred \$0.9 million of non-cash expense related to the amortization of the \$15.0 million license payment made to BMS following the NDA approval of OFIRMEV. No such amortization was incurred during the six months ended June 30, 2010.

Research and Development Expenses. Research and development expenses decreased \$1.7 million for the six months ended June 30, 2011, to \$5.3 million, from \$7.0 million for the six months ended June 30, 2010. This decrease was primarily due to a reduction in manufacturing development expenses incurred during the six months ended June 30, 2010 in preparation for the commercialization of OFIRMEV that were not incurred during the current period.

Selling, General and Administrative Expenses. Selling, general and administrative expenses increased \$23.8 million, to \$41.1 million, for the six months ended June 30, 2011, compared to \$17.3 million for the comparable period in 2010. This increase was primarily due to costs related to our team of hospital sales specialists, hired following the FDA approval of OFIRMEV in November 2010, including labor-related costs, travel expenses, selling and education related costs, and costs incurred for our national launch meeting in January 2011. Further, we have incurred additional advertising, marketing and promotion expenses and medical affairs costs during the six months ended June 30, 2011 in support of our commercial operations of OFIRMEV as compared to the 2010 period.

Other Operating Expenses. During the second quarter of 2010 we modified the design of our planned second production line for OFIRMEV, resulting in the partial cancellation of a capital equipment order for which the Company identified an alternative supplier. As a result of the partial cancellation of the equipment, we incurred a charge of \$1.2 million during the six months ended June 30, 2010 to impair the costs accumulated in construction-in-process for the equipment. Additionally, we incurred a charge of \$0.1 million related to a reduction in force of six individuals during the six months ended June 30, 2010. No similar charges were recorded for the six months ended June 30, 2011.

Other Income and Expense, Net

Net other expense increased \$1.8 million during the six months ended June 30, 2011, to \$2.3 million, compared to \$0.5 million for the six months ended June 30, 2010. This increase is primarily due to additional interest expense incurred on our outstanding debt balance, primarily due to a higher outstanding principal during the six months ended June 30, 2011 as compared to the same period in 2010.

Liquidity and Capital Resources

As a biopharmaceutical company focused on in-licensing, developing and commercializing proprietary product candidates principally for use in the hospital setting, we enter into agreements to acquire the rights to develop and commercialize product candidates. These agreements and related development programs take significant resources and may not result in a commercial product to generate revenue. For example, we obtained the exclusive patent rights and know-how for OFIRMEV, currently our only product, for the U.S. and Canada pursuant to our license agreement with BMS. Under this agreement, we have paid a total of \$40.0 million in up-front fees and milestone payments, and we may be required to make two future milestone payments totaling up to \$25.0 million upon the achievement of certain levels of net sales. We are also obligated to pay royalties on any net sales of OFIRMEV. Moreover, in the second quarter of 2010 we entered into an option agreement pursuant to which we obtained an option to acquire Incline during two option periods. In consideration for the option we paid a \$3.5 million upfront option fee and may pay a second \$3.5 million fee upon Incline receiving the second tranche of its Series A financing if we have not yet exercised our option to acquire Incline. During the first option period, we may acquire Incline for an amount not to exceed \$135.0 million. During the second option period, we may acquire Incline for an amount not to exceed \$228.0 million, plus payment of an additional amount not to exceed \$57.0 million upon FDA approval of IONSYS. We have notified Incline that we have decided not to exercise our option to acquire Incline during the first option period, but we continue to have the right to acquire Incline during the second option period. We have received notice from Incline that the closing of the second tranche of its Series A financing is expected to occur on or about September 1, 2011, which would open the second option period.

We have incurred over \$42.0 million in research and development costs through December 31, 2010 on the OFIRMEV development program. In January 2011, we commenced sales of OFIRMEV however, as of June 30, 2011, we have realized only minimal revenue and continue to operate at a loss. We had also previously entered into a license agreement for our former omiganan pentahydrochloride product candidate under which we paid to Migenix an aggregate of \$2.0 million in the form of an up-front fee, including the purchase of 617,284 shares of Migenix common stock. We incurred expenses of approximately \$57.5 million specific to the omiganan project, which was discontinued in 2008. In May 2009, we terminated our license agreement with Migenix, and we will not be required to make future milestone or royalty payments under this agreement.

We have incurred significant net losses since our inception and, as of June 30, 2011, we had accumulated a deficit of \$317.2 million. These losses have resulted principally from costs incurred in connection with research and development activities, including license fees, costs of clinical trial activities associated with our product candidates, the establishment of our commercial infrastructure, pre-commercialization manufacturing development activities and general and administrative expenses. We expect to continue to incur operating losses and expend significant resources in connection with our marketing and sales efforts for OFIRMEV, and our efforts to increase our manufacturing capacity to meet anticipated demand for this product. Further, we could incur significant expenses if we acquire or in-license additional products, technologies or businesses that are complementary to our own.

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Our future capital uses and requirements depend on numerous forward-looking factors. These factors include, but are not limited to, the following:

- our ability to successfully market and sell OFIRMEV;
- our capacity to manage our commercial infrastructure and related expenses, including our recently hired sales and marketing personnel and our agreements with third parties for warehousing, distribution, cash collection and related commercial activities;
- our execution of other collaborative, licensing or similar arrangements and the timing of payments we may make or receive under these arrangements;
- variations in the level of expenses related to our development programs for any future product candidates;
- any product liability or intellectual property infringement lawsuits in which we may become involved;
- regulatory developments affecting OFIRMEV or the product candidates of our competitors;
- the level of underlying hospital demand for OFIRMEV and wholesalers' buying patterns; and
- any determination to exercise our option to acquire Incline.

Since inception, our operations have been financed primarily through the sale of equity securities, in both public and private offerings. From our inception through June 30, 2011, we have received net proceeds of approximately \$366.3 million from the sale of our preferred stock, common stock and warrants to purchase common stock. Through June 30, 2011, the sales of shares of our preferred stock, common stock and warrants were as follows:

- from July 2004 to June 2011 (excluding our initial public offering, our February 2008 registered direct offering, our February 2009 private placement and our 2010 public offering), we issued and sold a total of 2,932,280 shares of common stock to our founders, employees, directors and consultants for aggregate net proceeds of \$2.6 million;
- from July 2004 to August 2004, we issued and sold a total of 8,085,108 shares of Series A-1 preferred stock for aggregate net proceeds of \$7.5 million;
- from June 2005 to September 2005, we issued and sold a total of 17,675,347 shares of Series A-2 preferred stock for aggregate net proceeds of \$17.6 million;
- in March 2006, we issued and sold a total of 53,870,000 shares of Series A-3 preferred stock for aggregate net proceeds of \$53.8 million;
- in the fourth quarter of 2006, we completed our initial public offering in which we issued and sold a total of 6,900,000 shares of our common stock for aggregate net proceeds of \$55.9 million;
- in February 2008, we completed a registered direct offering pursuant to an effective shelf registration in which we issued and sold a total of 9,240,307 shares of our common stock for aggregate net proceeds of \$49.1 million;
- in February 2009, we raised aggregate net proceeds of approximately \$86.2 million through a private placement transaction in which we issued 12,039,794 shares of common stock and warrants to purchase up to 6,019,897 additional shares of common stock at a price of \$7.84, all of which remain outstanding; and
- in November and December 2010, we completed a public offering in which we issued and sold a total of 12,500,000 shares of our common stock for aggregate net proceeds of \$93.6 million.

Additionally, we have secured growth capital through loans with Silicon Valley Bank, Oxford Finance Corporation and GE Business Financial Services Inc. As of June 30, 2011, the current facility with this syndicate had an outstanding principal balance of \$30.0 million and we had no further available credit. We will make interest-only payments on the outstanding balance of this facility through July 1, 2011, and subsequently we will make principal and interest payments to fully amortize the balance over the remaining 30 month term. In connection with the establishment of our loan agreements, we have issued warrants to the lenders to purchase shares of our stock. As of June 30, 2011, 63,079 shares of common stock had been issued from the exercise of warrants. Warrants to purchase an additional 50,331 common shares at \$12.67 per share and 254,793 common shares at \$7.0645 per share remain outstanding from our loan agreements.

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Liquidity

As of June 30, 2011, we had \$61.7 million in cash and cash equivalents, a decrease of \$50.5 million from the \$112.2 million at December 31, 2010. This decrease was primarily due to our use of cash from operations (\$39.6 million), net purchases of available-for-sale investment securities (\$10.5 million) and purchases of property and equipment (\$1.4 million). These cash outflows were partially offset by the receipt of \$1.4 million from the exercise of stock options during the six months ended June 30, 2011.

The \$39.6 million of cash used in operations during the six months ended June 30, 2011 represents an \$18.4 million increase from the \$21.2 million of cash used in operations during the comparable period in 2010. This additional use of cash during 2011 was primarily due to the increased net loss we incurred during the 2011 period as we launched commercial sales for OFIRMEV in January 2011 with approximately 150 sales representatives. As part of our launch efforts, we have continued to build our inventory stock to meet anticipated future demand. As of June 30, 2011, we held \$6.7 million of inventory, an increase of \$6.2 million from the \$0.5 million held at December 31, 2010. Our accounts payable and accrued liabilities have increased accordingly, due primarily to the increased commercial activities.

During the six months ended June 30, 2011, we continued to invest excess cash in investment vehicles to seek additional yield. During the 2011 period, we invested a net \$10.5 million in available-for-sale securities, increasing our investments from \$22.0 million at December 31, 2010 to \$32.4 million at June 30, 2011. The investments held at June 30, 2011 primarily consist of municipal and corporate debt obligations with varying short-term maturity dates.

Our property and equipment balance at June 30, 2011 increased \$1.1 million to \$10.1 million, from \$9.0 million as of December 31, 2010. This increase was primarily due to \$1.9 million in capital equipment purchases, a portion of which was accrued but unpaid at June 30, 2011, primarily for the manufacture of OFIRMEV. These purchases were partially offset by \$0.8 million of depreciation taken during the six months ended June 30, 2011. We are currently negotiating a development plan for a capacity increase at Baxter Healthcare Corporation, our primary third-party manufacturer for OFIRMEV. As part of this plan, we will fund all capital equipment purchases and facility improvements necessary for the capacity increase. However, we cannot reasonably estimate the cost of this expansion at this time as the capacity increase development plan has not been completed.

Capital Resources

Our cash, cash equivalent and short-term investment balances are our primary source of liquidity and currently the only sources available to us. We believe we have sufficient financial resources to fund our operations, at a minimum, for the next twelve months. However, our future funding requirements will depend on many factors, including, but not limited to:

- the costs associated with our efforts to commercialize OFIRMEV;
- the costs to manufacture commercial quantities of OFIRMEV at acceptable cost levels;
- the market acceptance for OFIRMEV and level of sales we are able to generate for the product; and
- any determination to exercise our option to acquire Incline.

Until we can generate significant cash from our operations, we expect to continue to fund our operations with our available financial resources, which are generated from the proceeds of offerings of our equity securities and our existing borrowings under our amended loan and security agreement. These financial resources may not be adequate to sustain our operations until we are able to generate significant positive cash flow from our operations and we may be required to finance future cash needs through the sale of additional equity securities, strategic collaboration agreements and debt financing. However, we cannot be certain that additional financing will be available when needed or that, if available, financing will be obtained on terms favorable to us or our stockholders. The capital markets have experienced volatility in recent years and the availability of credit has been adversely affected by illiquid credit markets and wide credit spreads. Further, concern about the stability of the markets in general, and the strength of counterparties specifically, has led many lenders and institutional investors to reduce, and in some cases, cease to provide funding to borrowers. Continued turbulence in the U.S. and international markets and economies may adversely affect our ability to obtain additional financing on terms acceptable to us, or at all. If these market conditions continue, they may limit our ability to timely replace maturing liabilities and to access the capital markets to meet liquidity needs. Having insufficient funds may require us to delay, scale-back or eliminate some or all of our programs or renegotiate less favorable terms than we would otherwise choose. Failure to obtain adequate financing also may adversely affect our ability to operate as a going concern. Additionally, if we raise funds by issuing equity securities, dilution to existing stockholders would result; and if we raise funds by incurring additional debt financing, the terms of the debt may involve significant cash payment obligations as well as covenants and specific financial ratios that may restrict our ability to operate our business.

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Off-Balance Sheet Arrangements

We had no off-balance sheet arrangements as of June 30, 2011.

Recent Accounting Pronouncements

See Note 3 to the Notes to Condensed Financial Statements in Item 1 above for further discussion of recent accounting pronouncements.

Caution on Forward-Looking Statements

This Quarterly Report on Form 10-Q, or Quarterly Report, includes forward-looking statements that are subject to risks and uncertainties, many of which are beyond our control. Forward-looking statements discuss matters that are not historical facts, and include, but are not limited to, discussions regarding our business, prospects, regulatory and commercialization strategies, growth strategy, future revenue, projected costs, competition, industry, regulatory environment, economic conditions, financial condition, liquidity and capital resources and results of operations. In this Quarterly Report, for example, we make forward-looking statements regarding: the anticipated U.S. market opportunity for OFIRMEV; the number of formulary approvals of OFIRMEV that we have received during the current year, and the potential for those formulary approvals to for future revenue growth; our strategy for building a long-term hospital pain franchise; our intention to vigorously enforce our intellectual property rights; the sufficiency of our capital resources to fund our operations; the potential for us to ultimately acquire Incline or other product candidates; and all of our financial estimates or projections. Such statements include, but are not limited to, statements preceded by, followed by or that otherwise include the words, “believe,” “may,” “might,” “can,” “could,” “will,” “would,” “should,” “estimate,” “continue,” “anticipate,” “intend,” “seek,” “plan,” “project,” “expect,” or similar expressions.

While we believe that the expectations reflected in this Quarterly Report are reasonable, the inclusion of any forward-looking statements should not be regarded as a representation that any of our plans will be achieved. Our actual results may differ from those anticipated in our forward looking statements as a result of various factors, including those set forth below under the caption “Part II, Item 1A — Risk Factors” and the differences may be material. These risk factors include, but are not limited to: our dependence on the successful commercialization of OFIRMEV, which is our only product; the potential that delays in achieving formulary acceptance for OFIRMEV at a substantial number of targeted accounts may enable competitors to further entrench their products and decrease the market potential for OFIRMEV; our ability to achieve broad market acceptance and generate revenues from sales of OFIRMEV; our ability to successfully enforce our marketing exclusivities and intellectual property rights, and to defend the patents covering OFIRMEV; the potential that we may be required to file lawsuits to defend our patent rights from challenges by companies seeking to market generic versions of intravenous acetaminophen, and the substantial costs associated with such lawsuits; the potential introduction of generic competition to OFIRMEV; our dependence on our licensors for the maintenance and enforcement of our intellectual property rights; the potential product liability exposure associated with pharmaceutical products such as OFIRMEV and other products we may in-license or acquire; our ability to fully comply with numerous federal, state and local laws and regulatory requirements that apply to our commercial activities; public concern regarding the safety of drug products such as OFIRMEV, which could result in the potential that regulatory agencies may implement new requirements to include unfavorable information in our labeling for OFIRMEV; our ability to ensure an adequate and continued supply of OFIRMEV to meet anticipated market demand; the risk that we may not be able to raise sufficient capital when needed, or at all; and other risks detailed below under Part II — Item 1A — Risk Factors and in our periodic public filings with the Securities and Exchange Commission. You are cautioned not to place undue reliance on these forward-looking statements, which speak only as of the date hereof. All forward-looking statements are qualified in their entirety by this cautionary statement and we undertake no obligation to revise or update such statements to reflect events or circumstances after the date hereof. This caution is made under the safe harbor provisions of Section 21E of the Private Securities Litigation Reform Act of 1995.

Item 3. *Quantitative and Qualitative Disclosures About Market Risk*

Our cash equivalents and short-term investments are classified as available-for-sale. As of June 30, 2011 our holdings consisted of investments in money market funds, debt obligations of government agencies, municipalities, commercial paper and certificates of deposit. These investments were made in accordance with an investment policy approved by our board of directors which specifies the categories, allocations, and ratings of securities we may consider for investment. The primary objective of our investment activities is to preserve principal while at the same time maximizing the income we receive without significantly increasing risk. Some of the financial instruments that we invest in could be subject to market risk. This means that a change in prevailing interest rates may cause the value of the instruments to fluctuate. For example, if we purchase a security that was issued with a fixed interest rate and the prevailing interest rate later rises, the value of that security will probably decline. To minimize this risk, we intend to maintain a

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portfolio which may include cash, cash equivalents and investment securities available-for-sale in a variety of securities which may include money market funds, government and non-government debt securities and commercial paper, all with various maturity dates. Based on our current investment portfolio, we do not believe that our results of operations would be materially impacted by an immediate change of 10% in interest rates.

We do not hold or issue derivatives, derivative commodity instruments or other financial instruments for speculative trading purposes. Further, we do not believe our cash, cash equivalents and investment securities have significant risk of default or illiquidity. We made this determination based on discussions with our investment advisors and a review of our holdings. While we believe our cash, cash equivalents and investment securities do not contain excessive risk, we cannot provide absolute assurance that in the future our investments will not be subject to adverse changes in market value. All of our investments are held at fair value. The following table shows the fair value of our cash equivalents and investments as of June 30, 2011 (in thousands):

| | <u>Amortized Cost Basis</u> | <u>Fair Value</u> |
|------------------------|---------------------------------|-------------------|
| Cash equivalents | \$ 61,683 | \$ 61,683 |
| Short-term investments | \$ 32,392 | \$ 32,392 |

Debt

The loans under our current loan and security agreement have fixed interest rates. Consequently, we do not have significant interest rate cash flow exposure on our debt. The aggregate balance of the loans, net of the loan discount, under the agreement at June 30, 2011 was \$29.1 million, and is collateralized by substantially all of our assets (excluding intellectual property). Under the terms of the agreement, we are precluded from entering into certain financing and other transactions, including disposing of certain assets and paying dividends, and are subject to various non-financial covenants and prepayment penalties.

Item 4. Controls and Procedures

We maintain disclosure controls and procedures that are designed to ensure that information required to be disclosed in our reports under the Securities Exchange Act of 1934, as amended, and the rules and regulations thereunder, is recorded, processed, summarized and reported within the time periods specified in the U.S. Securities and Exchange Commission's rules and forms and that such information is accumulated and communicated to our management, including our chief executive officer and chief financial officer, as appropriate, to allow for timely decisions regarding required disclosure. In designing and evaluating the disclosure controls and procedures, management recognizes that any controls and procedures, no matter how well designed and operated, can provide only reasonable assurance of achieving the desired control objectives, and management is required to apply its judgment in evaluating the cost-benefit relationship of possible controls and procedures.

Evaluation of disclosure controls and procedures. As required by U.S. Securities and Exchange Commission Rule 13a-15(b), we carried out an evaluation, under the supervision and with the participation of our management, including our chief executive officer and chief financial officer, of the effectiveness of the design and operation of our disclosure controls and procedures as of the end of the period covered by this Quarterly Report. Based on the foregoing, our chief executive officer and chief financial officer concluded that our disclosure controls and procedures were effective at the reasonable assurance level.

Changes in internal control over financial reporting. There was no change in our internal control over financial reporting that occurred during the period covered by this Quarterly Report that has materially affected, or is reasonably likely to materially affect, our internal control over financial reporting.

PART II. OTHER INFORMATION

Item 1. *Legal Proceedings*

Not applicable.

Item 1A. *Risk Factors*

You should carefully consider the risks described below, in addition to the other information contained in this report, before making an investment decision. Our business, financial condition or results of operations could be harmed by any of these risks. The risks and uncertainties described below are not the only ones we face. Additional risks not presently known to us or other factors not perceived by us to present significant risks to our business at this time also may impair our business operations.

We have marked with an asterisk () those risk factors that reflect substantive changes from the risk factors included in our previously filed Annual Report on Form 10-K for the year ended December 31, 2010.*

Risks Related to Our Business and Industry

Our success depends on our ability to successfully commercialize our only product, OFIRMEV®. *

Our success depends on our ability to effectively commercialize our only product, OFIRMEV, which was approved by the FDA in November 2010, for the management of mild to moderate pain, the management of moderate to severe pain with adjunctive opioid analgesics and the reduction of fever in adults and children two years of age and older.

We launched OFIRMEV in January 2011, but our ability to effectively commercialize and generate revenues from OFIRMEV will depend on several factors, including:

- our ability to create market demand for OFIRMEV through our own marketing and sales activities, and any other arrangements to promote this product we may later establish;
- our ability to train, deploy and support a qualified sales force;
- our ability to secure formulary approvals for OFIRMEV at a substantial number of targeted hospitals;
- our ability to maintain and defend our patent protection and regulatory exclusivity for OFIRMEV;
- our ability to procure a supply of OFIRMEV from our third-party manufacturers in sufficient quantities and at acceptable quality and pricing levels in order to meet commercial demand;
- the performance of our third-party manufacturers and our ability to ensure that our supply chain for OFIRMEV efficiently and consistently delivers OFIRMEV to our customers;
- our ability to implement and maintain agreements with wholesalers, distributors and group purchasing organizations on commercially reasonable terms;
- the occurrence of adverse side effects or inadequate therapeutic efficacy of OFIRMEV, and any resulting product liability claims or product recalls; and
- the availability of adequate levels of reimbursement coverage for OFIRMEV from third-party payors.

Any disruption in our ability to generate revenues from the sale of OFIRMEV or lack of success in its commercialization will have a substantial adverse impact on our results of operations.

Our efforts to successfully commercialize OFIRMEV are subject to many internal and external challenges and if we cannot overcome these challenges in a timely manner, our future revenues and profits could be materially and adversely impacted.

As OFIRMEV is a newly marketed drug, none of the members of our sales force had ever promoted OFIRMEV prior to its launch in January 2011. As a result, we are required to expend significant time and resources to train our sales force to be credible and persuasive in discussing OFIRMEV with physicians, nurses, hospitals, and other customers. In addition, we also must train our sales force to ensure that a consistent and appropriate message about OFIRMEV is being delivered to our potential customers. If we are unable to effectively train our sales force and equip them with effective materials, including medical and sales literature to help them inform and educate potential customers about the benefits and risks of OFIRMEV and its proper administration, our efforts to successfully commercialize OFIRMEV could be put in jeopardy, which could have a material adverse effect on our financial condition, stock price and operations.

In addition to extensive internal efforts, the successful commercialization of OFIRMEV will require many third-parties, over whom we have no control, to decide to utilize OFIRMEV. These third parties include physicians, pharmacists, and hospital pharmacy

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and therapeutics committees, or P&T committees. Generally, before we can attempt to sell OFIRMEV in a hospital, OFIRMEV must be approved for addition to that hospital's list of approved drugs, or formulary list, by the hospital's P&T committee. A hospital's P&T committee typically governs all matters pertaining to the use of medications within the institution, including review of medication formulary data and recommendations for the appropriate use of drugs within the institution to the medical staff. The frequency of P&T committee meetings at various hospitals varies considerably, and P&T committees often require additional information to aide in their decision-making process, so we may experience substantial delays in obtaining formulary approvals. Additionally, hospital pharmacists may be concerned that the cost of acquiring OFIRMEV for use in their institutions will adversely impact their overall pharmacy budgets, which could cause pharmacists to resist efforts to add OFIRMEV to the formulary, or to implement restrictions on the usage of the drug in order to control costs. We cannot guarantee that we will be successful in getting the approvals we need from enough P&T committees quickly enough to optimize hospital sales of OFIRMEV.

Even if we obtain hospital formulary approval for OFIRMEV, physicians must still prescribe OFIRMEV for its commercialization to be successful. Because OFIRMEV is a new drug with no track record of sales in the U.S. prior to January 2011, any inability to timely supply OFIRMEV to our customers, or any unexpected side effects that develop from use of the drug, particularly early in product launch, may lead physicians to not accept OFIRMEV as a viable treatment alternative.

We may require substantial additional funding and may be unable to raise capital when needed, which would force us to delay, reduce or eliminate some or all of our planned activities.*

We began generating revenue from the launch of OFIRMEV in January 2011, however, we expect our negative cash flow from operations to continue until we are able to generate significant revenues from sales of OFIRMEV. As a result, we may need to raise additional capital to:

- fund our operations as we implement our marketing strategies, establish and maintain our sales force and commercial infrastructure and commercialize OFIRMEV;
- purchase sufficient quantities of OFIRMEV from our contract manufacturers to meet customer demand;
- continue to fund the expansion of our contract manufacturers' capacity to produce OFIRMEV in order to meet future demand for this product;
- complete one or more efficacy, pharmacokinetic and pharmacodynamic studies of OFIRMEV in pediatric patients under two years of age, as required to comply with our post-commercialization commitment to the FDA;
- exercise our option to acquire Incline; or
- acquire or in-license other products, businesses or technologies that we believe are a strategic fit.

Our funding requirements related to the commercialization of OFIRMEV may exceed our current projections as a result of many factors, including, but not limited to:

- our sales of OFIRMEV may be lower than expected;
- the costs associated with our efforts to sell, market and distribute OFIRMEV, including costs associated with establishing and maintaining our sales force and commercial infrastructure, may be greater than anticipated;
- we may incur unexpected costs in order to ensure a sufficient supply of OFIRMEV from our contract manufacturers in order to meet customer demand; and
- we may be required to file lawsuits to defend our patent rights or regulatory exclusivities from challenges by companies seeking to market generic versions of intravenous acetaminophen, including any such costs we may be required to expend if our licensors are unwilling or unable to do so.

Until we can generate a sufficient amount of revenue from sales of OFIRMEV, if ever, we expect to finance future cash needs through public or private equity offerings, debt financings or corporate collaboration and licensing arrangements, as well as through interest income earned on cash and investment balances. For example, in February 2009, we completed a private placement of common stock and warrants to purchase common stock, raising net proceeds of approximately \$86.2 million. In June 2010, we drew an initial advance of \$20.0 million under our loan and security agreement with Oxford Finance Corporation, Silicon Valley Bank and GE Business Financial Services, Inc., and a second advance of \$10.0 million was made in November 2010, following the approval of OFIRMEV by the FDA. In addition, in November 2010, we undertook a public offering of common stock that raised net proceeds of approximately \$93.6 million. Our existing universal shelf registration statement, which was declared effective in May 2011, may permit us, from time to time, to offer and sell up to approximately \$150.0 million of equity or debt securities. However, there can be no assurance that we would be able to complete any such securities offerings, and to the extent that we raise additional capital by issuing equity securities, our existing stockholders' ownership will be diluted.

We believe that we currently have sufficient funds to meet our projected operating requirements, at a minimum, through the next twelve months. This estimate does not reflect any exercise of our right to acquire Incline or participation in other strategic

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transactions. We have based this estimate on assumptions that may prove to be wrong and we could spend our available financial resources faster than we currently expect. We cannot be certain that additional funding will be available on acceptable terms, or at all. If adequate funds are not available, we may be required to reduce the scope of or eliminate some or all of our sales, marketing and commercialization efforts for OFIRMEV, which could decrease sales of this product and have a material adverse effect on our financial condition, stock price and operations.

We have no manufacturing capabilities and depend entirely upon our contract manufacturers to produce OFIRMEV. If our contract manufacturers fail to meet our requirements for OFIRMEV, or fail to fully comply with cGMP regulations, we may be unable to meet market demand, and may lose potential revenues.*

The manufacture of pharmaceutical products requires significant expertise and capital investment, including the development of advanced manufacturing techniques and process controls, and the use of specialized processing equipment. We have no such manufacturing capabilities, so we have relied upon Baxter Healthcare Corporation, or Baxter, as our primary source for OFIRMEV.

Following the commercial launch of OFIRMEV, we amended our long-term development and supply agreement with Baxter in January 2011. In order to meet anticipated demand for OFIRMEV, Baxter has initiated planning activities to install additional production lines, and we have ordered additional, specialized processing equipment to expand the manufacturing capacity for OFIRMEV. Major components of this processing equipment are currently available from single sources, and if this equipment is not delivered on time or at all, the manufacturing capacity for OFIRMEV may not keep pace with anticipated demand. Any termination or disruption of our relationship with Baxter may materially harm our business and financial condition, and adversely impact our commercialization and sales efforts with respect to OFIRMEV.

In addition, in December 2010, we entered into an agreement with Lawrence Laboratories, an indirect wholly-owned subsidiary of BMS, to be a supplemental source for OFIRMEV. Bristol-Myers Squibb Srl, or BMS Anagni, an indirect subsidiary of BMS located in Anagni, Italy, will manufacture OFIRMEV on behalf of Lawrence Laboratories. BMS Anagni also currently manufactures intravenous acetaminophen for sale and distribution by BMS and its affiliates in a number of countries outside of the U.S. and Canada. The FDA approved the BMS Anagni facility as an additional manufacturing site for OFIRMEV in March 2011.

Baxter and Lawrence Laboratories must comply with strictly enforced federal, state and foreign regulations, including GMP regulations. The FDA will re-inspect our third party manufacturers' facilities from time to time and, in the event that any such inspection reveals that either facility is not in compliance with applicable regulations, the FDA may issue fines and civil penalties, suspend production, suspend or delay any subsequent product approvals, seize or recall our products, or withdraw our product approval, which would limit the availability of OFIRMEV. Any manufacturing defect or error discovered after products have been produced and distributed could result in even more significant consequences, including costly recall procedures, re-stocking costs, damage to our reputation and our relationships with our customers, product liability claims and litigation.

We also currently rely upon a single source for the manufacture of the active pharmaceutical ingredient, or API, for OFIRMEV, as well as for other critical components of OFIRMEV. We have entered into a supply agreement for the commercial supply of the API. If our supplier becomes unable to meet our demand for the API, the process of changing or adding a new API manufacturer may require additional testing and prior FDA approval and may be expensive and time-consuming. If we were unable to manage such changes effectively, we could face supply disruptions that could result in significant costs and delays, damage to our reputation or commercial prospects and cause us to lose potential revenues.

Although we actively manage these third party relationships to ensure continuity and quality, some events beyond our control could result in the complete or partial failure of these goods and services. Any such failure could have a material adverse effect on our financial condition and operations. In addition, as OFIRMEV is a new product, the effect of any delay or failure to deliver could be magnified due to the lack of a sales track record for OFIRMEV in the U.S.

We have never marketed a drug before, and if we are unable to maintain an effective commercial infrastructure, we will not be able to successfully commercialize OFIRMEV.*

We have built our own sales and marketing capabilities in order to market OFIRMEV directly to physicians, nurses, hospitals, group purchasing organizations and other customers, and will continue to incur significant expenses associated with the recruitment, training and compensation of our sales representatives. We expect that the annual sales force cost associated with each of our sales representatives will be approximately \$325,000, but it could be significantly more. The continued development of our hospital-focused sales, marketing and distribution infrastructure for our domestic operations will be expensive and time consuming, and there may be unforeseen costs and expenses or time-delays associated with such activities. If we are not successful in training and managing our sales and marketing personnel, we may not achieve our sales objectives. In addition, if we are unable to establish and maintain adequate sales, marketing and distribution capabilities, whether independently or with third parties, we may not be able to generate sufficient product revenue, may experience increased expenses, and may never become profitable.

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We expect intense competition for OFIRMEV, and new products may emerge that provide different or better therapeutic alternatives for our targeted indications.*

The biotechnology and pharmaceutical industries are subject to rapid and intense technological change. We will continue to face competition in our efforts to market and sell OFIRMEV from other biotechnology and pharmaceutical companies. There can be no assurance that developments by others will not render OFIRMEV obsolete or noncompetitive. Furthermore, new developments, including the development of other drug technologies and methods of preventing the incidence of disease, occur in the pharmaceutical industry at a rapid pace. These developments may render OFIRMEV obsolete or noncompetitive.

OFIRMEV will compete with well-established products with similar indications. Competing injectable products available for the treatment of pain include opioids such as morphine, fentanyl, meperidine and hydromorphone, each of which is available generically from several manufacturers, and several of which are available as proprietary products using novel delivery systems. Ketorolac, an injectable NSAID, is also available generically in the U.S. from several manufacturers, and Caldolor (ibuprofen for injection), an NSAID, is available for the treatment of pain and fever in adults. Competing products available for the treatment of fever in the hospital setting include acetaminophen administered orally and rectally, aspirin and NSAIDs, which may be administered orally, topically or intravenously. Additional products may be developed for the treatment of acute pain, including new injectable NSAIDs, novel opioids, new formulations of currently available opioids and NSAIDs, long-acting local anesthetics and new chemical entities as well as alternative delivery forms of various opioids and NSAIDs.

Competitors may seek to develop alternative formulations of intravenous acetaminophen for our targeted indications that do not directly infringe our in-licensed patent rights. The commercial opportunity for OFIRMEV could be significantly harmed if competitors are able to develop alternative formulations outside the scope of our in-licensed patents. On July 8, 2011, we received a notice from Paddock Laboratories, Inc., or Paddock, and on July 13, 2011, we received a notice from Exela Pharma Sciences, LLC, or Exela, each stating that it had filed an Abbreviated New Drug Application, or ANDA, with the FDA for a generic version of OFIRMEV. Both of these notices state that a "Paragraph IV" patent certification was made with respect to the two patents covering OFIRMEV that are listed in the FDA's Approved Drug Products with Therapeutic Equivalence Evaluations, commonly known as the Orange Book. A Paragraph IV patent certification is a certification by a generic applicant that, in the opinion of that applicant, the patent listed in the Orange Book for a branded product is invalid, unenforceable, or will not be infringed by the manufacture, use or sale of the generic product. We are currently reviewing the details of these notices. We intend to vigorously enforce our intellectual property rights relating to OFIRMEV, but we cannot predict the outcome of these matters or guarantee the outcome of any litigation. In addition, we are aware of several third-party U.S. and Canadian patents and patent applications directed to various potential injectable formulations of acetaminophen, including intravenous formulations, as well as methods of making and using these potential formulations. Compared to us, many of our potential competitors have substantially greater:

- capital resources;
- research development resources, including personnel and technology;
- clinical trial experience;
- regulatory experience;
- expertise in prosecution of intellectual property rights; and
- manufacturing, distribution, and sales and marketing experience.

As a result of these factors, our competitors may be able to obtain patent protection or other intellectual property rights that limit our ability to commercialize OFIRMEV. Our competitors may also develop drugs that are more effective, useful and less costly than ours and may be more successful than us in manufacturing and marketing their products. We expect to face similar competition in our efforts to identify appropriate collaborators or partners to help commercialize OFIRMEV in Canada.

If OFIRMEV does not achieve broad market acceptance, the revenues that we generate from its sales will be limited.

The commercial success of OFIRMEV will depend upon its acceptance by the medical community, our ability to ensure that the drug is included in hospital formularies, and coverage and reimbursement for OFIRMEV by third-party payors, including government payors. The degree of market acceptance of OFIRMEV, or any other product candidate we may license or acquire, will depend on a number of factors, including:

- limitations or warnings contained in the product's FDA-approved labeling;
- changes in the standard of care for the targeted indications for our product candidates, which could reduce the marketing impact of any superiority claims that we could make following FDA approval; and
- potential advantages over, and availability of, alternative treatments, including, in the case of OFIRMEV, a number of products already used to treat pain or fever in the hospital setting.

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Our ability to effectively promote and sell OFIRMEV and any other product candidates we may license or acquire in the hospital marketplace will also depend on pricing and cost effectiveness, including our ability to produce a product at a reasonable cost, achieve hospital formulary acceptance for the product and sell the product at a competitive price, as well as our ability to obtain sufficient third-party coverage or reimbursement. Since many hospitals are members of group purchasing organizations, which leverage the purchasing power of a group of entities to obtain discounts based on the collective buying power of the group, our ability to attract customers in the hospital marketplace will also depend on our ability to effectively promote OFIRMEV and any other product candidate to hospitals that are members of group purchasing organizations. We will also need to demonstrate acceptable evidence of safety and efficacy, as well as relative convenience and ease of administration. Market acceptance could be further limited depending on the prevalence and severity of any expected or unexpected adverse side effects associated with OFIRMEV and any other product candidates we may license or acquire. If OFIRMEV, or any other product candidates that are approved, do not achieve an adequate level of acceptance by physicians, health care payors and patients, we may not generate sufficient revenue from these products, and we may not become or remain profitable. In addition, our efforts to educate the medical community and third-party payors on the benefits and risks of OFIRMEV or any other product candidates may require significant resources and may never be successful.

We rely on third parties to perform many essential services for OFIRMEV and any other products that we commercialize, including services related to warehousing and inventory control, distribution, customer service, accounts receivable management, cash collection and adverse event reporting, and if such third parties fail to perform as expected or to comply with legal and regulatory requirements, our efforts to commercialize OFIRMEV or any other products may be significantly impacted and we may be subject to regulatory sanctions.

We rely on third-party service providers to perform a variety of functions related to the sale and distribution of OFIRMEV, key aspects of which are out of our direct control. The services provided by these third parties include warehousing and inventory control, distribution, customer service, accounts receivable management and cash collection. As a result, most of our inventory is stored at a single warehouse maintained by one such service provider. If these third-party service providers fail to comply with applicable laws and regulations, fail to meet expected deadlines, or otherwise do not carry out their contractual duties to us, or if our products encounter physical or natural damage at their facilities, our ability to deliver product to meet commercial demand would be significantly impaired. In addition, we have engaged third parties to perform various other services for us relating to adverse event reporting, safety database management, fulfillment of requests for medical information regarding OFIRMEV and related services. If the quality or accuracy of the data maintained or services performed by these third parties is insufficient, we could be subject to regulatory sanctions.

We face potential product liability exposure, and if successful claims are brought against us, we may incur substantial liability for OFIRMEV or other product candidates we may license or acquire and may have to limit their commercialization.

The use of OFIRMEV and any other product candidates we may license or acquire in clinical trials and the sale of any products for which we obtain marketing approval expose us to the risk of product liability claims. Product liability claims might be brought against us by consumers, health care providers or others using, administering or selling our products. If we cannot successfully defend ourselves against these claims, we will incur substantial liabilities. Regardless of merit or eventual outcome, liability claims may result in:

- decreased demand for OFIRMEV or other product candidates;
- loss of revenues;
- impairment of our business reputation;
- costs of related litigation;
- substantial monetary awards to patients or other claimants;
- withdrawal of clinical trial participants;
- significant distraction of our scientific and management personnel who may be involved in our efforts to defend against such claims; and
- the inability or lack of commercial rationale to continue commercialization of OFIRMEV or any other product candidates.

Although we currently have commercial product liability coverage for OFIRMEV, which includes coverage for any clinical trials we may perform, insurance coverage is becoming increasingly expensive and we may be unable to obtain commercially reasonable product liability insurance coverage at a reasonable cost or in sufficient amounts to protect us against losses due to liability. On occasion, large judgments have been awarded in class action lawsuits based on drugs that had unanticipated side effects. Our

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commercial product liability insurance coverage may not reimburse us or may not be sufficient to reimburse us for any expenses or losses we may suffer. A successful product liability claim or series of claims brought against us could cause our stock price to fall and, if judgments exceed our insurance coverage, could decrease our cash and adversely affect our business.

Although OFIRMEV has received regulatory approval from the FDA, it remains subject to substantial, ongoing regulatory requirements.

OFIRMEV remains subject to ongoing FDA requirements with respect to manufacturing, labeling, packaging, storage, distribution, advertising, promotion, record-keeping and submission of safety and other post-market information on the drug. The FDA has the authority to regulate the claims we make in marketing OFIRMEV to ensure that such claims are true, not misleading, supported by scientific evidence and consistent with the approved label for the drug. In addition, the discovery of previously unknown problems with OFIRMEV, such as adverse events of unanticipated severity or frequency, or problems with the facility where the product is manufactured, may result in the imposition of additional restrictions, including withdrawal of the product from the market.

For example, as a condition of the approval of OFIRMEV, we are required to complete one or more efficacy, pharmacokinetic and pharmacodynamic studies of OFIRMEV in pediatric patients under two years of age, and to submit the final results of this clinical trial to the FDA. Depending on the outcome of this study, we may be unable to expand the indications for OFIRMEV or we may be required to include specific warnings or limitations on dosing this product, which could negatively impact our sales of OFIRMEV.

We have implemented a comprehensive compliance program and related infrastructure, but we cannot provide absolute assurance that we are or will be in compliance with all potentially applicable laws and regulations. If our operations in relation to OFIRMEV fail to comply with applicable regulatory requirements, the FDA or other regulatory agencies may:

- issue warning letters or untitled letters;
- impose consent decrees, which may include the imposition of various fines, reimbursements for inspection costs, required due dates for specific actions and penalties for noncompliance;
- impose fines other civil or criminal penalties;
- suspend regulatory approval;
- suspend any ongoing clinical trials;
- refuse to approve pending applications or supplements to approved applications filed by us;
- impose restrictions on operations, including costly new manufacturing requirements;
- exclude us from participating in U.S. federal healthcare programs, including Medicaid or Medicare; or
- seize or detain products or require a product recall.

In addition to FDA restrictions, numerous other federal, state and local laws and regulations apply to the promotion and sale of pharmaceutical products, such as federal anti-kickback and false claims statutes. For example, the federal healthcare program anti-kickback statute prohibits, among other things, knowingly and willfully offering, paying, soliciting or receiving remuneration to induce or in return for purchasing, leasing, ordering or arranging for the purchase, lease or order of any healthcare item or service reimbursable under Medicare, Medicaid or other federally financed healthcare programs. This statute has been interpreted to apply to arrangements between pharmaceutical manufacturers on the one hand and prescribers, purchasers and formulary managers on the other. Violations of the anti-kickback statute are punishable by imprisonment, criminal fines, civil monetary penalties and exclusion from participation in federal healthcare programs. Although there are a number of statutory exemptions and regulatory safe harbors protecting certain common activities from prosecution or other regulatory sanctions, the exemptions and safe harbors are drawn narrowly, and practices that involve remuneration intended to induce prescribing, purchases or recommendations may be subject to scrutiny if they do not qualify for an exemption or safe harbor. Our practices may not in all cases meet all of the criteria for safe harbor protection from anti-kickback liability.

Federal false claims laws prohibit any person from knowingly presenting, or causing to be presented, a false claim for payment to the federal government, or knowingly making, or causing to be made, a false statement to have a false claim paid. Recently, several pharmaceutical and other healthcare companies have been prosecuted under these laws for allegedly inflating drug prices they report to pricing services, which in turn are used by the government to set Medicare and Medicaid reimbursement rates, and for allegedly providing free product to customers with the expectation that the customers would bill federal programs for the product. In addition, certain marketing practices, including off-label promotion, may also violate false claims laws. The majority of states also have statutes or regulations similar to the federal anti-kickback law and false claims laws, which apply to items and services reimbursed under Medicaid and other state programs, or, in several states, apply regardless of the payor. Sanctions under these federal and state laws may include civil monetary penalties, exclusion of a manufacturer's products from reimbursement under government programs, criminal fines and imprisonment.

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Because of the breadth of these laws and the narrowness of the safe harbors, it is possible that some of our business activities could be subject to challenge under one or more of such laws. Such a challenge could have a material adverse effect on our business, financial condition and results of operations.

Regulatory approval for any approved product is limited by the FDA to those specific indications and conditions for which clinical safety and efficacy have been demonstrated.

Any regulatory approval is limited to those specific diseases and indications for which a product is deemed to be safe and effective by the FDA. In addition to the FDA approval required for new formulations, any new indication for an approved product also requires FDA approval. If we are not able to obtain FDA approval for any desired future indications for our products, our ability to effectively market and sell our products may be reduced and our business may be adversely affected.

While physicians may choose to prescribe drugs for uses that are not described in the product's labeling and for uses that differ from those tested in clinical studies and approved by the regulatory authorities, our ability to promote the products is limited to those indications that are specifically approved by the FDA. Regulatory authorities in the U.S. generally do not regulate the behavior of physicians in their choice of treatments, and such off-label uses by healthcare professionals are common. Regulatory authorities do, however, restrict communications by pharmaceutical companies on the subject of off-label use. If our promotional activities fail to comply with these regulations or guidelines, we may be subject to warnings from, or enforcement action by, these authorities. In addition, our failure to follow FDA rules and guidelines relating to promotion and advertising may cause the FDA to suspend or withdraw an approved product from the market, require a recall or institute fines, or could result in disgorgement of money, operating restrictions, injunctions or criminal prosecution, any of which could harm our business.

We are subject to new legislation, regulatory proposals and healthcare payor initiatives that may increase our costs of compliance and adversely affect our ability to market our products, obtain collaborators and raise capital.

In March 2010, the President signed the Patient Protection and Affordable Care Act, or PPACA, which makes extensive changes to the delivery of health care in the U.S. The PPACA includes numerous provisions that affect pharmaceutical companies, some of which were effective immediately and others of which will be taking effect over the next several years. For example, the PPACA seeks to expand health care coverage to the uninsured through private health insurance reforms and an expansion of Medicaid. The PPACA will also impose substantial costs on pharmaceutical manufacturers, such as an increase in liability for rebates paid to Medicaid, new drug discounts that must be offered to certain enrollees in the Medicare prescription drug benefit, an annual fee imposed on all manufacturers of brand prescription drugs in the U.S., and an expansion of an existing program requiring pharmaceutical discounts to certain types of hospitals and federally subsidized clinics. The PPACA also contains cost containment measures that could reduce reimbursement levels for health care items and services generally, including pharmaceuticals. It also will require reporting and public disclosure of payments and other transfers of value provided by pharmaceutical companies to physicians and teaching hospitals. We cannot predict what effect the PPACA or other healthcare reform initiatives that may be adopted in the future will have on our business. Several lawsuits have been filed challenging the constitutionality of provisions of the PPACA, with varying results. Although it is possible that portions of the PPACA may be repealed or determined to be unconstitutional, other health reform legislation may be implemented. The continuing efforts of the government, insurance companies, managed care organizations and other payors of health care services to contain or reduce costs of health care could result in decreased net revenues from our pharmaceutical products and decrease potential returns from our development efforts.

In addition, there have been a number of other legislative and regulatory proposals aimed at changing the pharmaceutical industry. In particular, California has enacted legislation that requires development of an electronic pedigree to track and trace each prescription drug at the saleable unit level through the distribution system. California's electronic pedigree requirement is scheduled to take effect in January 2015. Compliance with California and future federal or state electronic pedigree requirements may increase our operational expenses and impose significant administrative burdens. As a result of these and other new proposals, we may determine to change our current manner of operation, provide additional benefits or change our contract arrangements, any of which could have a material adverse effect on our business, financial condition and results of operations.

Managed care organizations are increasingly challenging the prices charged for medical products and services and, in some cases, imposing restrictions on the coverage of particular drugs. Many managed care organizations negotiate the price of medical services and products and develop formularies which establish pricing and reimbursement levels. Exclusion of a product from a formulary can lead to its sharply reduced usage in the managed care organization's patient population. The process for obtaining coverage can be lengthy and costly, and we expect that it could take several months before a particular payor initially reviews our product and makes a decision with respect to coverage. For example, third-party payors may require cost-benefit analysis data from us in order to demonstrate the cost-effectiveness of OFIRMEV or any other product we might bring to market. For any individual third-party payor, we may not be able to provide data sufficient to gain reimbursement on a similar or preferred basis to competitive products, or at all.

Our reporting and payment obligations under the Medicaid rebate program and other governmental purchasing and rebate programs are complex and may involve subjective decisions, and any failure to comply with those obligations could subject us to penalties and sanctions, which could in turn have a material adverse effect on our business and financial condition.

As a condition of reimbursement by various federal and state healthcare programs, we must calculate and report certain pricing information to federal and state healthcare agencies. The regulations regarding reporting and payment obligations with respect to Medicaid reimbursement and rebates and other governmental programs are complex. Our calculations and methodologies are subject to review and challenge by the applicable governmental agencies, and it is possible that such reviews could result in material changes. In addition, because our processes for these calculations and the judgments involved in making these calculations involve subjective decisions and complex methodologies, these calculations are subject to the risk of errors. Any failure to comply with the government reporting and payment obligations could result in civil and/or criminal sanctions.

We may never receive approval outside of the U.S. to commercialize OFIRMEV or any other product candidates we may acquire.

Our rights to OFIRMEV include Canada, as well as the U.S. In order to market OFIRMEV and any other product candidates we may acquire in Canada or other jurisdictions outside of the U.S., we must comply with numerous and varying regulatory requirements of other countries regarding non-clinical testing, manufacturing, clinical safety and efficacy. Approval procedures vary among countries and can involve additional product testing and additional administrative review periods. The time required to obtain approval in other countries might differ from that required to obtain FDA approval. The regulatory approval process in other countries may include all of the risks detailed above regarding FDA approval in the U.S. as well as other risks. Regulatory approval in one country does not ensure regulatory approval in another, but a failure or delay in obtaining regulatory approval in one country may have a negative effect on the regulatory process in others. Failure to obtain regulatory approval in other countries or any delay or setback in obtaining such approval could have the same adverse effects detailed above regarding FDA approval in the U.S. As described above, such effects include the risks that OFIRMEV and any other products may not be approved for all indications requested, which could limit the uses of our products and have an adverse effect on product sales and potential royalties, and that any regulatory approvals we may obtain may be subject to limitations on the indicated uses for which our products may be marketed or require us to perform costly, post-marketing follow-up studies.

Public concern regarding the safety of drug products such as OFIRMEV could result in new requirements from regulatory agencies to include unfavorable information in our labeling, or require us to undertake other activities that may entail additional costs.

In light of widely publicized events concerning the safety risk of certain drug products, the FDA, members of Congress, the Government Accountability Office, medical professionals and the general public have raised concerns about potential drug safety issues. These events have resulted in the withdrawal of drug products, revisions to drug labeling that further limit use of the drug products and the establishment of risk management programs that may, for example, restrict distribution of drug products after approval. For example, in January 2011, the FDA issued a press release and posted on its website a drug safety communication asking manufacturers of prescription drug products containing combinations of acetaminophen and opioid medications to limit the amount of acetaminophen to no more than 325 milligrams (mg) in each dosage unit (i.e. each tablet or caplet). In the announcement, the FDA also requested manufacturers to update labels for such products to include a boxed warning highlighting the potential for severe acetaminophen-induced liver injury and a warning highlighting the potential for allergic reactions. The boxed warning required for affected products reaffirms previous statements made by the FDA that most cases of liver injury are associated with acetaminophen doses that exceed 4,000 mg per day. While the FDA has indicated that this communication does not apply to intravenous acetaminophen, it is possible that the FDA may apply similar labeling requirements to OFIRMEV in the future. In addition, we reaffirmed our dosing recommendations for OFIRMEV in July 2011 following a news release by a major manufacturer of over-the-counter acetaminophen products announcing its plan to lower the recommended maximum daily dose of some oral acetaminophen products in an effort to reduce the risk of accidental acetaminophen overdose among its customers in the over-the-counter setting. Any perception or concern that acetaminophen is unsafe could harm our ability to successfully commercialize and sell OFIRMEV, which could have a material adverse effect on our business, financial condition and results of operations.

In addition, the Food and Drug Administration Amendments Act of 2007, or FDAAA, granted significant expanded authority to the FDA, much of which is aimed at improving the safety of drug products before and after approval. In particular, the law authorizes the FDA to, among other things, require post-approval studies and clinical trials, mandate changes to drug labeling to reflect new safety information and require risk evaluation and mitigation strategies for certain drugs, including certain currently approved drugs. It also significantly expands the federal government's clinical trial registry and results databank, which we expect will result in significantly increased government oversight of clinical trials. Under the FDAAA, companies that violate these and other provisions of that law are subject to substantial civil monetary penalties, among other regulatory, civil and criminal penalties. Data from clinical trials may receive greater scrutiny, particularly with respect to safety, which may make the FDA or other regulatory authorities more likely to require additional preclinical studies or clinical trials.

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If the government or third-party payors fail to provide coverage and adequate coverage and payment rates for OFIRMEV or any future products we may license or acquire, if any, or if hospitals choose to use therapies that are less expensive, our revenue and prospects for profitability will be limited.*

In both domestic and foreign markets, our anticipated sales of OFIRMEV or any future products will depend in part upon the availability of coverage and reimbursement from third-party payors. Such third-party payors include government health programs such as Medicare, managed care providers, private health insurers and other organizations. In particular, many U.S. hospitals receive a fixed reimbursement amount per procedure for certain surgeries and other treatment therapies they perform. Because this amount may not be based on the actual expenses the hospital incurs, hospitals may choose to use therapies which are less expensive when compared to our product candidates. In addition, some third-party payors are emphasizing the substitution of branded pharmaceuticals with less expensive generic equivalents. An increase in the sales of generic pharmaceutical products could result in a decrease in revenues of branded pharmaceuticals. While there are no generic equivalents competing with OFIRMEV at this time, in the future we could face generic competition. On July 8, 2011, we received a notice from Paddock, and on July 13, 2011, we received a notice from Exela, each stating that it had filed an ANDA with the FDA for a generic version of OFIRMEV. These notices state that a Paragraph IV patent certification was made with respect to the two patents covering OFIRMEV that are listed in the FDA's Approved Drug Products with Therapeutic Equivalence Evaluations, commonly known as the Orange Book. A Paragraph IV patent certification is a certification by a generic applicant that, in the opinion of that applicant, the patent listed in the Orange Book for a branded product is invalid, unenforceable, or will not be infringed by the manufacture, use or sale of the generic product. We are currently reviewing the details of these notices. We intend to vigorously enforce our intellectual property rights relating to OFIRMEV, but we cannot predict the outcome of these matters or guarantee the outcome of any litigation. OFIRMEV or any other product candidates that we may in-license or acquire, if approved, will face competition from other therapies and drugs, as well as other routes of administration of acetaminophen, for these limited hospital financial resources. We may need to conduct post-marketing studies in order to demonstrate the cost-effectiveness of any future products to the satisfaction of hospitals, other target customers and their third-party payors. Such studies might require us to commit a significant amount of management time and financial and other resources. Our future products might not ultimately be considered cost-effective. Adequate third-party coverage and reimbursement might not be available to enable us to maintain price levels sufficient to realize an appropriate return on investment in product development.

Governments continue to propose and pass legislation designed to reduce the cost of healthcare. In some foreign markets, such as Canada, the government controls the pricing of prescription pharmaceuticals. In these countries, pricing negotiated with governmental authorities can take six to twelve months or longer after the receipt of regulatory marketing approval for a product. In the U.S., we expect that there will be an increase in federal and state proposals to implement pricing controls for prescription drugs, and new legislation and regulations affecting the pricing of pharmaceuticals might change before our product candidates are approved for marketing. For example, the U.S. Congress is considering a number of legislative and regulatory proposals with an objective of ultimately reducing healthcare costs. Legislative and regulatory actions under consideration in the U.S. include health care reform initiatives that could significantly alter the market for pharmaceuticals (such as private health insurance expansion, the creation of competing public health insurance plans, a variety of proposals that would reduce government expenditures for prescription drugs to help finance healthcare reform, or the eventual transition of the U.S. multiple payer system to a single payer system). Other actions under consideration include proposals for government intervention in pharmaceutical pricing, changes in government reimbursement, an accelerated approval process for "follow-on" biologics, legalization of commercial drug importation into the U.S., and involuntary approval of medicines for over-the-counter use. Such legislation could result in the exclusion of OFIRMEV and any other product candidates we may license or acquire from coverage and reimbursement programs, or lower the prices we would receive for our product candidates. Our revenues from the sale of OFIRMEV or any other approved products could be significantly reduced as a result of these cost containment measures and reforms, which would negatively impact our profitability.

If we breach any of the agreements under which we license rights to OFIRMEV from others, we could lose the ability to commercialize OFIRMEV.

In March 2006, we entered into an exclusive license agreement with BMS relating to OFIRMEV for the U.S. and Canada. Because we have in-licensed the rights to this product candidate from a third party, if there is any dispute between us and our licensor regarding our rights under our license agreement, our ability to continue to commercialize this product candidate may be adversely affected. Any uncured, material breach under our license agreement could result in our loss of exclusive rights to OFIRMEV and may lead to a complete termination of our related commercialization efforts.

If BMS breaches the underlying agreement under which we sublicense the rights to OFIRMEV, we could lose the ability to commercialize OFIRMEV.

Our license for OFIRMEV is subject to the terms and conditions of a license from SCR Pharmatop to BMS, under which BMS originally licensed the intellectual property rights covering OFIRMEV. If BMS materially breaches the terms or conditions of this underlying license from SCR Pharmatop, and neither BMS nor we adequately cure that breach, or BMS and SCR Pharmatop

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otherwise become involved in a dispute, the breach by BMS or disputes with SCR Pharmatop could result in a loss of, or other material adverse impact on, our rights under our license agreement with BMS. While we would expect to exercise all reasonable rights and remedies available to us, including seeking to cure any breach by BMS, and otherwise seek to preserve our rights under the patents licensed by SCR Pharmatop, we may not be able to do so in a timely manner, at an acceptable cost or at all. Any uncured, material breach under the license from SCR Pharmatop to BMS could result in our loss of exclusive rights to OFIRMEV and may lead to a complete termination of our commercialization efforts for OFIRMEV.

We have substantially increased the size of our organization, and we may experience difficulties in managing growth.

As of July 31, 2011, we had approximately 240 employees. The commercial launch of OFIRMEV required us to substantially expand our managerial, commercial, financial and other personnel resources, particularly in sales and marketing positions. For example, in anticipation of the commercial launch of OFIRMEV, we hired 147 sales representatives during the period from November 2010 through January 2011. Our management, personnel, systems and facilities currently in place may not be adequate to support this recent growth, and we may not be able to retain or recruit qualified personnel in the future due to competition for personnel among pharmaceutical businesses, and the failure to do so could have a significant negative impact on our future product revenues and business results. Our need to effectively manage our operations, growth and various projects requires that we:

- effectively train and manage a significant number of new employees, in particular our hospital sales specialists, who have no prior experience with our company or OFIRMEV, and establish appropriate systems, policies and infrastructure to support our commercial organization;
- ensure that our consultants and other service providers successfully carry out their contractual obligations, provide high quality results, and meet expected deadlines;
- continue to carry out our own contractual obligations to our licensors and other third parties; and
- continue to improve our operational, financial and management controls, reporting systems and procedures.

We may be unable to successfully implement these tasks on a larger scale and, accordingly, may not achieve our development and commercialization goals.

We may not be able to manage our business effectively if we are unable to attract and retain key personnel.

We may not be able to attract or retain qualified management and commercial, scientific and clinical personnel in the future due to the intense competition for qualified personnel among biotechnology, pharmaceutical and other businesses, particularly in the San Diego, California area. If we are not able to attract and retain necessary personnel to accomplish our business objectives, we may experience constraints that will significantly impede the achievement of our development objectives, our ability to raise additional capital and our ability to implement our business strategy.

Our industry has experienced a high rate of turnover of management personnel in recent years. We are highly dependent on the product acquisition, development, regulatory and commercialization expertise of our senior management, particularly Theodore R. Schroeder, our President and Chief Executive Officer, James B. Breitmeyer, M.D., Ph.D., our Executive Vice President, Development and Chief Medical Officer, William R. LaRue, our Senior Vice President, Chief Financial Officer, Treasurer and Assistant Secretary, and Scott A. Byrd, our Senior Vice President and Chief Commercial Officer. If we lose one or more of these key employees, our ability to successfully implement our business strategy could be seriously harmed. Replacing key employees may be difficult and may take an extended period of time because of the limited number of individuals in our industry with the breadth of skills and experience required to develop, gain regulatory approval of and commercialize products successfully. Competition to hire from this limited pool is intense, and we may be unable to hire, train, retain or motivate these additional key personnel. Although we have employment agreements with Mr. Schroeder, Dr. Breitmeyer, Mr. LaRue and Mr. Byrd, these agreements are terminable at will at any time with or without notice and, therefore, we may not be able to retain their services as expected.

In addition, we have scientific and clinical advisors who assist us in our product development and clinical strategies. These advisors are not our employees and may have commitments to, or consulting or advisory contracts with, other entities that may limit their availability to us, or may have arrangements with other companies to assist in the development of products that may compete with ours.

Our business and operations would suffer in the event of system failures.

Despite the implementation of security measures, our internal computer systems are vulnerable to damage from computer viruses, unauthorized access, natural disasters, terrorism, war and telecommunication and electrical failures. Any system failure, accident or security breach that causes interruptions in our operations could result in a material disruption of our drug development programs. To the extent that any disruption or security breach results in a loss or damage to our data or applications, or inappropriate disclosure of confidential or proprietary information, we may incur liability and our operations may be setback.

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Our future growth depends on our ability to identify and acquire or in-license products and if we do not successfully identify and acquire or in-license related product candidates or integrate them into our operations, we may have limited growth opportunities.

An important part of our business strategy is to continue to develop a pipeline of product candidates by acquiring or in-licensing products, businesses or technologies that we believe are a strategic fit with our focus on the hospital marketplace. For example, we signed an agreement in June 2010 granting us an option to acquire Incline. As part of our efforts to acquire businesses such as Incline, or to in-license products, we conduct technical, business and legal due diligence with the goal of identifying and evaluating material risks involved in such transactions, which may include:

- exposure to unknown liabilities;
- disruption of our business and diversion of our management's time and attention to develop acquired products or technologies;
- difficulty or inability to secure financing to fund development activities for such acquired or in-licensed technologies in the current economic environment;
- incurrence of substantial debt or dilutive issuances of securities to pay for acquisitions;
- higher than expected acquisition and integration costs;
- increased amortization expenses;
- difficulty and cost in combining the operations and personnel of any acquired businesses with our operations and personnel;
- effectiveness of the acquired business's internal controls and procedures;
- impairment of relationships with key suppliers or customers of any acquired businesses due to changes in management and ownership; and
- inability to retain key employees of any acquired businesses.

Additionally, in connection with any such acquisition or in-licensing transaction, we must estimate the value of the transaction by making certain assumptions about, among other things, likelihood of regulatory approval for unapproved products and the market potential for marketed products and/or product candidates. Ultimately, our assumptions may prove to be incorrect, which could cause us to fail to realize the anticipated benefits of a transaction. Despite our efforts, we ultimately may be unsuccessful in ascertaining or evaluating all such risks and, as a result, we might not realize the intended advantages of the acquisition or in-licensing transaction. If we fail to realize the expected benefits from the transactions we have consummated or may consummate in the future, the results of our operations and financial condition could be adversely affected.

It cannot be assured that, following an acquisition, we will achieve revenues, specific net income or loss levels that justify the acquisition or that the acquisition will result in increased earnings, or reduced losses, for the combined company in any future period. Moreover, we may need to raise additional funds through public or private debt or equity financings to acquire any businesses, which would result in dilution for stockholders or the incurrence of indebtedness. We may not be able to operate acquired businesses profitably or otherwise implement our growth strategy successfully.

We have limited resources to identify and execute the acquisition or in-licensing of third-party products, businesses and technologies and integrate them into our current infrastructure. In particular, we may compete with larger pharmaceutical companies and other competitors in our efforts to establish new collaborations and in-licensing opportunities. These competitors likely will have access to greater financial resources than us and may have greater expertise in identifying and evaluating new opportunities. Moreover, we may devote resources to potential acquisitions or in-licensing opportunities that are never completed, or we may fail to realize the anticipated benefits of such efforts.

We may not be able to exercise our option to acquire Incline and, even if we are able to, we may fail to realize the anticipated benefits of the transaction.*

We signed an agreement in June 2010 granting us the option to acquire Incline, but we may not have sufficient capital to exercise this option. If we elect to exercise the option, the payment of up to \$135.0 million during the first option period, or up to \$228.0 million, plus up to \$57.0 million upon FDA approval of IONSYS, during the second option period, would require us to raise additional funds to finance the acquisition. Raising such additional funds or paying up to 50% of the applicable option exercise payment in the form of our common stock would result in the incurrence of additional indebtedness or dilution for our stockholders. We have notified Incline that we have decided not to exercise our option to acquire Incline during the first option period, but we continue to have the right to acquire Incline during the second option period. We have received notice from Incline that the closing of the second tranche of its Series A financing is expected to occur on or about September 1, 2011, which would open the second option period.

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We are relying on Incline to develop and obtain regulatory approval for IONSYS. Although Ted Schroeder, our President and CEO, serves as our representative on Incline's board of directors, and we have formed a joint development committee to oversee the global development of, and pursuit of regulatory approval for, IONSYS, Incline will remain responsible for these activities unless and until we elect to acquire Incline. We do not control these development activities and therefore cannot be certain that they will be accomplished in a satisfactory manner. For example, Incline may breach one of the agreements under which it has licensed the rights to IONSYS, and lose the ability to continue to develop and commercialize this product candidate. In addition, Incline's efforts to develop improved patient safety features for IONSYS may be unsuccessful, or Incline may not develop a risk evaluation and management strategy, or REMS, for IONSYS that is acceptable to the FDA. Even if a REMS for IONSYS is approved by the FDA, the implementation of any such strategy may not be commercially feasible.

If we elect to acquire Incline, there will be a number of risks involved in the acquisition, including the potential for our management's attention to be diverted from, or for disruptions to affect, our ongoing business, and difficulties and expenses related to integrating the acquired business and retaining all or part of its personnel. In addition, there is the risk that our valuation assumptions for Incline may turn out to be erroneous or inappropriate due to unforeseen circumstances, which could result in our having overvalued Incline, or that the contemplated benefits of acquiring Incline do not materialize as planned. We cannot assure you that, if we acquire Incline, the acquisition will result in increased earnings or reduced losses for the combined company in any future period. The individual or combined effects of these risks could have a material adverse effect on our business.

Our business involves the use of hazardous materials and we and our third-party manufacturer must comply with environmental laws and regulations, which can be expensive and restrict how we do business.

Our third-party manufacturer's activities and, to a lesser extent, our own activities involve the controlled storage, use and disposal of hazardous materials, including the components of OFIRMEV and other hazardous compounds. We and our manufacturer are subject to federal, state and local laws and regulations governing the use, manufacture, storage, handling and disposal of these hazardous materials. Although we believe that the safety procedures for handling and disposing of these materials comply with the standards prescribed by these laws and regulations, we cannot eliminate the risk of accidental contamination or injury from these materials. In the event of an accident, state or federal authorities may curtail our use of these materials and interrupt our business operations.

Risks Related to Intellectual Property

The patent rights that we have in-licensed covering OFIRMEV are limited to a specific intravenous formulation of acetaminophen, and our market opportunity for this product candidate may be limited by the lack of patent protection for the active ingredient itself and other formulations that may be developed by competitors.*

The active ingredient in OFIRMEV is acetaminophen. Patent protection is not available for the acetaminophen molecule itself in the territories licensed to us, which include the U.S. and Canada. As a result, competitors who obtain the requisite regulatory approval can offer products with the same active ingredient as OFIRMEV so long as the competitors do not infringe any process or formulation patents that we have in-licensed from BMS and its licensor, SCR Pharmatop. We are the exclusive licensee of two U.S. patents and two issued Canadian patents owned by Pharmatop, under BMS's license to these patents from Pharmatop. U.S. Patent No. 6,028,222 (Canadian patent number 2,233,924) covers the formulation of OFIRMEV, and this patent expires in August 2017. U.S. Patent No. 6,992,218 (Canadian patent number 2,415,403) covers the process used to manufacture OFIRMEV, and this patent expires in June 2021. We plan to complete a pediatric clinical trial and, upon timely completion and the acceptance by the FDA of the data from this study, OFIRMEV will be eligible for an additional six months of marketing exclusivity.

We are aware of a number of third-party patents in the U.S. that claim methods of making acetaminophen. If a supplier of the API for our OFIRMEV product candidate is found to infringe any of these method patents covering acetaminophen, our supply of the API could be delayed and we may be required to locate an alternative supplier. We are also aware of several U.S. and Canadian patents and patent applications directed to various potential injectable formulations of acetaminophen as well as methods of making and using these potential formulations. For example, Injectapap, a liquid formulation of acetaminophen for intramuscular injection, was approved by the FDA for the reduction of fever in adults in March 1986, although it was subsequently withdrawn from the market by McNeil Pharmaceutical in July 1986.

The number of patents and patent applications directed to products in the same field as OFIRMEV indicates that competitors have sought to develop and may seek to market competing formulations that may not be covered by our licensed patents and patent applications. The commercial opportunity for OFIRMEV could be significantly harmed if competitors are able to develop alternative formulations of acetaminophen outside the scope of our in-licensed patents.

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Two third parties have challenged, and additional third parties may challenge the patents covering OFIRMEV, which could result in the invalidation or unenforceability of some or all of the relevant patent claims. For example, if a third party files an ANDA for a generic drug product containing acetaminophen and relies in whole or in part on studies conducted by or for us, the third party will be required to certify to the FDA that, in the opinion of that third party, the patent listed in the Orange Book for a branded product is invalid, unenforceable, or will not be infringed by the manufacture, use or sale of the third party's generic drug product. A third party certification that the new product will not infringe the Orange Book-listed patents for OFIRMEV, or that such patents are invalid, is called a Paragraph IV patent certification. If the third party submits a Paragraph IV patent certification to the FDA, a notice of the Paragraph IV patent certification must also be sent to us once the third-party's ANDA is accepted for filing by the FDA. A lawsuit may then be initiated to defend the patents identified in the notice. The filing of a patent infringement lawsuit within 45 days of the receipt of notice of a Paragraph IV patent certification automatically prevents the FDA from approving the ANDA until the earlier of the expiration of a 30-month period, the expiration of the patents, the entry of a settlement order stating that the patents are invalid or not infringed, a decision in the infringement case that is favorable to the ANDA applicant, or such shorter or longer period as the court may order. If a patent infringement lawsuit is not initiated within the required 45-day period, the third-party's ANDA will not be subject to the 30-month stay.

On July 8, 2011, we received a notice from Paddock, and on July 13, 2011, we received a notice from Exela, each stating that it had filed an ANDA containing a Paragraph IV patent certification with the FDA for a generic version of OFIRMEV. Each notice stated that the Paragraph IV patent certification was made with respect to both patents for OFIRMEV listed in the Orange Book. We are currently reviewing the details of these notices. We intend to vigorously enforce our intellectual property rights relating to OFIRMEV, but we cannot predict the outcome of these matters or guarantee the outcome of any litigation.

Certain pharmaceutical companies' patent settlement agreements with generic pharmaceutical companies have been challenged by the U.S. Federal Trade Commission alleging a violation of Section 5(a) of the Federal Trade Commission Act, and any patent settlement agreement that we may enter into with any generic pharmaceutical company may be subject to similar challenges, which could be both expensive and time consuming and may render such settlement agreements unenforceable.

Litigation or other proceedings to enforce or defend intellectual property rights are often very complex in nature, may be very expensive and time-consuming, may divert our management's attention from our core business, and may result in unfavorable results that could adversely impact our ability to prevent third parties from competing with our products. Any adverse outcome of such litigation could result in one or more generic versions of OFIRMEV being launched before the expiration of the patents we have in-licensed from BMS and its licensor, SCR Pharmatop, which could adversely affect our ability to successfully execute our business strategy to increase sales of OFIRMEV and negatively impact our financial condition and results of operations.

We depend on our licensors for the maintenance and enforcement of our intellectual property and have limited control, if any, over the amount or timing of resources that our licensors devote on our behalf, or whether any financial difficulties experienced by our licensors could result in their unwillingness or inability to secure, maintain and enforce patents protecting our intellectual property.

We depend on our licensor, BMS, and its licensor SCR Pharmatop, or Pharmatop, to protect the proprietary rights covering OFIRMEV and we have limited, if any, control over the amount or timing of resources that BMS or Pharmatop devote on our behalf, or the priority they place on maintaining and enforcing our patent rights, and prosecuting patent applications to our advantage.

Pharmatop is under a contractual obligation to BMS to maintain the issued OFIRMEV patents in the U.S., and to diligently prosecute the patent applications and maintain any issued patents related to OFIRMEV in Canada. BMS has the opportunity to consult, review and comment on any patent office communications. We may not receive any patent from the applications in Canada, or if patents are issued they may be inadequate to protect our OFIRMEV product from competition.

For a third-party challenge to the validity or enforceability of the OFIRMEV patents, we will have some ability to participate in either Pharmatop's or BMS' defense thereof. In the event that neither Pharmatop nor BMS elects to defend the third-party challenge, we may have the opportunity to defend it. BMS has the first right to prosecute a third-party infringement of the OFIRMEV patents relating to OFIRMEV, and Pharmatop has the second right. We may not have the ability to cooperate with BMS or Pharmatop in any such third-party infringement suits. In certain instances, we may be allowed to pursue a third-party infringement claim ourselves.

It is possible that Pharmatop or BMS could take some action or fail to take some action that could harm the patents related to OFIRMEV. For example, if Pharmatop decides it no longer wants to maintain the OFIRMEV patents, to prosecute the patent applications related to OFIRMEV in Canada, or if Pharmatop or BMS decide not to defend the patents against third party challenges, we risk losing the benefit of all or some of those patent rights. Moreover, Pharmatop or BMS may experience serious difficulties related to their respective businesses or financial stability, and may be unwilling or unable to continue to expend the financial resources required to maintain and prosecute these patents and patent applications, or to defend the patents against third party challenges.

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Our success will depend in part on our ability to obtain and maintain patent protection for OFIRMEV, both in the U.S. and Canada. While we intend to take actions reasonably necessary to enforce our patent rights, we depend on our licensors to protect a substantial portion of our proprietary rights. We may have limited, if any, control or involvement over the defense of these claims, and our licensors could be subject to injunctions and temporary or permanent exclusionary orders in the U.S. or other countries.

We or our licensors may also be notified of alleged infringement and be sued for infringement of third-party patents or other proprietary rights. Our licensors are not obligated to defend or assist in our defense against third-party claims of infringement. We have limited, if any, control over the amount or timing of resources, if any, that our licensors devote on our behalf or the priority they place on defense of such third-party claims of infringement. Because of the uncertainty inherent in any patent or other litigation involving proprietary rights, we or our licensors may not be successful in defending claims of intellectual property infringement by third parties, which could have a material adverse affect on our results of operations. Regardless of the outcome of any litigation, defending the litigation may be expensive, time-consuming and distracting to management.

Because it is difficult and costly to protect our proprietary rights, we may not be able to ensure their protection.

Our commercial success will depend in part on obtaining and maintaining patent protection and trade secret protection for OFIRMEV or any other product candidates that we may license or acquire and the methods we use to manufacture them, as well as successfully defending these patents and trade secrets against third-party challenges. We will only be able to protect our technologies from unauthorized use by third parties to the extent that valid and enforceable patents or trade secrets cover them.

The patent positions of pharmaceutical and biotechnology companies can be highly uncertain and involve complex legal and factual questions for which important legal principles remain unresolved. No consistent policy regarding the breadth of claims allowed in pharmaceutical or biotechnology patents has emerged to date in the U.S. The patent situation outside the U.S. is even more uncertain. Changes in either the patent laws or in interpretations of patent laws in the U.S. and other countries may diminish the value of our intellectual property. Accordingly, we cannot predict the breadth of claims that may be allowed or enforced in our patents or in third-party patents.

The degree of future protection for our proprietary rights is uncertain, because legal means afford only limited protection and may not adequately protect our rights or permit us to gain or keep our competitive advantage. For example:

- our licensors might not have been the first to make the inventions covered by each of our pending patent applications and issued patents;
- our licensors might not have been the first to file patent applications for these inventions;
- others may independently develop similar or alternative technologies or duplicate any of our product candidates or technologies;
- it is possible that none of the pending patent applications licensed to us will result in issued patents;
- the issued patents covering our product candidates may not provide a basis for commercially viable active products, may not provide us with any competitive advantages, or may be challenged by third parties;
- we may not develop additional proprietary technologies that are patentable; or
- patents of others may have an adverse effect on our business.

Patent applications in the U.S. are maintained in confidence for at least 18 months after their earliest effective filing date. Consequently, we cannot be certain that our licensors were the first to invent or the first to file patent applications on our product candidates. In the event that a third party has also filed a U.S. patent application relating to our product candidates or a similar invention, we may have to participate in interference proceedings declared by the U.S. Patent and Trademark Office to determine priority of invention in the U.S. The costs of these proceedings could be substantial and it is possible that our efforts would be unsuccessful, resulting in a material adverse effect on our U.S. patent position. Furthermore, we may not have identified all U.S. and foreign patents or published applications that affect our business either by blocking our ability to commercialize our drugs or by covering similar technologies that affect our drug market.

In addition, some countries, including many in Europe, do not grant patent claims directed to methods of treating humans, and in these countries patent protection may not be available at all to protect our product candidates. Even if patents issue, we cannot guarantee that the claims of those patents will be valid and enforceable or provide us with any significant protection against competitive products, or otherwise be commercially valuable to us.

We also rely on trade secrets to protect our technology, particularly where we do not believe patent protection is appropriate or obtainable. However, trade secrets are difficult to protect. While we use reasonable efforts to protect our trade secrets, our licensors, employees, consultants, contractors, outside scientific collaborators and other advisors may unintentionally or willfully disclose our

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information to competitors. Enforcing a claim that a third party illegally obtained and is using our trade secrets is expensive and time consuming, and the outcome is unpredictable. In addition, courts outside the U.S. are sometimes less willing to protect trade secrets. Moreover, our competitors may independently develop equivalent knowledge, methods and know-how.

If our licensors or we fail to obtain or maintain patent protection or trade secret protection for OFIRMEV or any other product candidate we may license or acquire, third parties could use our proprietary information, which could impair our ability to compete in the market and adversely affect our ability to generate revenues and achieve profitability.

If we are sued for infringing intellectual property rights of third parties, it will be costly and time consuming, and an unfavorable outcome in any litigation would harm our business.

Our ability to develop, manufacture, market and sell OFIRMEV or any other product candidates that we may license or acquire depends upon our ability to avoid infringing the proprietary rights of third parties. Numerous U.S. and foreign issued patents and pending patent applications, which are owned by third parties, exist in the general fields of pain treatment and cover the use of numerous compounds and formulations in our targeted markets. Because of the uncertainty inherent in any patent or other litigation involving proprietary rights, we and our licensors may not be successful in defending intellectual property claims by third parties, which could have a material adverse affect on our results of operations. Regardless of the outcome of any litigation, defending the litigation may be expensive, time-consuming and distracting to management. In addition, because patent applications can take many years to issue, there may be currently pending applications, unknown to us, which may later result in issued patents that OFIRMEV may infringe. There could also be existing patents of which we are not aware that OFIRMEV may inadvertently infringe.

There is a substantial amount of litigation involving patent and other intellectual property rights in the biotechnology and biopharmaceutical industries generally. If a third party claims that we infringe on their products or technology, we could face a number of issues, including:

- infringement and other intellectual property claims which, with or without merit, can be expensive and time consuming to litigate and can divert management's attention from our core business;
- substantial damages for past infringement which we may have to pay if a court decides that our product infringes on a competitor's patent;
- a court prohibiting us from selling or licensing our product unless the patent holder licenses the patent to us, which it would not be required to do;
- if a license is available from a patent holder, we may have to pay substantial royalties or grant cross licenses to our patents; and
- redesigning our processes so they do not infringe, which may not be possible or could require substantial funds and time.

We may be subject to claims that our employees have wrongfully used or disclosed alleged trade secrets of their former employers.

As is common in the biotechnology and pharmaceutical industry, we employ individuals who were previously employed at other biotechnology or pharmaceutical companies, including our competitors or potential competitors. Although no claims against us are currently pending, we may be subject to claims that these employees or we have inadvertently or otherwise used or disclosed trade secrets or other proprietary information of their former employers. Litigation may be necessary to defend against these claims. Even if we are successful in defending against these claims, litigation could result in substantial costs and be a distraction to management.

Risks Related to Our Finances and Capital Requirements

We have incurred significant operating losses since our inception and anticipate that we will incur continued losses for the foreseeable future.

We began generating revenues from the commercialization of OFIRMEV in January 2011. Prior to that time, we focused primarily on in-licensing and developing OFIRMEV and our former product candidate, omiganan pentahydrochloride, with the goal of supporting regulatory approval for these product candidates. We have incurred losses in each year since our inception in May 2004, including net losses of \$56.6 million, \$45.5 million and \$57.1 million for the years ended December 31, 2010, 2009 and 2008, respectively. As of June 30, 2011, we had an accumulated deficit of \$317.2 million. These losses, among other things, have had and will continue to have an adverse effect on our stockholders' equity and working capital. For example, while our development expenses decreased in 2010 and 2009 due to the completion of our clinical development program for OFIRMEV, and the discontinuation of our development program for our omiganan pentahydrochloride product candidate, we incurred increased pre-commercialization expenses during 2010 and 2009 as we prepared for the potential market launch of OFIRMEV. Further, in 2011 we have incurred significant increased sales, marketing and outsourced manufacturing expenses, as well as expenses related to the commercialization and marketing of this product. As a result, we expect to continue to incur significant operating losses for the foreseeable future. Because of the numerous risks and uncertainties associated with developing pharmaceutical products, we are unable to predict the extent of any future losses or when we will become profitable, if at all.

We currently have no history of revenue and may never be profitable.

Our ability to become profitable depends upon our ability to generate revenue. We began to market OFIRMEV in January 2011, and we had not generated any revenue prior to that time. Our ability to generate revenue depends on a number of factors, including, but not limited to, our ability to:

- effectively commercialize OFIRMEV;
- manufacture commercial quantities of OFIRMEV at acceptable cost levels;
- successfully manage our commercial organization and the supporting infrastructure required to successfully market and sell OFIRMEV; and
- obtain regulatory approval for any other product candidates that we may license or acquire.

We have incurred and anticipate continuing to incur significant costs associated with our efforts to commercialize, market and sell OFIRMEV. We also do not anticipate that we will achieve profitability for a period of time after generating material revenues, if ever. If we are unable to generate revenues, we will not become profitable and may be unable to continue operations without continued funding.

Our short operating history makes it difficult to evaluate our business and prospects.

We were incorporated in May 2004 and have only been conducting operations with respect to OFIRMEV since March 2006 and our discontinued omiganan pentahydrochloride product candidate since July 2004. Prior to 2009, our operations were limited to organizing and staffing our company, in-licensing and conducting product development activities, including clinical trials and manufacturing development activities, for OFIRMEV and omiganan pentahydrochloride. Recently, we began to establish our commercial infrastructure for OFIRMEV, and in January 2011 we launched OFIRMEV and began generating revenues. We have not yet demonstrated an ability to successfully market and sell OFIRMEV or any other product candidate. Consequently, any predictions about our future performance may not be as accurate as they could be if we had a history of successfully commercializing pharmaceutical products.

Our quarterly operating results may fluctuate significantly.

We expect our operating results to be subject to quarterly fluctuations. Our net loss and other operating results will be affected by numerous factors, including:

- our ability to successfully market and sell OFIRMEV;
- our capacity to manage our commercial infrastructure and related expenses, including our recently hired sales and marketing personnel and our agreements with third parties for warehousing, distribution, cash collection and related commercial activities;
- our execution of other collaborative, licensing or similar arrangements and the timing of payments we may make or receive under these arrangements;
- variations in the level of expenses related to our development programs for any future product candidates;
- any product liability or intellectual property infringement lawsuits in which we may become involved;
- regulatory developments affecting OFIRMEV or the product candidates of our competitors; and
- the level of underlying hospital demand for OFIRMEV and wholesalers' buying patterns.

If our quarterly or annual operating results fall below the expectations of investors or securities analysts, the price of our common stock could decline substantially. Furthermore, any quarterly or annual fluctuations in our operating results may, in turn, cause the price of our stock to fluctuate substantially. We believe that quarterly comparisons of our financial results are not necessarily meaningful and should not be relied upon as an indication of our future performance.

Raising additional funds by issuing securities may cause dilution to existing stockholders and raising funds through lending and licensing arrangements may restrict our operations or require us to relinquish proprietary rights.

To the extent that we raise additional capital by issuing equity securities, our existing stockholders' ownership will be diluted. For example, we undertook a public offering of our common stock in November 2010 through which we issued a total of 12.5 million shares and raised net proceeds of \$93.6 million. If we raise additional funds through alternative means such as licensing arrangements,

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it may be necessary to relinquish potentially valuable rights to our potential products or proprietary technologies, or grant licenses on terms that are not favorable to us. Any debt financing we enter into may involve covenants that restrict our operations. These restrictive covenants may include limitations on additional borrowing and specific restrictions on the use of our assets as well as prohibitions on our ability to create liens, pay dividends, redeem our stock or make investments. For example, in June 2010, we entered into an amended and restated loan and security agreement with Oxford Finance Corporation, Silicon Valley Bank and GE Business Financial Services Inc. for a credit facility of up to \$30.0 million. We drew the first advance of \$20.0 million under this loan in June 2010. We amended this facility and drew the second advance of \$10.0 million in November 2010, following FDA approval of OFIRMEV.

Our current loan and security agreement with Oxford Finance Corporation, Silicon Valley Bank and GE Business Financial Services Inc. contains a variety of affirmative and negative covenants, including required financial reporting, limitations on the disposition of assets other than in the ordinary course of business, limitations on the incurrence of additional debt and other requirements. To secure our performance of our obligations under our current loan and security agreement, we pledged substantially all of our assets other than intellectual property assets, to the lenders. Our failure to comply with the covenants in the current loan and security agreement could result in an event of default that, if not cured or waived, could result in the acceleration of all or a substantial portion of our debt and potential foreclosure on the assets pledged to secure the debt.

We will continue to incur significant increased costs as a result of operating as a public company, and our management will be required to devote substantial time to new compliance initiatives.

As a public company, we incur significant legal, accounting and other expenses under the Sarbanes-Oxley Act of 2002, as well as rules subsequently implemented by the SEC and The NASDAQ Stock Market LLC, or NASDAQ. These rules impose various requirements on public companies, including requiring establishment and maintenance of effective disclosure and financial controls and appropriate corporate governance practices. Our management and other personnel have devoted and will continue to devote a substantial amount of time to these compliance initiatives. Moreover, these rules and regulations increase our legal and financial compliance costs and make some activities more time-consuming and costly. For example, these rules and regulations make it more difficult and more expensive for us to obtain director and officer liability insurance, and we may be required to accept reduced policy limits and coverage or incur substantially higher costs to obtain the same or similar coverage. As a result, it may be more difficult for us to attract and retain qualified persons to serve on our board of directors, our board committees or as executive officers.

The Sarbanes-Oxley Act of 2002 requires, among other things, that we maintain effective internal controls for financial reporting and disclosure controls and procedures. As a result, we are required to periodically perform an evaluation of our internal controls over financial reporting to allow management to report on the effectiveness of those controls, as required by Section 404 of the Sarbanes-Oxley Act. Additionally, our independent auditors are required to perform a similar evaluation and report on the effectiveness of our internal controls over financial reporting. These efforts to comply with Section 404 and related regulations have required, and continue to require, the commitment of significant financial and managerial resources. While we anticipate maintaining the integrity of our internal controls over financial reporting and all other aspects of Section 404, we cannot be certain that a material weakness will not be identified when we test the effectiveness of our control systems in the future. If a material weakness is identified, we could be subject to sanctions or investigations by NASDAQ, the SEC or other regulatory authorities, which would require additional financial and management resources, costly litigation or a loss of public confidence in our internal controls, which could have an adverse effect on the market price of our stock.

In addition, on July 21, 2010, the Dodd-Frank Wall Street Reform and Protection Act, or the Dodd-Frank Act, was enacted. There are significant corporate governance and executive compensation-related provisions in the Dodd-Frank Act that require the SEC to adopt additional rules and regulations in these areas such as “say on pay” and proxy access, and the SEC has since issued final rules implementing “say on pay” measures. Our efforts to comply with corporate governance and related requirements have resulted in, and are likely to continue to result in, an increase in expenses and a diversion of management’s time from other business activities.

The use of our net operating loss carryforwards and research tax credits may be limited.*

Our net operating loss carryforwards and research and development tax credits may expire and not be used. As of December 31, 2010, we have generated federal and state net operating loss carryforwards of approximately \$219.3 million and \$224.7 million, respectively. We also have federal and state research and development tax credit carryforwards of approximately \$4.2 million and \$2.2 million, respectively. Our net operating loss carryforwards will begin expiring in 2024 for federal purposes and 2018 for state purposes if we have not used them prior to that time. Our federal tax credits will begin expiring in 2024 unless previously used and our state tax credits carryforward indefinitely. Additionally, under Internal Revenue Code Sections 382 and 383, the annual use of our net operating loss carryforwards and research tax credits will be limited in the event a cumulative change in our ownership occurs within a three-year period. We expect to complete an analysis as to whether such a change of ownership has occurred in the next 12 months, and in such an event, we may be limited to the amount of net operating loss carryforwards and research tax credits that could be utilized annually in the future to offset taxable income. Any such annual limitation may significantly reduce the utilization of the

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net operating loss carryforwards and research tax credits before they expire. In addition, California and certain states have suspended use of net operating loss carryforwards for certain taxable years, and other states are considering similar measures. As a result, we may incur higher state income tax expense in the future. Depending on our future tax position, continued suspension of our ability to use net operating loss carryforwards in states in which we are subject to income tax could have an adverse impact on our operating results and financial condition.

Our results of operations and liquidity needs could be materially negatively affected by market fluctuations and economic downturn.

Our results of operations could be materially negatively affected by economic conditions generally, both in the U.S. and elsewhere around the world. Continuing concerns over inflation, energy costs, geopolitical issues, the availability and cost of credit, the U.S. mortgage market and a difficult residential real estate market in the U.S. have contributed to increased volatility and diminished expectations for the economy and the markets going forward. These factors, combined with volatile oil prices, declining business and consumer confidence and continued unemployment concerns, have precipitated significant economic uncertainty. Domestic and international equity markets continue to experience heightened volatility and turmoil. These events and the continuing market upheavals may have an adverse effect on us. In the event of continuing market turbulence, our results of operations could be adversely affected by those factors in many ways, including making it more difficult for us to raise funds if necessary, and our stock price may decline.

Risks Relating to Securities Markets and Investment in Our Stock

Our stock may be subject to substantial price and volume fluctuations due to a number of factors, many of which are beyond our control and may prevent our stockholders from reselling our common stock at a profit.*

The market prices for securities of biotechnology and pharmaceutical companies have historically been highly volatile, and the market has from time to time experienced significant price and volume fluctuations that are unrelated to the operating performance of particular companies. For example, the volatility in the overall capital markets reached unprecedented levels during 2008 through 2010, which affected most equity securities. Similar market volatility could reduce the market price of our common stock in spite of our operating performance. Further, high stock price volatility could result in higher stock-based compensation expense.

The trading prices for our common stock during the 52 weeks ending June 30, 2011 ranged from a high of \$10.00 to a low of \$6.59. The market price of our common stock is likely to continue to be highly volatile and may fluctuate substantially due to many factors, including:

- announcements concerning our operating results and the hospital formulary acceptance of OFIRMEV;
- market conditions in the pharmaceutical and biotechnology sectors or the economy as a whole;
- price and volume fluctuations in the overall stock market;
- the failure of OFIRMEV to achieve commercial success;
- announcements of the introduction of new products by us or our competitors;
- developments pertaining to the ANDAs relating to OFIRMEV, including any future ANDA filings, and any other challenges to our patents and other intellectual property rights;
- developments concerning product development results or intellectual property rights of others;
- litigation or public concern about the safety of our potential products;
- actual fluctuations in our quarterly operating results, and concerns by investors that such fluctuations may occur in the future;
- deviations in our operating results from the estimates of securities analysts or other analyst comments;
- additions or departures of key personnel;
- health care reform legislation, including measures directed at controlling the pricing of pharmaceutical products, and third-party coverage and reimbursement policies;
- developments concerning current or future strategic collaborations; and
- discussion of us or our stock price by the financial and scientific press and in online investor communities.

The realization of any of the risks described in these “Risk Factors” could have a dramatic and material adverse impact on the market price of our common stock. In addition, class action litigation has often been instituted against companies whose securities have experienced periods of volatility in market price. Any such litigation brought against us could result in substantial costs and a diversion of our management’s attention and resources, which could hurt our business, operating results and financial condition.

Future sales of our common stock may cause our stock price to decline. *

Persons who were our stockholders prior to the sale of shares in our initial public offering continue to hold a substantial number of shares of our common stock that they may now be able to sell in the public market. Significant portions of these shares are held by a small number of stockholders. Sales by our current stockholders of a substantial number of shares, or the expectation that such sales may occur, could significantly reduce the market price of our common stock. Moreover, the holders of a substantial number of shares of common stock may have rights, subject to certain conditions, to require us to file registration statements to permit the resale of their shares in the public market or to include their shares in registration statements that we may file for ourselves or other stockholders.

For example, we undertook a public offering of our common stock in November 2010 through which we issued a total of 12.5 million shares, and in May 2009, we completed the registration of approximately 18.1 million shares of our common stock in connection with a financing transaction completed in February 2009. As a result, all of the shares currently outstanding may generally be freely sold in the public market, subject to volume and other limitations applicable to our affiliates. We have also registered all common stock that we may issue under our employee benefits plans. As a result, these shares can be freely sold in the public market upon issuance, subject to restrictions under the securities laws.

Furthermore, any future equity financing we may undertake, or the expectation of such financing, could reduce the market price of our common stock over dilution concerns. In addition, certain of our officers have established, and other of our directors and executive officers may in the future establish, programmed selling plans under Rule 10b5-1 of the Securities Exchange Act of 1934, as amended, for the purpose of effecting sales of our common stock. If any of these events cause a large number of our shares to be sold in the public market, the sales could reduce the trading price of our common stock and impede our ability to raise future capital.

Our executive officers and directors and their affiliates may exercise control over stockholder voting matters in a manner that may not be in the best interests of all of our stockholders.

As of June 30, 2011, our executive officers and directors and their affiliates together controlled approximately 40.0% of our outstanding common stock. As a result, these stockholders will collectively be able to significantly influence all matters requiring approval of our stockholders, including the election of directors and approval of significant corporate transactions. The concentration of ownership may delay, prevent or deter a change in control of our company even when such a change may be in the best interests of all stockholders, could deprive our stockholders of an opportunity to receive a premium for their common stock as part of a sale of our company or our assets, and might affect the prevailing market price of our common stock.

Anti-takeover provisions under our charter documents and Delaware law could delay or prevent a change of control which could limit the market price of our common stock and may prevent or frustrate attempts by our stockholders to replace or remove our current management.

Our amended and restated certificate of incorporation and amended and restated bylaws contain provisions that could delay or prevent a change of control of our company or changes in our board of directors that our stockholders might consider favorable. Some of these provisions include:

- a board of directors divided into three classes serving staggered three-year terms, such that not all members of the board will be elected at one time;
- a prohibition on stockholder action through written consent;
- a requirement that special meetings of stockholders be called only by the chairman of the board of directors, the president or by a majority of the total number of directors;
- advance notice requirements for stockholder proposals and nominations;
- a requirement of approval of not less than 66-2/3% of all outstanding shares of our capital stock entitled to vote to amend any bylaws by stockholder action, or to amend specific provisions of our certificate of incorporation; and
- the authority of the board of directors to issue preferred stock on terms determined by the board of directors without stockholder approval.

In addition, we are governed by the provisions of Section 203 of the Delaware General Corporate Law, which may prohibit certain business combinations with stockholders owning 15% or more of our outstanding voting stock. These and other provisions in our amended and restated certificate of incorporation, amended and restated bylaws and Delaware law could make it more difficult for stockholders or potential acquirers to obtain control of our board of directors or initiate actions that are opposed by the then-current board of directors, including to delay or impede a merger, tender offer or proxy contest involving our company. Any delay or prevention of a change of control transaction or changes in our board of directors could cause the market price of our common stock to decline.

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We have never paid dividends on our capital stock, and we do not anticipate paying any cash dividends in the foreseeable future.

We have paid no cash dividends on any of our classes of capital stock to date and we currently intend to retain our future earnings, if any, to fund the development and growth of our business. We do not anticipate paying any cash dividends on our common stock in the foreseeable future. Furthermore, our current loan and security agreement with Oxford Finance Corporation, Silicon Valley Bank and GE Business Financial Services Inc., restricts our ability to pay dividends. As a result, capital appreciation, if any, of our common stock will be your sole source of gain for the foreseeable future.

We may become involved in securities class action litigation that could divert management's attention and harm our business.

The stock markets have from time to time experienced significant price and volume fluctuations that have affected the market prices for the common stock of biotechnology and pharmaceutical companies. These broad market fluctuations may cause the market price of our common stock to decline. In the past, securities class action litigation has often been brought against a company following a decline in the market price of its securities. This risk is especially relevant for us because biotechnology and biopharmaceutical companies have experienced significant stock price volatility in recent years. We may become involved in this type of litigation in the future. Litigation often is expensive and diverts management's attention and resources, which could adversely affect our business.

Item 2. *Unregistered Sales of Equity Securities and Use of Proceeds*

Not applicable.

Item 3. *Defaults Upon Senior Securities*

Not applicable.

Item 4. *(Removed and Reserved)*

Item 5. *Other Information*

Not applicable.

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Item 6. Exhibits

| Exhibit Number | Description of Exhibit |
|-----------------------|--------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------|
| 3.1 | Amended and Restated Certificate of Incorporation of the Company, incorporated herein by reference to Exhibit 3.1 to the Company's Quarterly Report on Form 10-Q (File No. 001-33103) for the period ended September 30, 2006 as filed with the SEC on November 30, 2006 |
| 3.2 | Amended and Restated Bylaws of the Company, incorporated herein by reference to Exhibit 3.2 to the Company's Quarterly Report on Form 10-Q (File No. 001-33103) for the period ended September 30, 2006 as filed with the SEC on November 30, 2006 |
| 3.3 | Amendment of Amended and Restated Bylaws of the Company, incorporated herein by reference to Exhibit 3.1 to the Company's Current Report on Form 8-K (File No. 001-33103) as filed with the SEC on December 17, 2007 |
| 4.1 | Form of the Company's Common Stock Certificate, incorporated herein by reference to Exhibit 4.1 to the Company's Quarterly Report on Form 10-Q (File No. 001-33103) for the period ended September 30, 2006 as filed with the SEC on November 30, 2006 |
| 4.2 | Amended and Restated Investor Rights Agreement dated February 21, 2006, incorporated herein by reference to Exhibit 4.2 to the Company's Registration Statement on Form S-1 (File No. 333-135821) as filed with the SEC on July 17, 2006 |
| 4.3 | Registration Rights Waiver and Amendment dated November 29, 2007, incorporated herein by reference to Exhibit 4.5 to the Company's Current Report on Form 8-K (File No. 001-33103) as filed with the SEC on December 3, 2007 |
| 4.4 | Form of Warrant to Purchase Stock issued to Silicon Valley Bank on November 30, 2007, incorporated herein by reference to Exhibit 4.6 to the Company's Current Report on Form 8-K (File No. 001-33103) as filed with the SEC on December 3, 2007 |
| 4.5 | Form of Warrant to Purchase Stock issued to Oxford Finance Corporation on November 30, 2007, incorporated herein by reference to Exhibit 4.7 to the Company's Current Report on Form 8-K (File No. 001-33103) as filed with the SEC on December 3, 2007 |
| 4.6 | Form of Warrant to Purchase Stock issued to GE Business Financial Services Inc. (formerly known as Merrill Lynch Business Financial Services Inc.), on November 30, 2007, incorporated herein by reference to Exhibit 4.8 to the Company's Current Report on Form 8-K (File No. 001-33103) as filed with the SEC on December 3, 2007 |
| 4.7 | Form of Warrant to Purchase Stock issued on February 18, 2009, incorporated herein by reference to Exhibit 10.2 to the Company's Current Report on Form 8-K (File No. 001-33103) as filed with the SEC on February 20, 2009 |
| 4.8 | Form of Warrant to Purchase Stock issued on June 18, 2010, incorporated herein by reference to Exhibit 4.10 to the Company's Current Report on Form 8-K (File No. 001-33103) as filed with the SEC on June 21, 2010 |
| 31.1 [±] | Certification of Chief Executive Officer pursuant to Rule 13a – 14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 31.2 [±] | Certification of Chief Financial Officer pursuant to Rule 13a – 14(a) and 15d-14(a), as adopted pursuant to Section 302 of the Sarbanes-Oxley Act of 2002 |
| 32 [±] | Certification of Chief Executive Officer and Chief Financial Officer pursuant to 18 U.S.C. Section 1350, as adopted pursuant to Section 906 of the Sarbanes Oxley Act of 2002 |
| 101.INS ^{±†} | XBRL Instance Document |
| 101.SCH ^{±†} | XBRL Taxonomy Extension Schema Document |
| 101.CAL ^{±†} | XBRL Taxonomy Extension Calculation Linkbase Document |
| 101.DEF ^{±†} | XBRL Taxonomy Extension Definition Linkbase Document |
| 101.LAB ^{±†} | XBRL Taxonomy Extension Label Linkbase Document |
| 101.PRE ^{±†} | XBRL Taxonomy Extension Presentation Linkbase Document |

[±] Included in this Report.

[†] Pursuant to Rule 406T of Regulation S-T, these interactive data files are deemed not filed or part of a registration statement or prospectus for purposes of Section 11 or 12 of the Securities Act, are deemed not filed for purposes of Section 18 of the Exchange Act, and otherwise are not subject to liability under these sections.

SIGNATURES

Pursuant to the requirements of the Securities Exchange Act of 1934, as amended, the registrant has duly caused this report to be signed on its behalf by the undersigned thereunto duly authorized.

CADENCE PHARMACEUTICALS, INC.

Dated: August 4, 2011

By: _____ /S/ WILLIAM R. LARUE

William R. LaRue
*Senior Vice President, Chief Financial Officer,
Treasurer and Assistant Secretary
(Principal Financial and Accounting Officer)*

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CERTIFICATION

I, Theodore R. Schroeder, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cadence Pharmaceuticals, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including any consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ THEODORE R. SCHROEDER

Theodore R. Schroeder
President, Chief Executive Officer and Director
(Principal Executive Officer)

Date: August 4, 2011

CERTIFICATION

I, William R. LaRue, certify that:

1. I have reviewed this quarterly report on Form 10-Q of Cadence Pharmaceuticals, Inc.;
2. Based on my knowledge, this report does not contain any untrue statement of a material fact or omit to state a material fact necessary to make the statements made, in light of the circumstances under which such statements were made, not misleading with respect to the period covered by this report;
3. Based on my knowledge, the financial statements, and other financial information included in this report, fairly present in all material respects the financial condition, results of operations and cash flows of the registrant as of, and for, the periods presented in this report;
4. The registrant's other certifying officer and I are responsible for establishing and maintaining disclosure controls and procedures (as defined in Exchange Act Rules 13a-15(e) and 15d-15(e)) and internal control over financial reporting (as defined in Exchange Act Rules 13a-15(f) and 15d-15(f)) for the registrant and have:
 - (a) Designed such disclosure controls and procedures, or caused such disclosure controls and procedures to be designed under our supervision, to ensure that material information relating to the registrant, including any consolidated subsidiaries, is made known to us by others within those entities, particularly during the period in which this report is being prepared;
 - (b) Designed such internal control over financial reporting, or caused such internal control over financial reporting to be designed under our supervision, to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements for external purposes in accordance with generally accepted accounting principles;
 - (c) Evaluated the effectiveness of the registrant's disclosure controls and procedures and presented in this report our conclusions about the effectiveness of the disclosure controls and procedures, as of the end of the period covered by this report based on such evaluation; and
 - (d) Disclosed in this report any change in the registrant's internal control over financial reporting that occurred during the registrant's most recent fiscal quarter (the registrant's fourth fiscal quarter in the case of an annual report) that has materially affected, or is reasonably likely to materially affect, the registrant's internal control over financial reporting; and
5. The registrant's other certifying officer and I have disclosed, based on our most recent evaluation of internal control over financial reporting, to the registrant's auditors and the audit committee of the registrant's board of directors (or persons performing the equivalent functions):
 - (a) All significant deficiencies and material weaknesses in the design or operation of internal control over financial reporting which are reasonably likely to adversely affect the registrant's ability to record, process, summarize and report financial information; and
 - (b) Any fraud, whether or not material, that involves management or other employees who have a significant role in the registrant's internal control over financial reporting.

/s/ WILLIAM R. LARUE

William R. LaRue

Senior Vice President, Chief Financial Officer,
Treasurer and Assistant Secretary
(Principal Financial and Accounting Officer)

Date: August 4, 2011

**CERTIFICATION PURSUANT TO SECTION
1350 OF CHAPTER 63 OF TITLE 18
OF THE UNITED STATES CODE AS
ADOPTED PURSUANT TO SECTION 906
OF THE SARBANES-OXLEY ACT OF 2002**

In connection with the filing of the Quarterly Report on Form 10-Q of Cadence Pharmaceuticals, Inc. (“Cadence”) for the quarterly period ended June 30, 2011, as filed with the Securities and Exchange Commission on the date hereof (the “Report”), each of the undersigned officers of Cadence, hereby certifies, pursuant to Section 906 of the Sarbanes-Oxley Act of 2002, 18 U.S.C. Section 1350, that, to our knowledge:

(1) The Report fully complies with the requirements of Section 13(a) or 15(d), as applicable, of the Securities Exchange Act of 1934, as amended, and

(2) The information contained in the Report fairly presents, in all material respects, the financial condition and results of operations of Cadence.

The undersigned have executed this Certification effective as of August 4, 2011.

/S/ THEODORE R. SCHROEDER

Theodore R. Schroeder
President, Chief Executive Officer and Director
(Principal Executive Officer)

/S/ WILLIAM R. LARUE

William R. LaRue
Senior Vice President, Chief Financial Officer,
Treasurer and Assistant Secretary
(Principal Financial and Accounting Officer)

The foregoing certification is being furnished solely to accompany the Report pursuant to 18 U.S.C. Section 1350, and is not being filed for purposes of Section 18 of the Securities Exchange Act of 1934, as amended, and is not to be incorporated by reference into any filing of Cadence, whether made before or after the date hereof, regardless of any general incorporation language in such filing. A signed original of this written statement required by Section 906 has been provided to Cadence and will be retained by Cadence and furnished to the Securities and Exchange Commission or its staff upon request.